Q2 2018 Earnings Call

Company Participants

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

Other Participants

- Andreas Evert Cornelis van Embden, Analyst
- Barrie Cornes, Analyst
- Ben Cohen, Analyst
- Dhruv Gahlaut, Analyst
- Lena Thakkar, Analyst
- Nick Johnson, Analyst
- Robert Rampton, Analyst

MANAGEMENT DISCUSSION SECTION

Lance Henry Batchelor {BIO 6884486 <GO>}

Okay. I think we will start. Good morning, everybody. You may be able to see that I've bumped my head. Don't worry, I'm getting better. If anyone wants to hear the story, I'll see you afterwards, but it involves the tailgate of my car parked outside. It got dark and then I ran outside and met the tailgate coming the other way.

Welcome to our interim results for the six-month period ending July 2017. I'm going to run you through an overview of our financial and our strategic performance in the year so far and then, I'm going to hand over to Jonathan, our CFO, and he will take you through the numbers. And then, of course, we'll be available after that for Q&A.

So, it's another strong set of results. I've been in this role now for just over three-and-a-half years. This is the seventh set of results as a PLC and I'm very pleased to say that we have again delivered strong profit growth and we have real momentum. Profits are up again. I'm particularly pleased with the growth of our core retail broking and travel businesses, which combined are up 10.5%. This growth has meant cash generation has again been very strong. That's allowed us to drive debt down even further into our medium-term range.

Saga's interim dividend has increased again by a significant amount to £0.03 per share. That's a 11.1% increase on last year. Quite simply, the Saga model continues to deliver an ever improving quality of earnings. We're moving increasingly away from a dependence on underwriting and towards a more capital efficient broking model. We're demonstrating, as I say, an ever improving quality of earnings.

You know this graph, any of you who've been long before. It's one of my favorites. I've used it often before. It's such a simple way to demonstrate what we are trying to do. You can see that profits are up, that's the dark blue bar; debt is down, that's the red-dotted line, and it continues to fall towards the lower end of our targeted range.

The one addition to this slide since the last time is the light-blue block, which is the progression of our dividend. Our consistent profit growth and the increasingly diversified nature of the Saga business has allowed us progressively to move our payout ratio up.

The really big news today for us is the launch of Saga Possibilities, our new membership program that we briefed you on six months ago. The team has done an incredible job working on this over the last six months, I'm very proud of them, and we're now in the market. This is all about saying thank you to our customers and encouraging them to enjoy more of Saga.

Over time, every one of our customers, whatever product or service they buy from us, will be invited to become members of Saga Possibilities, and they'll get access to money-can't-buy events such as a special performance of The Gruffalo's Child with your grandchildren as Saga takes over the whole of the Lyric Theater in London, an intimate members-only concert with Mica Paris (00:03:25) held at the crypt in St. Paul's Cathedral, going alone to the National Maritime Museum for an exclusive tour of the Death in the Ice exhibition, and many, many other opportunities that we have in the pipe that will run nationwide for years to come for Saga members only.

We're also using Saga's influence buying power and the fact that we have more than 2 million customers to help our members get some great deals. We've worked with over 15 carefully-selected and well-known partners to provide a range of exclusive benefits for our members, and those range from partnerships with, for example, Nuffield Health, Prezzo, Majestic and Apple. Finally, our members will join a community to share their knowledge, their experiences to ask questions, to learn from each other, and very importantly to help us shape the future of Saga Possibilities over time.

Now, we've also used the launch of Saga Possibilities as an opportunity to refresh our brand's look and feel, our brand identity. Of course, we're always focused on the need to keep the Saga brand relevant, and this new identity brings to life our new keep doing ethos. Keep doing is all about celebrating what's at the heart of Saga's purpose and our members' needs. That is bare desire to carry on living life to the full by always embracing new experiences and new opportunities. Keeping the brand relevant is, of course, a vital part of the Saga business model, because right back to the genesis of Saga in the early 1950s.

For those of you who've been following EU data protection legislation, you will be aware that GDPR comes live in May 2018. GDPR puts customers in control of the data that customers hold – that companies hold on them and how it can be used. Just to be clear, we really welcome this change. We see it as an opportunity to increase our engagement with our customers, with our members, and to create a beneficial long-term relationship with them.

Now, membership of Saga has always been a vision of mine ever since I arrived, and the launch of Saga Possibilities and the new brand identity that I've just described is a pivotal moment for Saga and its members. But, it's also important to remember how that will lead to improved outcomes that we talked about in our Capital Markets Day back in March. Making the brand more relevant to our target customer and continuing to develop our product propositions will lead to smarter acquisition, and ultimately over time, it will lower the cost of acquiring new customers into the business.

Saga Possibilities will also deepen the engagement that we have with our customers and members. And over time, it will encourage them to stay with us for a bit longer and to hold more products and services with Saga.

Now, we're just at the start of this exciting journey and we plan to keep adapting and evolving the program over time to help us achieve our target of growing the total number of products held by our HACs, our high-affinity customers, over the next few years.

Now, some big news. I'm delighted to be able to say that we are going ahead with our second ship, Spirit of Adventure to be delivered in August 2020. This is a bit earlier than previously planned and it will complete the transformation of our cruise business from all hardware to world class.

In the mean time, we continued to work extremely hard on the proposition for Spirit of Discovery, our first new ship, which remains on track for delivery in June 2019. The final design is pretty much signed off now and the build starts early in 2018. We've received fantastic feedback both from potential customers and from existing cruise members about the look, feel, design of that ship.

And we've had a spectacular response to our sales program. We now have over 18,000 advanced and pre-registered customers. A high proportion of those are first-time bookers with Saga Cruises. That really is a testament to Saga's deep relationship with our target segment and their demand, and their appetite to travel with us.

By the way, the initial calls with those advanced customers who've pre-registered with us, as we start to turn those into firm bookings, are showing a conversion rate of over 80%. In fact, demand has been so strong for the first ship that have first cruised almost two years away is now sold out, and I've actually had to beg to get myself a cabin on that trip.

So, let's just finish with an overview of the Saga strategy. As you have heard, a tremendous amount has happened over the last six months, but our strategy remains unchanged and very clear. We've taken a huge step forward towards becoming truly customer centric with the launch of Saga Possibilities. It gives us a platform and the tools that we need to grow the number of HACs and the number of products that they buy over time.

Our core insurance and travel businesses are growing. Work to deliver several new IT systems is progressing in the background quietly with little fuss. So, for example, our new claims platform is now live. Guidewire, our new broking platform is on time and on budget. Our largest insurance product, motor, is expected to transition onto Guidewire in the first half of next year. We've ordered our second new ship, as I said, Spirit of Adventure, for an earlier than anticipated delivery in August 2020 and that will complete the renewal of the fleet. The business is trading well and we're driving some real momentum and all of that gives me confidence that Saga is growing. We're on track to deliver against expectations for the full year and it's an exciting time for us.

So, I'm now going to hand over to Jonathan who will talk you through the numbers in some more detail.

Jonathan Stanley Hill {BIO 16892113 <GO>}

Thanks, Lance, and good morning, everybody. It's great to be here again presenting another really good set of results for the first half of the year. So, I'll start by looking at the group's overall results for the first six months. Revenue is relatively flat against the first half of last year due to the adjustment associated with the quota share arrangement. A better measure (00:10:11) of our top line growth is customer spend, which is a new metric we introduced at the year-end, and that increased by nearly 4% to £617 million from the first six months of last year.

Underlying profit before tax, as Lance said, is up by 5.5% to £110 million, benefiting from the strong growth in our core businesses. Profit before tax was £103 million after adjusting for two factors. Firstly, there was a one-off charge related to the successful refinancing of our previous banking facilities during May of this year. The remaining unamortized fees of the old facilities were £4.3 million. Secondly, there was a negative movement on the fair value of derivatives of £2.9 million compared a credit of £5.4 million in the first half of 2016. And these movements were associated with the changes in FX and fuel market rates, with the H1 impact mainly due to sterling's weakness.

And while reported PBT was down by 6.3%, our tax charge actually reduced by nearly 11%, benefiting from the reduced corporate tax rate in place during the period. And our effective tax rate in H1 of this year was 19% compared to 20% in the first half of last year. Therefore, profit after tax and earnings per share were down by around 5%.

The strong cash flows have enabled further deleveraging to 1.8 times from 1.9 times at the start of the year, with our net debt at July 31, 2017 having reduced by around £74 million from a year earlier. As a result of the underlying profit growth and further deleveraging, we have increased that interim dividend by just over 11% to £0.03.

We've delivered a 10.4% profit growth in our retail broking and travel businesses. Retail broking itself is up by 4.7% in aggregate, and travel delivered an improvement of 63%. Underwriting profits are lower with the reduced reserve releases, as expected. Again, the diversity and the resilience of the model has proven itself, and the quality of earnings are improving as we generate more profit from areas of the group where we do not allocate capital.

I'll now look at each of the businesses in turn. We continue to be flexible in our management of the entire group, trading off volume and value across our various P&Ls. In the right-hand column of this slide, you can see our retail broking performance in aggregate with that 4.7% increase in total profit. This has been assisted by reductions in both marketing and operational costs as we look to improve our efficiency within that broking business. Some of this results from the work that we presented to you at the Capital Markets Day in terms of efficiency of customer targeting and therefore, cost per acquisition. It also shows our ability to continue to drive down our operational costs.

I'll now look at each of the broking businesses in turn. We've seen a lot of change in the first half of this year in the motor market. The combination of the Ogden announcement in February and the IPT increase has driven significant increases in gross written premiums across the market.

The new FCA renewal wording has increased transparency of pricing, which is encouraging drivers to look around. However, we hope that the more recent Ogden announcement will lead to a period of lower premium inflation and less persistency volatility than the industry has seen recently.

Within this changing environment, our retail broking business has delivered a strong written performance. Saga-branded core motor policies were flat in the half compared to H1 of last year, excluding the policy reduction resulting from our decision to discontinue our direct choice brand. Net revenue in the motor business was lower, reflecting firstly the fact that we did actually have a very strong written performance, leading to an increase in net revenue per policy, offset by an increased deferral of revenue, because broking revenue from policies underwritten by our broker – by our underwriter, AICL, increased as a proportion of the broker total net premium written.

Let me explain that again, because it's a bit complicated. If I start with AICL, AICL applied measured price rises after the February Ogden changes; whereas we saw significantly more aggressive net rate changes from our external panel underwriters. Therefore, AICL was more competitive on net rates relative to those external underwriters. Therefore, while the number of policies written by AICL in H1 of this year – underwritten by AICL in the H1 of this year compared to H1 a year earlier is lower, the amount of net revenue generated in the services businesses in our retail broking businesses was higher from those AICL-underwritten policies.

And because we have to recognize that revenue over 12 months when a policy is underwritten by AICL, therefore, we had to defer more of the revenue. I'm happy to take people through that again after the meeting, but hopefully, that explains why the revenue has gone down.

Moving on, we have seen third-party underwriters reevaluate the cost of Ogden and we would expect that this relative competitive position may not remain as pronounced as it was during the first half of this year. I would say that what we've seen is a great example of the panel operating as it should do and as we expected it to do. And the profit per policy has clearly benefited strongly from the efficiencies that I described earlier.

The home insurance market, as everybody in the room will know, remains extremely challenging. Premiums were relatively flat compared to H1 in the previous year, with modest claims inflation, increasing net rates. With these market conditions, we chose to reduce policy volumes marginally, prioritizing value over volume. And therefore, net revenue was down marginally, but the profit was slightly ahead.

On other insurance, this is primarily made up of our PMI and our travel insurance products. The significant reduction in policies was entirely within our travel insurance area. This reflected the fact particularly in Q1 that we were competitively disadvantaged on our net rates due to our SOLAS underwriter not having as effective hedges in place as other underwriters in the market. While the volume shortfall was significant, the profit impact was limited with reduced net revenues and reduced associated marketing costs.

We do believe that this competitive disadvantage is unwound, and we are now returning to more comparable travel insurance volumes year-on-year during H2. PMI has performed very well during the first half of the year. And therefore, overall, we managed with the benefit of some of those efficiency gains again to marginally increase profitability in this area of the business.

Moving on to motor underwriting. Our underwriter, AICL, again delivered a strong underwriting result. Revenues reduced marginally as a result of lower earned policies against the comparable period. We delivered an improvement in the pure combined operating ratio of 1.7% to 97.1%.

The ongoing favorable experience in small and large personal injury claims has enabled the business to release £39 million worth of reserves held in respect of previous years. This is £2 million lower than the reserve releases during H1 in the prior year as expected.

As a result, the total underwriting profit has reduced to £47 million from £49 million in the first half of last year. The group is seeing relatively stable claims frequency with claims severity continuing to inflate at that sort of mid-single digit level. We are seeing some of the effects of weaker sterling feeding through to costs.

While the initial Ogden announcement in February led to a limited strengthening of our reserves of £4 million at the last year-end, we will take our time to consider and work through the more recent announcement. The outcome of this does remain reasonably uncertain and we will keep a close eye on the progress of the legislation associated with this.

We have included a detailed slide in the appendix to show the pre- and post-quota share position of the underwriter.

Moving onto Solvency II. The group's solvency capital requirement on the 31st of July 2017 had reduced to £84 million from £103 million at the start of this financial year. This has benefited from two elements; firstly, our positive claims experience; and secondly, the ongoing positive impact of that quota share arrangement.

We started the year with £147 million of available capital, which reduced to £142 million at the half year. And over the same period, therefore, our solvency capital ratio increased from 143% to 169%, which sits at the upper end of where you should probably expect to see it sitting going forward.

At the same time, we paid a dividend from our underwriter of £45 million during the first half of 2017, compared to £50 million in the first half of 2016. We have assessed the sensitivity of our solvency capital ratio to various potential changes, and we believe that our solvency position is very robust.

The travel business delivered a 63% increase in profit. Tour operating revenues were strongly up from both the impact of sterling's weakness, increasing the cost of our holidays, but also as our customers continue to purchase higher-value long-haul holidays. Profits from the tour operating businesses were 9% higher and are expected to be positive for the full year, given the forward-booking position and the increasing benefits of the efficiency program in these businesses.

Cruise benefited from a strong increase in cruise days, with Saga Sapphire in dock for 63 days in the first half of last year and then we had Pearl in for 21 days of maintenance in the first half of this year. As Lance said, we've now got sign-off the purchase of our second ship, Spirit of Adventure, and we have accelerated the time of delivery from early 2021 to August 2020. While the currency has moved since the hedging of the first ship, the business case does remain compelling with significant returns in excess of our cost of capital.

We have included in the appendix the split of our emerging businesses and the central costs, so we can see those separately. In aggregate, our emerging businesses delivered a small profit compared to a small loss in the first half of last year. Group costs are relatively flat compared to the first six months of last year. These costs do include charges associated with the restructuring of the legal joint venture structure with Tilney to a lower-cost commercial model.

We benefited in the first half from a reduced finance cost due to lower debt. And offsetting this, we had an increase of nearly £2 million in the non-cash pension charge. This is a charge based on the actuarial valuation of the pension benefits accrued during the six-month period and is higher than in the first half of last year due to the low level of corporate bond yields at the 1st of February, 2017, which is effectively what drives the calculation of this charge. This increased charge will persist in H2 of this year as well, but is not expected to materially impact next year. Therefore, overall emerging businesses and central costs were flat compared to H1 in the prior year.

We have a consistent history of strong cash flow generation. In the first half of 2017, we delivered available operating cash flow of £90 million. This was £7 million lower than the first half of last year, primarily due to that lower dividend being paid out of vehicle. And you should expect us to deliver in the full year a more normalized level of cash flow generation around 70% of trading EBITDA.

As Lance has said, we continue to move down our leverage range to 1.8 times at the half year. Net debt has reduced to £460 million from £534 million a year earlier. We remain on track to approach the lower end of the leverage range by the time of the delivery of Spirit of Discovery, the first ship, in June 2019. On the drawdown of the debt on each of the ships, we will move above the 2 times leverage and then quickly deleverage back within the range, within 12 months of the drawdown of each of those debt elements.

We are confident of increasing the group's underlying profit for the full year in line with our expectations. This takes into account the current trading environment for insurance and our current trading position in travel. Our bookings for this year are 6% and 8% ahead in tour operating and cruises respectively, and we are now effectively fully booked. These profit improvements will be partially offset by lower reserve releases as previously guided. And while pension costs will be higher for the full year, this will be offset by lower finance costs. Our tax rate will be close to the underlying corporation tax rates for the financial year, and we are confident that we can achieve this profit growth in this financial year and are on track to deliver in line with our expectations.

I'll now join Lance for some Q&A. I hope we've got some microphone coming around. So, if I can just ask people to wait, say who they are for the ether (00:25:57), and then give us their questions please.

Q&A

Q - Ben Cohen {BIO 1541726 <GO>}

Thanks very much. It's Ben Cohen at Investec. My question – my first question was on the retail broking revenue in motor. That affects the sort of deferral. Does that unwind in the second half? And should that mean that we would see a stronger than kind of normal growth rate? And tied into that, how is the build out of the panel going? Would you expect just the underlying growth rate in that retail broking business to pick up in the second half? Thank you.

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

I'm happy to take both of those. In terms of the retail broking, the good thing is it's not profit lost. It's just profit that moved between periods. So, we should see certainly some good support in terms of the profitability. I'm not going to give specific profit projections by individual insurance line. In aggregate, we're still confident at the overall level in terms of our group target, but certainly, it's not lost profit. It's just a point of timing of recognition.

In terms of the panel, it's a very interesting question, because I think there was a view that we should see rapidly increasing proportions of business moving to third-party underwriters. What we've seen is the beauty of the panel. As AICL priced more effectively in terms of Ogden, we saw that they became more competitively advantaged and actually pretty much held its share at a very solid level.

As the panel becomes more competitive as it's now started to re-price some of that more aggressive pricing it has (00:27:34) in Ogden, we now see the panel doing a greater share. That's what it's supposed to do. Whoever gives the best price gets the business. We are agnostic. All we want to do is make sure we get the best price of risks through to our broking business.

We will see what happens as the external underwriters or our own underwriter continue to price the February Ogden change, new Ogden changes, and what happens on excess of losses that gets renegotiated in Q4 into the January renewals period.

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

Such an important point. There is no right answer to what proportion of panel volume is taken by AICL versus external underwriters. As Jonathan says, it's getting the most competitive possible underwriting price, so that our broking business can sell effectively.

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

As you can tell from my quite difficult explanation, it's quite difficult for me to forecast precisely what's going to happen when I have movements in competitiveness between our internal underwriter and our external underwriters, but that's my challenge, not yours.

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

Other questions?

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good morning. Dhruv Gahlaut, HSBC. Three questions. Firstly, could you update in terms of what is the stock of reserve buffer at this point, percentage of premiums are in total terms?

Secondly, also, could you update in terms of how rate have developed year-on-year pricing in the motor segment versus the underlying claim inflation? You mentioned frequency is down, severity is up. So, how is the blended rate, as in what percentage is the claim inflation running at?

And thirdly, on the broker business, especially in motor, how should we think of the resilience in terms of the margins if we believe rates could come down in the motor segment in the next 12 months; as in currently, I can see the home business has seen some decline in total profitability on back of difficult trading environment.

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

I think first I'm going to answer your third question. We're not going to try and estimate with our crystal ball which way rates are going to go. I think that's – I'll leave that to greater minds in line like yourself to work our way, you think rates are going to go. I mean, logically, with whiplash and Ogden, we'll see what happens on that and how that feeds through to growth.

Secondly, on the – your first question on reserve buffer, we never specifically say. We do say in the press release that we have not changed the reserve buffer from the previous reporting point. I think you'll find we've said that at every reporting date, and we've only ever reported the reserve buffer once, which was at IPO, which was around 15%. So, you can, therefore, extrapolate from that whether we have or not degraded our buffer, which we have not.

The next question was where. I think I'm just trying to get the precise question. Is it...

(00:30:39).

Yeah. I mean, what we've seen is the market moving at, I guess, 20% on some of the AA-type measures. That's a mixture of, as you will know, IPT, Ogden, all sorts of stuff. I think on an underlying basis, we're probably seeing mid-single digit, and then we see a lot of movement around Ogden above and below that, so – and different people are pricing that in very different ways, as I've explained, in terms of our net rate performance. So, on underlying claims inflation taking out Ogden noise, I think we're seeing something pretty sensible. If I was to say anything, I'd say we're probably seeing frequency at or below prior-year levels, which is partially offsetting some of that increasing inflationary pressure from some of the FX costs around the motor parts.

Q - Lena Thakkar {BIO 16225519 <GO>}

Thanks. Lena Thakkar from HSBC. A couple of travel-related questions. Just firstly on those 6,500 new ship tickets that you've sold, can you give us any indication of the pricing on those?

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

The key points on pricing with the new ship is that we have not raised the prices as we transitioned from the old ship to the new. So, for comparable experience, you'll pay about the same price you would have done on the old ship. There is a higher mix of larger suites on the new ship. And so, overall, if you look at the new ship, you might expect a higher per diem on average. But for a single passenger going to a single cabin, you'd expect them to be paying roughly the same sorts of amounts as before.

So, we've always been very clear that the new ships, the case for them is a cost-based case. They are much more efficient to run. They use much less fuel and so on. We're not using that as an opportunity to ramp up pricing.

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

What I would say is it's fully supportive of the original business case. We had obviously said before we have tested all of the cost metrics having done testing the hull form in terms of knowing now which engines we have actually procured, and therefore, the fuel efficiencies that we expect. So, I think at the last reporting date, we said we were very comfortable on the cost side. We feel increasingly confident on the demand and revenue side as well as the cost side, supporting that original investment case.

Q - Lena Thakkar {BIO 16225519 <GO>}

And so, can you put a number on the mix impact at all?

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

We haven't put that number out into the market at the moment. So, I can't right now.

Q - Lena Thakkar {BIO 16225519 <GO>}

Okay. Fine. And then, just a question on slide 28, which are some of the travel detail. It looks like the gross profit margin on the tour op business has fallen by a couple of percent. I guess that's down to FX. So...

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

Yeah, it is. We had a small proportion – a great spot, can I say? There was a small proportion of the unhedged euro which we bought at spot (00:33:35) which impacted the first half margin. Marginally, obviously that was offset by the efficiency gains. We are fully hedged for the second half, and we can see the margins coming through there. And as we look at that, plus the efficiency gains, we're very comfortable with where we expect the profit growth to be year-on-year.

Q - Lena Thakkar {BIO 16225519 <GO>}

Okay. So, sort of more generally on that, given that consumers are paying more for their holidays at the moment due to FX, are you able to pass that on at all or think about passing that on? And so, how should I think about that margin going forward?

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

Well, the answer is, we – where FX impacts, we do pass the prices on, and we have seen price increases. What we tend to see is that some customers absorb that, and other customers have a set budget for their holiday, and what you'll see them do is downgrade slightly. So, they might go for 10 days instead of 14, or they might go to a three-star hotel instead of a four-star hotel.

But what we tend to find was, it's all (00:34:29) good customers, because they're living from savings, and they have a budget each year for their holiday. They will spend that budget, and that broadly protects us at a margin level from the impact of the currency. It just means that sadly the customer gets a little bit less for their money.

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

So, effectively, at the time we price, nearly - a very, very large proportion of the currency is fixed at the point we price; on the small proportion, that wasn't fixed. We then clearly took an FX hit on that element. We're fully hedged for the second half of the year. We're very clear on the margins, and we're quite comfortable.

Q - Lena Thakkar {BIO 16225519 <GO>}

Thank you.

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

Thank you for some travel questions.

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

Andreas van Embden, Peel Hunt. The high-affinity customers, they were down 1%. You have launched the sort of Saga Possibilities.

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

Yes.

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

It has been launched, right? It's up and running?

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

This week. We're launching it three days ago.

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

Okay.

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

Yeah.

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

So, what's your expectation? Is that going to really drive your core customer base up or are you trying to hold it flat? That's the first question.

The second question is back to the panel and the flat policies. I just wondered whether the footprint expansion strategy is just starting kick in and work within that panel, i.e., are you expanding your whole of (00:35:45) market?

And secondly, is the panel a net beneficiary from switching activity in the market given the strong rate increases or are you suffering from increased switching activity? Just wondering how come policies are flat and are not increasing in today's market.

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

I'll take the first half of your question, and hand over Jonathan the second half. So, the HACs, the high affinity customers, what we said back in March at our Capital Markets Day was that over a five-year period, our goal is to grow the number of products purchased by HACs by a set target. And we were very clear at that point to say that we're not sure exactly what the mix will be between more customers versus more purchase.

And essentially, the clock now starts, because with the launch of membership this week, we now, for the first time, have the tool kit in place to start really developing those HAC relationships, to start persuading higher value customers to stay with us longer, purchase a little bit more.

And honestly, looking one year or five years ahead, it's very difficult to project the exact balance that we will see between more people compared to more products. That is just - you can model anything you like, but until you live with it in the real world, you can't possibly know what the maths will be. But, we're expecting the direction of travel to be more loyalty and more products.

So, I cannot say to you five years from now, we'll have this many more customers or we'll have bought this many more products, but we're confident that we will be able to generate a significant proportion actually of our growth over the next few years from that HAC pool.

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

So, just going back to the panel question, if we go back to the original purpose for putting the panel in place, it was twofold. One was where customers sat at the upper end of the risk spectrum of what AICL underwrote at. It was likely that we might get a benefit from somebody else taking a different view on those customers in terms of their risk appetite, and they're willing to price that net risk lower than AICL was. That was going to be our gain A.

Gain B was going to be, it would broaden the footprint and enable us to write somebody who has an Aston Martin and a 17-year old son that they stupidly might want to put on that car, which clearly AICL was never going to underwrite. And we then overlay the question of volume and value across all of our products, and we have a choice of growth or taking more of that in value. And we will do that every year across the different product set, and we will try and deliver the right outcome in terms of delivering the steady profit growth that we're targeting to deliver.

So, that is what we're doing. So, you can't look in isolation at a single product and say, doesn't this mean you're just going to increase that by 20% per annum. We have to look across the whole portfolio and balance what we're doing in terms of volume and value. But, it certainly gives us another lever in the toolbox to be able to manage the business.

Does that answer the question? I'm not quite sure whether I've answered that or not.

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

Yeah. You started off by saying ...

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

Good. Sorry. Could we get the microphone down to Andreas as well, please? Thank you.

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

You were hoping at the beginning, you mentioned you would hope for a less volatility and persistency. And I just wondered whether you actually meant that the switching activity has been increasing, hence, you're suffering from increased switching activity in the market, or do you mean something else (00:39:29).

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

That's nothing to do with the panel per se, that is just that as we saw a market where you've got, as you guys know, 20% plus price rises going through, and then you've got the FCA wording going into statements with the prior year and the current year. That naturally, the mixture of the pricing effect and the transparency effect is clearly leading to a market where you've got an increased level of switching. But we're seeing levels of switching that we – persistency levels that we feel comfortable with in the current pricing environment.

That's all I meant in terms of if we look forward, if we look at the effects and the impacts we've had in H1 of this year between IPT, Ogden and the FCA wording. If we then cast forwards, if you then think that we've got an improvement in the Ogden environment, and hopefully we'll see what happens on IPT. We'll hope we don't get another increase coming through, and we already then have the FCA wording, and we shouldn't hopefully have the same sort of level of price increases and, therefore, persistency volatility.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi. Nick Johnson from Numis. Three questions. Firstly on the operating efficiencies, which you talked about which are (00:40:41) quite significant. Could you just elaborate a bit on how those have been achieved, I guess, other than marketing? Is it still a work in progress, and should we expect further savings? Just we could understand that a bit better, please.

Secondly, on the second new ship, can you just say what the cost is relative to the first ship? Is it exactly the same other than FX or is there a difference for the second ship? And then thirdly, on the Tilney joint venture, you mentioned the statement that you've moved from a JV to, I think, you termed a commercial arrangement. Can you just give us a feel for how that differs to a straight forward JV, please? Thanks.

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

Do you want to take the first?

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

Do you want to go for number three and then, I'll...

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

Yeah, sure. Yeah. Well, I'll answer the last one first, on the Tilney JV. So, we've been operating with Tilney for two years now in the wealth management space. It's an important part of our money products portfolio. But, what we've both concluded after two years operating together is that a JV is not the most efficient and cost-effective way to run that relationship and that what we should actually do is to mimic the other supply arrangements that we have with credit card suppliers and loan suppliers and share trading suppliers and so on, and just have a straightforward supply arrangement in place.

So, that means shutting down the JV venture, which means absorbing the loss that was sitting on that balance sheet. So, we're just taking that in one and getting it out of the way, and then we'll have a more streamlined and efficient working relationship together without all of the legal entity requirements that came from a JV. It's about streamlining and simplifying.

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

And then, if I take the efficiencies question, I mean, the marketing efficiency is clearly common, where you can improve the efficiencies of your direct channel, therefore, you can remove your highest cost channel being in the insurance environment, your PCWs. So, the more that we can understand our customers, personalize that approach to marketing, we can drive cost out, all the stuff that we talked about at Capital Markets Day that we're bringing in smart marketing.

If we then think about specific areas, particularly around the retail broker, we've got a lot of work that we talked about before in terms of call center, in terms of continuing to squeeze efficiencies and productivity improvements out, using things like digital speech analytics, et cetera. We've got stuff like e-documents and making sure that we interact more and more digitally with our customers. As we improve our digital experience, we can reduce costs in the back office.

And then I think the third area is just general good cost management. I think we continue to look at areas where we can optimize and create efficiencies and take a good look at every cost out in the business, as you'd expect any business to do, and we'll continue to do that. And if there's anything significant that is meaningful, we'll come back and explain that to you.

And then, finally on the cost of ship, yeah, it's relatively the same cost for the two ships. Obviously, there's an FX impact that we're working through and we will - as we get through to financing the ship, which will be - the financing will be set by the back end of the year when we'll set our hedging strategy for that ship as we determine the best way to do that to cover ourselves, but hopefully, give ourselves some opportunity if we see exchange rate volatility.

Q - Robert Rampton {BIO 20079733 <GO>}

Hi. Robert Rampton, UBS. Three questions for me. On the motor, how much of your business comes from price comparison websites and how has that changed? On motor again, outside price comparison websites, how many customers were you essentially turning away, because they fell outside AICL's risk footprint? And then finally, a minor point, can you talk about how add-on GWP has changed year-on-year in 1H in motor? Thanks.

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

I haven't got the exact number in front of me, so about half of motor is from price comparison websites.

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

Can you deal with the second one, I want a second (00:45:03)?

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

Yeah. So, before we launched the panel, what we said was that about three quarters of all of the customers who approach us, essentially, were not given a competitive quote, because AICL only focuses on low-risk, low-mileage drivers. And if you came to us with that Aston Martin and the teenager that Jonathan mentioned earlier on, you were not going to get a competitive quote from us.

Hypothetically, we can now offer a competitive quote to anybody, but this comes back to the point Jonathan made earlier on. You don't necessarily want to go after anybody and everybody and pull them in. We're not, at our heart, a motor insurance company. What we are seeking to do is to bring customers in for long-term relationships. So, we're playing that balance of profit and numbers that we've talked about earlier on today. So, our goal is not to go out there and grow the number of motor policies as rapidly as possible.

The good news is that if you think about high affinity customers and who they are, they travel a lot, they go on cruise ships, they have multiple insurance policies. You won't be surprised to hear, they're very often not low-mileage, old vehicle, small vehicle drivers. If you're a regular cruise customer, it's likely that you drive quite a nice car. And now, for the first time, we're actually able to write policies for critical customers like that rather than trying to persuade them to take a holiday with us, but turning them away on motor. So, that's been a big step forward for us.

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

On PCWs, we were (00:46:34) and I'm just going to go through the products, because I think it's quite an important point. I think on motor, we were approaching 40% in the first half of last year. That's significantly down towards the third and the first half of this year. So, we've seen a significant reduction in our reliance and motor on PCWs.

On home, our reliance is down again. It's below 10% that come through PCWs. PMI is effectively none, because it's not a PCW-type product. And on travel, we're down significantly year-on-year, but part of that I think we'd need to see normalize as we see the net rate get back to the same point, because I think the place where we'll have lost the business most by being uncompetitive will have come through that PCW channel. So, the first half of last year is by the (00:47:24) third.

But what you can see is reliance is down. There are a lot of – we've got two products there which are not reliant on PCW and are not good PCW-type products. And I think the good news is our reliance in motor is down.

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

And you had a question on GWP.

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

What I can tell you is the add-ons were flat, and you can see that within the document. We haven't moved the pricing on those add-ons significantly. It's all year-on-year. So, I think it's relatively flat year-on-year. We're not a big relier on add-ons or other forms of income to drive our profitability in that business.

Q - Barrie Cornes {BIO 2389115 <GO>}

Hello. It's Barrie Cornes from Panmure Gordon. A couple of bigger question – bigger-picture questions, if I may. First of all, in terms of your UK underwriting, motor (00:48:12) insurance underwriting, a lot of owners and shareholders of these businesses are looking to exit at the moment. I just wonder how, where did you are to the underwriting side of the business?

And secondly, in terms of pension freedoms, a lot of people with small pension ports of less than £30,000 have cleared out and I just wondered, if as result of that, you've seen an increase in particularly travel which may in theory run out I guess after a year or two as those pots have been cleared out as it were (00:48:44).

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

Sure. Well, first of all, we are very attached to our underwriter. We believe it gives us a real competitive advantage in the marketplace. There is no one else that we're aware of that has an understanding of older drivers, low mileage, smaller vehicle drivers like us, and that does give us a competitive advantage both in terms of writing risk, but also in terms of helping our broking business to price effectively.

And, of course, the visibility that we get into the whole market end to end, all the way through the claims experience is a very important part of our understanding of whether our customers are being well looked after. It helps us, for example, when we operate a panel to really understand how the market is working, so that when we're having discussions with other panelists, we have real visibility into what's really going on, and we're not just dependent on what they tell us. So, that's why, you should expect us to continue in the underwriting space, and we're good at it as I hope you can see.

And then, on your second question around pension freedoms, it's very hard for us to disaggregate where customer money comes from. When those pension freedoms came into place, we were watching carefully and we were asked whether that was leading to an immediate spike or change in customer behavior, and we didn't see that. What we saw was pretty steady behavior. So, there's nothing I'm aware of that links our growth in travel to that phenomenon.

Q - Barrie Cornes {BIO 2389115 <GO>}

Thanks.

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

Any more questions? Otherwise, we'll call it a day, and then you can all come and ask Jonathan to take you through again the underwriting. Thank you very much for your questions, and thank you for listening.

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

Thanks very much.