Y 2019 Earnings Call

Company Participants

- Gary Duggan, Chief Executive Officer, Retail Insurance Broking
- James Quin, Chief Financial Officer
- Lance Batchelor, Group Chief Executive Officer
- Robin Shaw, Chief Executive Officer of Travel Business
- Stuart Beamish, Chief Customer Officer

Other Participants

- Andreas van Embden, Analyst
- Benjamin Cohen, Analyst
- Edward Morris, Analyst
- Joanna Parsons, Analyst
- Jonny Urwin, Analyst
- Nick Johnson, Analyst
- Ruchi Gupta, Analyst
- Unidentified Participant

Presentation

Lance Batchelor {BIO 6884486 <GO>}

Good morning, everybody. Thank you very much for Joining us. As I think you all know I'm Lance Batchelor. I'm the Group CEO of Saga. I'm joined today by our new CFO, James Quin; by our Chief Customer Officer, Stuart Beamish; and by the CEOs of our Insurance and Travel Divisions, Robin Shaw and Gary Duggan. Our Chairman, Patrick O'Sullivan is also with us this morning.

Today, we're going to cover our prelim results from last year, as well as an update on our strategy for the business. So we're going to take a little longer than we usually do, allowing time for questions, we expect to be finished at about 11 O'clock this morning.

Let's put today's announcement into context. This is a critically important day for Saga. We're making a fundamental change to our strategy. It takes us back to our heritage. It addresses the increasing challenges that we've been seeing in parts of our business, most notably insurance broking. By the way, the slides are not going to change while I open up. We've also announced lower projected profits, a significant reduction in dividend and a goodwill write-down.

Now, I'm of course aware that this morning's news will come as a disappointment to our shareholders and to the stock market. But, it's both necessary and it's the right thing to do. We're going to explain the reasons for those changes, what they mean in practice and how they set Saga up for growth albeit from a lower level.

Now, over recent years, Saga has made some good progress and if I may, I'd like to highlight five things in particular. We've cut our debt by over GBP300 million since the IPO. We've replaced a huge majority of our IT platforms. We've designed and built a new ship with another one coming and even before the first ship arrives, our Travel division has grown from GBP5 million in profit per annum to over GBP20 million. And finally, we've launched a membership program Possibilities, which has attracted over 1 million members.

But, and here's the big but, I need to be equally explicit about what we've not achieved since IPO. We have not grown customer numbers, and today is an acknowledgment that to do so, needs a very, very different approach across the whole of the Saga business, and in particular in how we sell insurance.

When I look right back to the early days of Saga in the 1950s, what made the company so successful was its single-minded focus on giving customers what they wanted. Products designed specifically for our unique demographic. In the early days, of course, that was holidays, tailored for the retired and then about 20 years ago, we added insurance products, specifically designed for the older-age group.

Both sets of products were crafted to meet customer needs. They were competitively priced. They had extraordinary levels of service, strong advertising support, and importantly, they attracted deep brand loyalty. At some point along the way, Saga shifted its focus from being primarily about delighting the customer and became overly focused on short-term profitability. And meanwhile, as you know, the world's been changing. In Insurance and Travel, people can nowadays easily access low cost rather generic products online. There's been a commoditization of the mass market and there's digitization and there's GDPR and there's regulatory intervention. Customers are quite -- quite understandably and I think rightly willing to move brands in order to chase a better deal, and all of this has been brought into sharper relief for us recently.

In insurance, and I think to some extent in travel as well, Saga has been caught between two worlds. We're not a strict out low cost player, that's not what our customers want from us and it's not what we want to be. But nor do we offer the kind of bespoke and customized products and services that an Audley Travel or a Hiscox insurance offers.

One place, we do get it really right is in Cruise, where we attract passionate loyalty and we command a healthy premium, because our product is different and better. Now, the result of this being caught between two different pricing models is that over a decade or more, Saga has gradually lost market share in both insurance and travel, and we aim to change that. We're making a bold and fundamental change in our strategy. It's going to take us back to our heritage. Saga is rediscovering itself as an organization that exists primarily for its customers, an organization that's going to offer distinctive products to a distinct part of the market.

And as our customers increasingly embrace membership, we're going to give them very clear reasons to choose Saga and to stay with Saga. There are significant consequences to all of this and we've had to make some difficult decisions. Earnings will reduce by over a third to between GBP105 million and GBP120 million. This is driven by lower margins in Insurance, a fundamental change in renewal pricing, lower reserve releases and by the investment in new products. We'll then be able to grow from a stronger and more sustainable base. And James is going to cover all of this in more detail in a few minutes time.

Now, we're not starting from scratch. Our debt levels are much reduced. For the first few years as a PLC that was a real imperative for us. We've replaced most of the Group's key IT platforms, which makes us much more flexible and more efficient. Many of the changes that we're announcing today would not have been possible on our old IT platforms. I have a very dedicated and focused team, who've been involved in every step of shaping this new strategy .

The launch of membership in late 2017, really brought home to us, what we stand for and why Saga exists. We now have well over 1 million members. That's the majority of our customer base. Listening to them has helped shape the future of Saga and it is changing our relationship with them. You're going to hear more about from Stuart shortly about the membership opportunity and how developing that proposition is supporting retention and will grow value.

On the other side of this chart. The first new cruise ship is on track, on time, on budget for delivery in June going to sea with paying passengers in July. Pre-sales for the ship are very strong and the build of the second ship has now started and she will be delivered next summer, in summer 2020. Robin will tell you more about that shortly.

Let's talk about the reasons for change. We have to make a fundamental step change because incremental change has proved to be insufficient. Against the backdrop of a growing demographic, Saga's seen a slow but steady decline in customer numbers.

As we said over a year ago, this cannot be sustainable. Not only are we missing out on an extraordinary opportunity, but we won't have a business in five years time if we allow this to continue. On the right, you can see, our underlying profit over the last few years, which we've held more or less flat. The pressures on our Broking business have been largely hidden by a period of extraordinarily strong reserve releases. But we've also been extracting ever more margin from a declining base, that's unsustainable. If our recent results tell us one thing, it is that we cannot keep delivering these levels of profitability, let alone grow, unless we make a major change to our customer proposition and accept that we have to reduce our margins to do so.

Let's have a look at the brand. Saga has brand awareness that most brands would die for and our loyal customers love the brand. But as you can see, there is an opportunity gap here between the awareness and the consideration. Everyone's heard of us, but not everyone would consider buying from us. Now, this is not particularly surprising, given that we haven't advertised for years, that we've pursued a very strong direct model, but to a slowly decreasing number of people, as our marketing database becomes smaller and our insurance product hasn't meaningfully changed in many years. This is an area we need to address and we've already seen a positive impact from our first TV advertising campaign in over five years.

In Broking, we have a profitable business with good customer service and many loyal customers. But what you can clearly see here, is declining policy count and declining retention rates. On the right, you can see that when we grew business last year, our new business last year. We weren't able to increase the number of customers, who came to us direct. This increased our exposure to price comparison websites and whilst those do have a positive lifetime value, the business is considerably lower margin than we want and it will reduce our profitability this year and for the next year as well.

The conclusion is clear. If Saga is to have a future, we have to grow customers. And if we are to grow customers, we have to grow using the direct channel. It's also vital to understand, why we couldn't grow direct in the recent past. This is where our long-term under investment in the customer proposition has come home to roost. We simply haven't had a sufficiently differentiated product or strong enough brand consideration to grow our direct customers. This is the challenge that has arguably been a long time coming, but it's one that we have to crack now.

Turning to Travel, our Cruise division represents Saga, what Saga needs to be. Saga at its best. We provide a fantastic tailored experience for loyal members, who'd come back again and again. No one else can do what we do. We own a good return, whilst delivering exceptional levels of customer satisfaction. Robin will explain that we are now working hard to migrate the rest of the Travel division in a similar direction and at a faster pace.

So as I said, today is a very important day for Saga. We have some major challenges to address, particularly in Insurance. We know that for Saga as a whole, the answer is to offer different and better products at the right price, backed by strong branded advertising. In Insurance Broking, in particular, we need to shift the balance between customer satisfaction and profit, more towards customer satisfaction. A better customer proposition at a price that reflects that. Lower margins but more customers, who want to use Saga and then see their loyalty rewarded. More customers who want to buy more from Saga.

So today, we are firstly relaunching Saga's insurance proposition to the customer, with an innovative fixed price offer as the leading element, clearly evidencing our change in approach. This will be sold only through direct channels and it will receive significant advertising support. Second, we are cutting the margins that we charge to renewing customers, as we seek to reward loyalty. Third, we are accelerating the move of Saga Travel to a more specialized value-added sector, such as rivers and escorted tours and long haul. Fourth, we're building out our membership offering to establish it as a main route to the customer and to give customers another reason to choose us and to stay with us. Finally, we're focusing on ex -- we are focusing on execution with tight delivery and rollout of current programs. So, for example, the new ships, our new IT platforms, and very firm cost control to keep our costs flat as we grow.

A little bit on membership, most of Saga's customers are now members. All of our products and services will be viewed through this prism. We'll innovate hard and fast to ensure that what we sell meets the needs of our members that everything we do is different and better. We'll actively seek to grow member numbers mainly through customer acquisition but also by opening the program up to others in our target market.

Within the membership base, we'll stimulate active engagement from as many members as possible. As Stuart is going to tell you, we've seen improved engagement as we strengthen the membership offering. We have clear detailed plans to do that, accepting that it remains early days for membership. As engagement has increased, we have started to see real commercial benefits. New customers coming to travel, potential multi-product benefits, early signs of retention benefits too. It's very small, but it is a start.

Now, the impact of all these changes will be a reduction of earnings, mostly driven by lower Insurance margins, as well as the declining reserve releases. I know these decisions will be difficult for shareholders. I recognize that, but it's the right thing for the business. It's essential that we make these changes to our business and that we have the right degree of prudence in our balance sheet to allow us to execute them.

Our new strategy will deliver growth, more customers, more loyal customers and more cash flow. From the lower level of profitability, we will grow profits. The team are going to take you through each of these targets. But over the next three to five years, we intend to grow our retail profit by at least GBP20 million from the rebased level. We're going to target a COR of 97% in underwriting. And we're going to achieve the target that we set out back in 2017, which is to grow our travel business to between GBP60 million and GBP75 million in profit by 2021, '22. So that's what today is all about: setting Saga up to win not just year by year but for the long-term.

I'm going to hand over now to James, who is going to take you through this plan in more detail.

James Quin {BIO 18345789 <GO>}

Thank you, Lance, and good morning. As you know, this is my first set of results, since taking over as Group CFO on the 1st of January. It is nice to see some familiar faces here. For those of you, who don't know me. My background is very much in insurance. I joined from Zurich, where I was most recently the UK, CFO. And in total I have spent about 28 years in the insurance industry, with Zurich, a number of investment banks and with PwC. But before I give you a summary of the results, I thought I would highlight some initial and very brief thoughts on Saga.

And I will just start by saying that underneath the gravity of what we're announcing today, there is a strong business. Even at the level of our rebased earnings, Saga's Insurance operations are profitable and well-positioned with a large number of loyal customers, who mainly come to us on a direct basis. And we, of course, also have a strong offering in Travel. However, the company has labored to deliver a level of profitability that met expectations set some time ago, but that are not sustainable.

I am now focused on working with Lance and the team to help us grasp the nettle and making the changes that will start to address our challenges. Now, I will be talking to you twice today. First, I'm going to talk about the 2018, '19 results. I'm not going to go into the details here, but what the aim is to give you some information on the key trends in our numbers. And to help you understand the context for our starting point. Later, I will come back and explain, the financial impacts of the new strategy.

So turning to results, and there are really two key moving parts. First, Retail Broking profitability reduced sharply compared to the previous year. This is partly because we started the year with a smaller book of renewal customers, but the bigger challenge, particularly in the last six months has been a significant decline in new business margins.

For reasons that I will come back to shortly, we expect a further decline in broking profit before tax in the next two years. This decline in the level of earnings expectations for Retail Broking has required us to impair the value of insurance goodwill, which has in turn led to us reporting a net loss for the 2018, '19 financial year. The second main feature of our results is a very high level of reserve releases from our underwriter, while this has been a big and recurring positive in recent years. For reasons I will explain, we expect the contribution from AICL to significantly reduce in the next few years.

Travel had a solid year and we continued to make very good progress in Cruise, the start of this year has been somewhat challenging in Tour Ops as it has been for the whole industry. And our Tour revenues are down around 3% compared to the prior period.

Now in a year of challenge, there are two key positives in our results. First, we achieved the cost saving targets, we set out a year ago. And second, we remain very profitable and the conversion of earnings to cash has continued to be very good.

Let me now go into some more details. Overall, our underlying profit before tax is in line with the guidance we gave the market 12 months ago. But of course, the mix of profits is very different to what was expected. Underwriting outperformed, but not in a way that is likely to be sustainable, offsetting this Retail Broking had a tough year and we do expect a further decline in broking earnings in 2019, '20. This reduction has two important consequences. Most importantly, it has been a significant factor in the Board's decision to reduce the full year dividend from 9p per share to 4p. Second, it has also led us to impair goodwill relating to the Insurance business by GBP310 million.

Turning now to the divisional results. As you can see on this slide, the biggest change in our results has been in Retail Broking, where profit before tax reduced by GBP25 million. This was partially offset by higher underwriting earnings and an improvement in emerging businesses and central costs. Most of the change in this latter category is explained by one-off charges in the '17, '18 results and a one-off gain in the '18, '19 numbers.

Now to provide more explanation of the performance of broking, I include some additional information on the next slide that shows a walk from '17, '18 results to '18, '19 profit before tax. Now what you can see here is so that overall broking profit before tax reduced by GBP17 million on a written basis. That is excluding the impact of the written to earned adjustment, and there are four main items here. The biggest is an GBP11 million decline in the contribution from home and motor new business. There are a number of reasons, why this has happened.

First, the Group set a priority to stabilize the home and motor policy count with a conscious decision to win -- to reduce pricing to win more new business. Second, a lot more new business was sourced from price comparison websites. This business typically has lower margins and higher acquisition costs than the business Saga has traditionally written on a direct basis. Third, external factors such as GDPR have had an adverse impact on volumes and acquisition costs. And last, as other insurers have noted, the market was competitive through much of last year.

The second main item impacting last year is a reduction in renewal earnings, particularly on the home book. This is a product of a smaller renewal book due to lower new business in the '17, '18 year and higher net rates from panel Insurers. It was, however, for the most part, expected.

The third item is a loss of GBP5 million relating to the impact of adverse claims experience on profit share arrangements for the PMI product. This charge is expected to be one-off. Indeed, we are now starting to see the benefit of changes in policy terms coming through an improved claims experience, with this also starting to be recognized in the net rates charged by our insurer. We have a very good PMI proposition for customers and this is a significant contributor to the earnings from other products.

And fourth, going the other way, we reduced Retail Broking operating expenses by GBP7.7 million, which was ahead of target. Now, as I mentioned, the challenges we faced in the last 12 months are likely to be ongoing. And as I explain on the next slide, we expect a further decline in profitability in broking in the current year.

There are two main reasons, why we think this will happen and each has a broadly similar impact. First, the reduced level of margin in last year's new business will lead to a reduction in renewal business profitability in the next few years.

Second, as Lance has explained, we anticipate changing our approach to renewal pricing. While there is a GBP5 million positive expected in PMI, given the one-off loss in last year's results, these pressures mean that run rate earnings for the broking business are expected to be between GBP15 million and GBP25 million lower in the current year and with an additional GBP10 million impact expected on earnings for the year after. This reduction in future earnings expectations is what is behind our decision to reassess the carrying value of insurance goodwill and to impair this by GBP310 million.

As required by accounting standards, we have taken a fairly prudent valuation approach here and we've not included the benefits of the strategic relaunch that Gary will shortly talk about, but of course, there is no getting around the fact that this is a disappointing outcome. Next, I will talk to the performance of the underwriting business. As you can see on this slide, both of the last two years have seen a very high level of reserve releases and a level that is significantly above future expectations.

There are two main reasons why this has happened. First, our actuaries have put greater weight on positive recent claims trends within best estimate reserving. This leads to one-off reserve benefits of GBP32 million in the most recent year and around GBP20 million in the year before. Second, a historically very prudent approach to initial loss picks has supported ongoing very high levels of reserve releases further helped by benign large loss experience in the last 12 months.

I show this in more detail in the next slide where I set out the more recent accident year loss ratios. What I show here in the left-hand chart is the initial booked loss ratio and the current booked loss ratio for the Saga motor book. The difference between the two is the reserve releases in the most recent and prior years.

This shows that Saga took a very prudent view of the initial loss picks from 2010 to 2013 with booked loss ratios in the mid 90s. Another key factor has been the benefit from a significant improvement in claims experience relative to expectations. There are multiple reasons for this, but one of them has been the implementation of the LASPO reforms in 2013.

This has helped to support benign underlying claims trends for pretty much the whole motor insurance industry and has been a key reason why reserve releases have been so positive. In recent years, however, and in line with AICL's role within the Group, the benefits of benign claims experience has been increasingly reflected in both pricing and reserving. This means that while we still hold the same level of explicit margin and it may well be prudent in large loss reserves for recent accident years, we don't expect these to develop to anything like the levels seen in some of the previous years. In terms of current claims inflation, this is generally running in line with expectations. So to cut to the chase, we do expect a couple more years of high reserve releases, but we expect our reported combined ratio to trend to around 97% in the next three years.

Let me now turn to other aspects of our results. Our Travel business have an overall solid year. As we reported previously within Tour Ops, there are considerable pressures at the more commoditized end of the market, which is our stays and where we saw passenger numbers decline by 7%. Equally, we are seeing a much more resilient performance from our differentiated holidays propositions, including tours, river cruise and third-party cruise. This shift in mix has supported an improvement in gross profit per passenger and has enabled us to hold Tour Ops profits flat on the prior year.

In Cruise, we had a good year. Growth in revenues was partly down to lower days in dock, but it was also down to strong demand for the final season of the Pearl II ship. In terms of forward bookings, we are not immune to the same pressures as other travel companies, with Tour Ops revenues around 3% down for current departures in comparison to last year. It is a headwind, but I wouldn't say, it is a big issue for us. And more importantly, we continued to make very good progress on forward bookings for the new cruise ships, where we remain on track with the business plan assumptions.

As I set out on the next slide, we also made good progress in reducing our cost base. Here I show a walk from '17 '18 expenses to '18 '19. The main point to highlight is that the target set at the beginning of the year. That is to reduce in-year admin costs by GBP10 million was achieved. As was signaled back at the time, some of these savings were reinvested in marketing costs, which increased by GBP6 million. This included additional marketing for the new cruise ships plus higher acquisition costs within the Insurance business. We will continue to put a high priority on improving efficiency and absorbing inflationary pressures over the next five-year period.

On the next slide, I show Saga's operating cash generation, which has been one of the Group's real strengths. As you can see from this walk, we generated operating free cash flow of around GBP181 million in the year. A small increase in comparison to the year before. On this basis, we converted roughly 80% of EBITDA to cash during the year, which enabled us to reduce net debt by around GBP40 million. There were a few moving parts here and naturally, future cash generation will be impacted by lower Insurance earnings. But the point remains that the Group has a good track record of turning profits into cash and using this to reduce leverage.

I realize this has been a relatively quick cantor through quite a lot of moving parts in our results. My main focus here has been to give you a view on the financial context for today's announcement, particularly as it relates to Insurance.

And with that, I'll now hand over to Gary, who will take you through our strategy for Retail Broking. Thank you.

Gary Duggan {BIO 18331803 <GO>}

Good morning, everyone, and thanks, James, for the introduction. I'll be taking you through the new Saga Insurance Broking Strategy. The rationale for the changes and why I think we're in a strong position to respond to some of the challenges ahead. The UK insurance market is undergoing a substantial period of change, with the industry's pricing practices front and center of the debate. We are taking the opportunity to embrace those changes. And I believe that Saga can help lead the way to creating a healthier, more sustainable insurance market in the future.

As Lance mentioned earlier on, Saga has been very much focused on short-term profit, relying on our in-force book of customers, traditional direct marketing channels and offering undifferentiated products. And this has contributed to a decline in policy volumes, margins and retention levels. Whilst we have a profitable Insurance business with a solid foundation, it's become increasingly clear to me over the last 12 months or so, since I've been in the role, that the insurance broking business needs a fundamental change in strategy.

The new strategy focuses on growing our direct channels, rewarding loyalty and becoming more efficient. But first let me provide you with some market context. We operate in a growing demographic within the over 50s market, where the market is changing rapidly. Whilst there are an increasing number of customers, who are shopping around on PcWs, the growth in direct players with product-led messaging, in addition to our recent research, shows that there is evidence that customers are now looking for, not just the cheapest products, but also a high quality product with the right level of cover, insurer using technology to drive down their servicing costs, and finally, the regulatory intervention has increased significantly recently with a specific focus on the industry standard practice of discounting the new business and increasing premiums on renewals. As James pointed out earlier on, there are a number of internal and external market factors that have led to a decline in policies and profitability, which highlight the need for change. Saga's brand consideration has decreased and our market share is in decline. The marketing database has reduced and the short-term profit focus has led to a very narrow communications approach.

We have not innovated or adapted to the changes in customers' requirements, offering the same price led products in both PCWs and through our direct channels. And as a consequence, this has led to a decrease in our direct volumes. We've become increasingly reliant on lower value PCW business in order to drive policy growth in what is a highly competitive market. Despite all this, as I've said, I believe we have a solid foundation for growth. We have a loyal customer base and we deliver excellent service to our customers.

We've got a prudent track record in direct marketing and a well-known brand. We've invested in Guidewire, which will help to accelerate our innovation agenda. And we have the emerging opportunities arising from the membership program that Lance mentioned earlier on. So whilst we have a solid foundation, our response to the market challenges were quite a fundamental change in strategy. We are driving growth through our direct channels by developing distinctive, highly targeted propositions, creating standouts in a competitive direct marketplace.

The UK Insurance sector is not exactly known for product innovation, but I'm convinced that we are ideally positioned to launch positive, customer-driven innovative solutions into a market that needs to change. We're investing in our brand salience and reducing the number of people who reject the brand and Stuart will talk more about that later on. We will improve our direct marketing economics, converting more of our quotes into sales, widening the footprint and shifting the product mix to higher-value, feature-rich products.

But in order to win in direct channels, we have to change the operating model. So we've moved the customer conversation away from a price-led discussion with our customers into building longer-term relationships with our customers by delivering high-value, differentiated propositions, including membership. And it's these new high-quality premium products, including the fixed price feature that have been developed with a specific focus on the needs of our customers. We will promote these products through a broad range of media channels from May and they will only be available by coming direct to Saga. We will still offer our essentials range of products through the PCW's, where some of our customer segments are initially attracted to a lower price, lower-cover product, but we will also then have the opportunity to offer those customers our direct products at renewal. But first, let me talk to you in a little bit more detail about the three-year fixed product that Lance mentioned earlier on.

So we've been testing this product now since October. We've sold over 6,000 policies to customers who have asked for a quote, and customers can buy the product and acknowledge that if their circumstances don't change, they don't make a claim or IPT doesn't increase, then their premium will not go up for three years. And over 60% of customers who were offered the product chose the fixed price product instead of our standard variable price product that is traditional in the industry.

The Trustpilot feedback from customers has been absolutely overwhelmingly positive as you can see. You're finally respecting loyalty, rather than favoring new customers, this is unique. The price guarantee was the deciding factor. There are some tremendous comments there from customers and supported by the research findings that we have really does mean that this product feature will appeal to our customers. And by the way, really importantly, the contact center staff absolutely love it as well.

We launched the new home product last week with the majority of customers selecting the three-year fixed above the standard products and we have sold over 1,000 policies in a week. And we've done that without any direct marketing activity, which is evidence -- clear evidence that our customers, when given the choice, are prepared to pay for a higher quality product with a price promise.

Our new motor three-year fixed price product went live today. So the three-year fixed is a tremendous feature for us and totally unique in the UK motor insurance market. But I think it's also important to see that our new products have other exciting features and benefits as well. For example, we have private health care benefit in the event of injuries, for customers arising from a crash. So we now have two high-quality home and motor products, with some exciting and unique benefits that will make us really stand out in a crowded marketplace.

The developments of these products have been absolutely critical to enable our customer service agents to confidently lead conversations with customers about some of the fantastic benefits that our products have, rather than just focusing on price. And I genuinely believe that this will have a profound impact on the culture of the insurance broking business. We will, of course, continue to offer the price-led products from our essentials range available to more price-led customers through the PCWs. So now that we can give customers a broader choice of products and these products are a complementary addition to the high-quality travel and PMI products that we already have. And these new products are the first new products in our step to delivering against our innovation agenda. We have a pipeline of new ideas and propositions in our innovation lab that are currently being worked up and developed to follow up on these new products.

So we now believe we have something to really shout about in the market. We have highly -- high-quality, differentiated products and we are injecting some significant marketing investment now to launch these products, but in order to be successful, we need to give more customers, more reasons to quote Saga through our direct channels with a very clear call to action and we will make the most of this opportunity by seizing first mover advantage and demonstrating the value of our new products to both new and existing customers. And we will achieve this by highly visible impactful promotional campaigns to maximize the opportunity at launch and we will focus the marketing messages on some of the compelling new features, unique features that our products have, including the three-year fixed.

And we will do what we do best, which is to follow up the marketing with delivering excellent customer service. In the past, our marketing had been very focused on leveraging our existing database of customers, but going forward, we will be expanding our marketing campaigns investing in a broader range of media channels. We know, for example, that our customers over-index in the traditional media channels of newspapers, TV and digital. So that is where the majority of the media spend will be focused as it will provide us with the broadest and the most efficient reach in addition to which TV and digital channels are also very well-suited to delivering emotive campaigns, which we believe will really resonate strongly with our demographic.

So we're now in a much stronger position to leverage these media channels because we have something exciting to talk about. And once we've built awareness of the new products, we will then optimize the marketing spend for the remainder of the year. So in order to maximize the value of the marketing investments, we have now adopted a far more progressive approach to customer loyalty. So in the past, our focus has been very much limited to retaining customers via pricing and discount. We've changed our approach now and we will utilize a broader range of solutions to retain our customers. We will offer fixed price product. We will offer our customers a flatter renewal pricing. We will deliver enhanced product benefits and we will make a claim's commitment, all of which will help to keep more of our customers for longer. And of course, we have something that other insurers don't have. We have a wide range of membership program that delivers some fantastic offers and experiences, which Stuart will take you through later on.

We committed to expanding the footprint and we've increased our third-party panel share of motor new business to 30%, a significant increase. Our overall motor new business volumes increased by 11% last year and the majority of the growth came for -- younger age of the -- of our demographic, with newer more expensive vehicles. And whilst our data models are very well-established now, we are driving further efficiencies, by expanding quotability and becoming more competitive for more customers, we will convert more of our quotes into sales.

We have over 30 footprint expansion initiatives lined up, some new highly predictive data models and some new insurance products that are all lined up to deliver further efficiencies this year. And in addition to expanding our footprint, we've reduced our operating costs by over GBP7 million last year, by eliminating some of the complexities in some of the processes, by reducing the number of repeat calls from customers and by the implementation of Guidewire.

And I believe, there are further opportunities to improve our efficiencies as we rollout Guidewire into our home insurance products by the end of this year. We've trialed and we're now in the process of rolling out automated robotic processes, expanding our web chat function and improving our digital service and capabilities, which will all help to eliminate some of the customer friction points in our journeys and also reduce our costs further.

So to sum up, we are launching a new strategy for the insurance broking business and it will transform this business, and James will talk through the financial implications later on, but meanwhile, I'll just summarize, I think, some of the things that I believe the transformational strategy will take us to over the next five years. It will deliver increased customer advocacy and drive up improvements in our NPS scores. It will -- we will increase the percentage of customers that come through our direct channels and by our new high quality, premier-level products. There will be an improvement in our operational efficiency, reducing our costs to serve and improving our retention levels. And this will add around GBP20 million profit to the rebased profit numbers and deliver about a 5% increase in Saga-branded policy numbers. So we've embraced the need for change and I am confident that this is the right strategy for the insurance broking business.

So now, I'd just like to hand you over to Robin, who is the CEO of our Travel business. Thank you.

Robin Shaw {BIO 20138547 <GO>}

Thank you, Gary. Good morning, everyone. Travel has always been at the heart of Saga and today I want to give you some clear guidance on our future strategic direction. So let me begin with my key messages. Firstly, our significant investment in the new cruise ships is fully on track and I will give a lot more detail in due course. Our tour operating businesses remain profitable, but we need to accelerate the changes that we've already started by focusing on holiday segments where we can win and ultimately we can earn more margin. We started these changes, we need to continue in earnest.

In conjunction, there is a clear opportunity to improve our commercial performance. Specifically, this is around purchasing, revenue management and full utilization of our commitments. As we do this, we must not lose sight of the importance of the customer. This has been a bedrock for the Travel business over recent years. Importantly, we intend to deliver on our commitment made in early 2017 to increase our '16/'17 PBT by four times to five times. This equates to a Travel PBT in '21/'22 between GBP60 million and GBP75 million.

As James mentioned earlier 2018/'19 has been a solid year for Travel. In Tour Operations, PBT has been flat as overall passenger declines have been offset by higher revenues and margins per passenger. And this has resulted from a steady, -- but -- steady move from commoditized short haul into higher margin segments such as rivers, special interests and escorted tours. Cruise profitability is again broadly flat in '18/'19 versus prior year, but we've been able to absorb fuel rate increases of around GBP2 million and additional marketing of GBP1.7 million largely in support of driving '19/'20 revenues.

We also continued to drive overhead cost efficiencies, with total Travel overheads reducing from 10.3% of revenue to 9.5% of revenue in '18/'19. Given the significant investment in new cruise ships, I would now like to provide more detail of progress. We have been talking about this for a long time and the journey started some 3.5 years ago when we signed our contract with Meyer Werft, our shipbuilders in Germany. Since then, we have designed a completely new ship led by customer insights and we are now on track to deliver Spirit of Discovery in June of this year, ready for her first revenue cruise on the 10th of July. The second new ship, Spirit of Adventure, will use the same platform, a sister ship effectively and therefore reduce overall build and design times. The second ship will be delivered in August 2020, just 14 months after the first ship. These new vessels will replace both of our existing vessels and indeed I'm pleased to say that we've agreed the sale of Saga Pearl II, which will leave us in mid-April.

Cruise is not a new business for Saga and we have built considerable loyalty and expertise since our first cruise operations in 1997. Our cruise operation epitomizes our focus on the customer. The graph on this chart shows how we have consistently increased our revenues per passenger day yet at the same time, we have consistently achieved 98% of our customers rating us excellent or good for value for money.

We have delivered this by investing back into the product, improving the service, improving the quality and for example by moving to a much more fully inclusive product. Indeed, Saga cruises as Lance mentioned, is an excellent example of where Saga wants to be in all of its markets, providing high-quality, differentiated products and services which appeal to our customers and deliver strong margins.

Outside of cruise, within Tour Operations, we continue to receive high praise through independent travel awards. Transformation is probably an overused word in business, but our new cruise ships genuinely fit that description. Clearly, the most obvious factor over the two years where we replaced our ships is that our capacity will increase by some 74%, but we should not underestimate the change -- the step change in the customer proposition. These small new all-balcony ships will provide unrivaled levels of quality and service of ships operating out of the UK. They will be characterized by bespoke design, high-quality and genuinely personalized service. It is, therefore, no coincidence that we're describing ourselves as boutique cruising.

On the regulatory front, our new ships also address the maritime industry's continuous drive for higher standards around sustainability, which in turn allows our ships to operate in previous destinations, otherwise off limits. I can safely say that by August 2020, we will have the newest and most environmentally-friendly fleet in the industry.

In summary, the new cruise ships will enhance our already highly differentiated proposition and ultimately provide some, if not the highest, levels of service and quality in the UK cruise market.

The positive business case for the new ships was primarily driven by a combination of lower non-customer facing costs, such as fuel and lower repairs and maintenance costs in the early years. And also a natural economy of scale, benefiting from a slightly larger ship, albeit a small ship, still by today's standards,

The waterfall chart here gives an indication of the high level of EBITDA per capacity day for the new ships. With the new ship costs verified now, the key variable in order to hit our business case is a revenue per capacity day of GBP235. To date, we are fully on track to achieve this with booked per diems of GBP275 and load factors on target for 85%. As a result, we are confident that each ship can and will deliver the previously communicated GBP40 million of EBITDA per ship.

So again, in summary, importantly, all elements of the cruise transformation are on track. The ship will be delivered on time. We have already started to cut the steel for the second ship, Spirit of Adventure. The capital investment is on budget, the original business case and as I mentioned critically, demand generation is in a very positive place and we have booked 78% of all of Spirit of Discovery's revenue for its first cruises between July '19 and January 2020.

In summary, we're almost exactly where we plan to be at this point in time. And here, the latest pictures of Spirit of Discovery taken last week. For the cruise team, me personally, this is not only a critical investment that must generate the required return, it's also hugely emotional. The passion, the pride, the sheer hard work to make this happen, I've rarely seen before. It would be a very proud moment for Saga, when she launches. Emotions aside, she will exit this dry dock at the end of May and then start her passage up to the North Sea for sea trials, prior to delivery to us on the 20th of June.

Now, turning to Tour Operations. Since January 2018, I've added Tour Operations to my responsibilities. Whilst we have started the Change program, this does need to accelerate, to create a more profitable and a more sustainable tour operating business.

This chart here introduces a very simple segmentation of margins versus a level of specialism. The top left segment doesn't really exists, high-margin commodity products. And bottom left is increasingly dominated by the large volume tour operators such as Thomas Cook, Jet2 and TUI. And indeed, the online travel aggregators.

This fly-and-flop, largely short-haul market is not the future for Saga Travel. Therefore, over time, Saga Holidays will increase its activities on the higher margin, more differentiated segments, such as rivers, escorted tours, and special interest holidays. Titan is different. This business is already focused on higher margin escorted tours. But this is -- as a significant player in this specialized segment, needs to focus on improving its commercial model. The top right and most attractive segment for Saga provides a sense of direction in order for us to achieve our transformation and profit goals.

So, what will this mean for each of our businesses? Saga Holidays, over time will have a reducing share from short haul commodity into more specialized segments. The top left bar chart illustrates that this has already happened to a certain extent. But this strategy will continue and will result in stable revenues but increasing PBT margins over the next few years.

Titan does have a strong number two position in this marketplace of escorted tours. It is now in a position to grow moderately, in the low single digits, but also a significant opportunity to again increase its PBT margins through improved revenue management, inventory management and purchasing. In summary, we now have strong and credible plans for Tour Operations businesses and it's now about execution. Possibilities is an exciting initiative at Saga. And Stuart Beamish, our Chief Customer Officer, will talk in more detail later. Encouragingly, we are already seeing signs within Travel of increased levels of engagement and hard sales. Since July, we can attribute over 1,600 passengers who have booked through Possibilities, of which nearly 40% are first-time travel buyers.

Importantly, this also represents a low sales acquisition cost and this coming year, we are targeting to achieve over 4,000 booked passengers through Travel Possibilities. Possibilities is in its early stages, but the Travel team are particularly excited about its potential. So hopefully this has added some understanding to the Saga Travel business, but against each of our messages what are we committing to. Firstly, as I've explained, we are on track to deliver the business case for the new ships and $40 million EBITDA per vessel. Within Tour Operations, we will continue to focus on higher margin more differentiated segments and this will deliver broadly flat revenues, but PBT margins increase in the 2 percentage points to 3 percentage points range by '21/'22. Our focus on the customer will continue and we'll use NPS as our overarching benchmark. Lastly and significantly, our commitment to deliver the 4 times to 5 times '16/'17 PBT by '21/'22 remains intact, i.e., the GBP60 million to GBP75 million PBT.

So in summary, in travel, our focus on the customer will always be at the bedrock of our business. We have clear plans. We're going to focus on differentiated holidays whether cruise or Tour Operations and this combined with more robust commercial management will ensure that Saga Travel is successful in the years to come.

I'll now hand over to Stuart Beamish. Thank you.

Stuart Beamish {BIO 20609682 <GO>}

Thank you, Robin and good morning everyone. Just by way of introduction, I joined Saga just over two years ago and I have been in my current role just over a year. I joined from Barclaycard and prior to that had marketing roles in British Airways, BMI and Virgin. So from my perspective, it's been great joining another great British brand. And brand and membership is what I'm going to talk about today both in terms of current performance and also our plans, because both are key enablers to the Group strategy. What you will see over the coming slides are, firstly, that customer satisfaction and brand awareness are both strong points for the group. But the brand is not top of mind enough for consumers. And we're going to address this with a customer-focused strategy, focused on new products, advertising and membership. 18 months since launch, over 1 million customers have signed up to Possibilities our membership program. Engagement in the program is growing and we're starting to see a clear link between engagement and commercial value. And therefore in the coming year, we're going to be adding new benefits to monetize the program.

So turning first to customer satisfaction. Last year, we introduced brand Net Promoter Score across Saga. As you'll be aware, this is an established industry measure for customer advocacy. Unlike transactional NPS, it focuses on the entire customer experience. So we feel this gives us the most robust measure we can have for customer satisfaction. We are very pleased with the initial results, as you can see from the chart on the screen, we have positive scores across the business. Cruise is the standout, but I'd like to talk for a moment about insurance.

When you look across the insurance sector, it tends to score much lower than others, when it comes to NPS. So we think that our Insurance score currently actually screens very well against the rest of the market. When you consider that in both Travel and Insurance we are launching new products this year, we are confident these scores will grow.

So in summary, when customers try Saga, they have a positive experience. But how effective is our brand at attracting new customers in the first place? Well, this is more of a mixed bag. Firstly, as you've heard already from Lance, brand awareness for Saga is exceptionally high. As you can see from the chart on the left, we now ask this question in relation to each of the sectors in which we operate and is high across the Board. However, when we look at brand consideration, the drop off from awareness is larger than we would like. This chart on the right shows Saga's prompted brand consideration compared to the average of our key competitors in each of the sectors in which we operate. So we've now embarked on a major program to improve brand consideration through a combination of new products, marketing and membership.

You've already heard from Gary and Robin about new products, so I'm going to talk about advertising and then move on to membership. In terms of our advertising, it's fair to say that our marketing approach at Saga had become a little tired. We've had a narrow focus on direct marketing on one or two daily newspapers. But also the way we have presented the brand had led people to perceive us as old fashioned. So at the start of this year, we introduced a new communication strategy across the Group. Starting with Travel, as you can see from the example on the slide and the TV ads, that hopefully, you saw as you came in today. We've made a big change to the style of our communications. At the same time, we've also made the brand more visible using more digital media and both digital and broadcast TV. It's early days, but the -- so far, the results have been very encouraging.

The chart on the right shows that already, after just one campaign, we're starting to tackle that old-fashioned perception with quite a significant drop and that's just, as I said from the first campaign. Also the audience comments that we've received are extremely positive. I've included some as an example on the slide. I particular like the first and last comments because they point to this being unexpected from Saga. That's great evidence of starting to drive change in perception and that's going to help us push up those all-important consideration scores. So based on these results, we're going to be rolling out this approach across our three-year fixed-price Insurance campaign so that all of our activity across the group will work together to improve brand perception.

I'd now like to turn to membership. So Possibilities was launched 18 months ago. We started off with some offers, with some key brand partners, Apple, Majestic Wine and others and some free gifts, which we use to encourage members or customers to sign up.

We have then added Dining Possibilities in October. This is our own Saga Dining program that gives customers discounts and offers at over 1,100 UK branded restaurants. It's already one of the largest dining programs in the UK. And by creating our own scheme, we can tailor the proposition to our members and also collect usage data, which is very important for us for marketing.

Last summer, we launched Travel Possibilities giving members access to deals with Saga Holidays, Titan, and Saga Cruises and this also gives us an excellent distribution channel for late availability. And last week, we launched Entertainment Possibilities in partnership with Ambassador Theatre Group, giving members exclusive offers on theaters and shows.

Since launch, we've also sourced over 300 events and balloted tickets for members to attend. These have included the likes of private gigs with Mica Paris, Lulu, Days at the Races, Audience With Style events and others. We've had over 400,000 ballot entries for members to attend those since launch. It's been one of most popular aspects of the program.

So I'm now going to take three slides to talk through the results of membership since launch. So far, over 1 million customers have signed up, that's 84% on average of those asked. Now that's a high sign-up rate for any loyalty program, but also encouraging when you consider our objective to build brand affinity to Saga. Over 90% of members have given positive consent to marketing. That compares to 73% for non-members at Saga. We've got over 200,000 additional marketing contacts for direct marketing through membership communications, that who -- otherwise we wouldn't have access to. But the number of members only really tells part of the story, because as with all loyalty programs, the commercial value is driven by members who engage with the benefits of the program. So having successfully signed up many customers to membership, we are now keen to grow member engagement.

The summary here is that as we are adding new benefits, we're seeing membership grow. Firstly, as you can see from the chart on the left, membership is helping to lift Saga's overall marketing response rates, with email open rates far higher than industry standards and also Saga averages, these really are exceptional email engagement rates. We've also been tracking member usage of the program and we've seen that grow as we've added new benefits, particularly since Dining Possibilities in October.

We've clearly got some way to go in terms of engagement. But this is evidence that we've been adding the right benefits for our members. We're also getting faster adding new features. As I said, we've just launched entertainment possibilities last week and a new global AccorHotels partnership is about to launch, and these should drive a further boost in engagement. As we grow membership numbers and usage of the program increases, we're keen to establish the link between Possibilities and commercial value. What we can see already is that members engaging most in Possibilities are slightly younger, have more product holdings with Saga, provide more contribution and are more likely to give marketing consent. So membership is already providing a stronger route to access our key Saga customers.

In terms of multi-product holdings, the numbers we're looking at here refer to our core products only. That's insurance policies, holidays and cruises. The Group average for core products is 1.4 products per customer. That's 1.2 from non-members and 1.7 from engaged members. As usage grows, we recognize there is a need to better establish cause and effect between membership and these numbers. But we expect increasing engagement in the program to lead to increasing commercial value.

So the formula we are following for generating value for membership is this: Firstly, signing up members. We're still doing so at a rate of 10,000 a week. Secondly, creating benefits, which drive engagement. Thirdly, monetizing, both in terms of direct sales from products like Travel Possibilities and also indirectly leveraging the higher marketing engagement to influence purchase.

In terms of the program itself, we will continue to develop the proposition to add new benefits to provide value for our members. And in turn drive retention, multi-product holdings and travel contribution. We also believe that in the future membership can play an important role in driving new customer acquisition.

In terms of what we're going to build? Well, 18 months on, we've got some clear insights in terms of what our members want from Saga. And this is going to be used to refine and strengthen the program. Firstly, we are going to scale access to experiences by testing paid for events and that will enable us to open access to more members. Secondly, by creating online communities for our members to connect with each other, which members are already telling us is something, they're very interested in. And thirdly, to expand the level of incentives and customer recognition through Possibilities to support our commercial objectives. For example, to acknowledge a forthcoming renewal or incentivize additional product holdings. And all of this will be -- continue to be supported by third-party offers from well-known, high quality brands in dining, retail, travel and entertainment.

In terms of execution, but there's a lot of detail on here and I don't propose to talk to all of it, but we have a clear product roadmap for Possibilities over the coming 12 months to 18 months. I don't propose to go in detail but just to highlight a few things, the scaling events, expanding retention and cross-sell incentives and developing communities in sort of beat to launch this year.

One other aspects to highlight is digital, two-thirds of the unique visits to Possibilities often tablets and phones, that's higher digital usage than we've seen from our customers previously. So we'll be investing to develop the digital experience to make easier for members to get value from the program. That will include a digital version of Saga Magazine and a new member app this year.

Finally, in keeping with the executional focus, these are the core 12-month goals we've set for brand and membership. We're aiming to deliver growth back into brand consideration, double member engagement, grow the number of customers with multi-product holdings and contribute to the goals already outlined for Travel profitability and Insurance retention, all of which we hope to update you on going forward.

Thank you. I'll now hand back to James.

James Quin {BIO 18345789 <GO>}

Thank you, Stuart, and hello, again. I'm now going to spend a few minutes taking you through the implications of our strategy for our finances. First, as you have heard from Lance, we're expecting underlying profit before tax for the current year to be in a range of GBP105 million to GBP120 million, and I will shortly explain the reasons for this in more detail. Second, while the re-basing of earnings is of course very disappointing, we believe this will establish a level from which we can grow profits. We expect the strategy outlined by Gary to enable us to grow new business volumes and improve customer retentions. This would add at least GBP20 million from the lower earnings base from broking.

In addition, with two new cruise ships and a strategy to transform tour ops profitability, we think we can more than quadruple travel earnings compared to the level of 2016/'17. Third, I'm sure you will have a number of questions about the new three-year product in terms of accounting and risk, and I will look to answer some of those today. I think the key point I want to leave you with is we have spent a lot of time on this area ahead of the go-live decision and our financial plans and our accounting both contain elements of prudence.

Fourth, while our absolute levels of debt are in line with expectations, lower earnings will lead to a higher ratio of debt to EBITDA than previously anticipated. However, we expect this to reduce quickly and back to an overall Group leverage ratio of around 2 times over the next four to five years and an ex-cruise leverage ratio of below 1.5 times. And last, we have the level of financial flexibility we need to support our strategy. Our business model remains highly cash generative. We've agreed amendments to the covenants in our short-term debt and we have credit facilities in place until May 2023.

These factors support our new target payout ratio of 50%, which balances the priority of reducing our debt with sustainable cash returns to our investors. So, let me now turn to the details, starting with our earnings expectations for the current year. And on this slide, I shall walk from actual 2018/'19 earnings to the new guidance that we published today. As you can see, there are two main moving parts here. First, and the biggest, is the reduction in expected reserve releases. Now, as you know, this is not a precise science and there is an element of volatility to claims experience that could lead to releases being either higher or lower than this amount.

However, based on what we can see today and this is an area in which I have spent a lot of time in the last few months, we would expect our reserve releases to be between GBP30 million and GBP40 million for the full year. Now this is a big decline compared to the levels of last year, but I should emphasize that it is more or less what we had previously anticipated for the '19, '20 year.

Second, there are a number of moving parts in our Retail Broking business earnings. As I mentioned earlier, the lower margins in new business that we wrote last year will lead to lower renewal profitability in future years. And we also anticipate making changes to our renewal pricing on a proactive basis. Netting off the expected GBP5 million improvement in PMI. These factors are expected to reduce earnings by between GBP15 million and GBP25 million.

There are then two other factors within the broking results, which more or less cancel each other out. On the positive, reductions in AICL pricing should provide an in-year benefit of around GBP5 million. Going the other way, the relaunch of the Insurance strategy is expected to have a net P&L cost of around GBP5 million in the first year, and I'll come back to this shortly.

Turning to other parts of the Group. We expect Travel earnings to be higher than last year, mainly in Cruise, albeit with increased cash flows from the Spirit of Discovery, partially offset by the fact that for three months of the year we'll only have one ship in operation. We then do have a small increase in central costs, it is roughly 50% due to a one-off gain in last year's results and 50% due to additional costs to support membership and other investments in data and other capabilities to support the new product propositions. We expect to hold underlying costs flat.

Let me now spend a bit of time explaining the financial drivers and risks of the new Insurance strategy, and specifically, the new three-year fixed product. As Gary explained, we will focus on our direct heritage and capabilities with a truly differentiated product in the form of three-year fixed. More specifically, we are aiming to grow new business and to improve retention in combination enabling us to grow our policy count at around 5% a year. We are helped by the fact that our core demographic, the over 65s, are growing in number at a compound rate of around about 2% a year. And we also think that we can recover some of the market share lost in recent years.

In terms of profitability, we are planning on an assumption that the three-year fixed product is broadly neutral to margins per policy. This balances two different factors. On the positive, we'll be paid for the risk we are taking in guaranteeing the price for three years and that will include a reasonable margin for volatility and risk. We should also see an increase in revenues per policy from the added policy features in the premium product. In terms of costs, we need to invest to support this new strategy and as Gary explained, we are ready to go with our new advertising campaign. While we see this as a cost effective way of winning new business, it is a lot more expensive than the old direct channels upon which Saga has relied in the past, particularly, direct mail.

In the short term, we'll have a small increase in admin costs, although this will over time be more than compensated for by improved efficiency. The other cost we allow for relates to how we will account for the fixed element of the product and the assumptions we make for inflation. I'll explain this in more detail shortly, but the key point here is that we believe that our assumptions are prudent. So the message I want to leave you with, is that the new strategy is a way of driving real growth in the business based on a realistic and sustainable view of margins.

On this slide, I'll look to explain three things. First, the accounting for three-year fixed; second, how we've modeled this in our planning and third, the risk considerations relating to the three-year fixed product.

I'll start with the accounting. Our approach to three-year fixed is expected to be based around the deferral of part of the premium paid by our customers. The deferral reflects our estimate of the cost of providing a price guarantee. As such, it will be calculated as a percentage of the net rate of the product based on expected future inflation and other factors which influence risk.

It will also include a margin for volatility. We've modeled this using analyses from AICL for home and motor and based on prudent assumptions. We will then release the deferred income in years two and years three of the policy. In other words, over the life of the price guarantee.

In terms of our planning assumptions, the deferral of part of the income is of course fully allowed for. In addition, we have made prudent assumptions for inflation. Now, we don't see a reason why inflation would be higher for price promised customers compared to our standard customers and indeed there is actually a good reason as to why it may well be lower, but of course, we can reprice standard customers if inflation is higher than expected, but that would not be the case in the short term for those on three-year fixed.

From my perspective, there are two ways of thinking about this. First, if we decide to keep the risk on balance sheet, then we have an inflation contingency to protect us. Second, if we decide to lay off the risk to insurers, then we've effectively built the cost of doing so into our planned projections. And so the financial risk, we believe that the pricing of the planning assumptions we are making, protect us against claims inflation persistently running at high single-digit levels.

The other risk is a one-time increase in claims inflation above this level. Now this is not likely to be a major risk in the short-term as volumes of three-year fixed customers grow from what will obviously be a very low starting point. In addition, a simultaneous shock around inflation for both motor and home is very unlikely. And the accounting deferral approach would overtime build up significant buffers that would help us to withstand this type of scenario.

Nonetheless, while we've been prudent in our planning, internal risk modeling does highlight a level of exposure in certain adverse scenarios but extreme ones. As we roll out the new proposition, we will of course be in test and learn mode. But I'm talking here about a possible few -- 1 in 50 exposure of less than 10% of our broking earnings, not about the risks to capital. In addition, we will look to reduce this risk through insurance or reinsurance options before three-year fixed becomes a significant part of the portfolio.

On a next slide, I will look to wrap all these together in setting expectations for the broking business over the next few years. On this slide, I've tried to simplify the key economics of the broking business; it's basically policy count times, gross margin, less overheads. Starting with the top line, we expect this year will be a transitional period of test and learn. We expect to write more business directly and less on PCWs. Overall, policy count is expect to be around roughly flat.

As mentioned before though, our focus here is on sustainable growth. We're targeting a 5% annual increase in policy count, resulting more or less equally from better retentions and higher new business. These aren't easy targets, and neither do we see them as unrealistic. In terms of margins, last year the gross margin per policy across home and motor was around GBP80. This is gross revenue less marketing costs.

For the reasons already explained, we expect this to decline this year to between GBP71 pounds and GBP74 pounds of policy. We then expect the decline next year to be between GBP67 and GBP70 per policy; after which, we expect margins to be more stable. This is the impact of the ongoing margin pressures that I referred to earlier and which, of course, represents a significant headwind to the business, but the point here is that even allowing for these headwinds, what I'm trying to show you here are the building blocks for how successful execution of the strategy would add at least GBP20 million to earnings compared to the re-based level of the current year. But I want to stress at this point that these margins are intended to be indicative, changes in mix can, of course, lead to higher or lower numbers, and of course, we live in a competitive and dynamic market.

Within this indicative view, we assume no real change in the current pricing environment and we've also made prudent assumptions around inflation and assume no increase in retention rates from reducing renewal pricing for long-tenured customers. So I would hope that these assumptions prove to be somewhat prudent, but we are not relying on that being the case in our planning. Before I move away from Insurance, let me make a couple of points about AICL. As you know, the role of AICL is to price risk for our target customers based on advance risk insights and supporting our aspiration to grow.

In recent years, AICL had shrunk. There are various reasons for this but one of them is an overly prudent approach to pricing. Following recent actions, pricing is now better aligned to the target return and while this will mean lower underwriting earnings, it will help retail broking grow policy count and earnings over time. The priority now for AICL is to further improve pricing and claim sophistication and the team have a number of important initiatives underway. It may not be the biggest needle mover in terms of Group earnings based purely on what we see in AICL's results, but the point here is that this will be a critical enabler of the Group's Insurance strategy in the next few years.

So, let me now wrap up on how we see the next few years in terms of earnings and cash. You've heard from both Gary and I on what we plan for Insurance and you've heard from Robin about our financial targets for the Travel business. If we combine those with an increasing contribution from Personal Finance and by holding overhead costs flat, we see potential to grow earnings from the re-based '19/'20 level. We also expect this to support an ongoing level of -- a high level of cash conversion. For Insurance, we will naturally see much lower dividends from AICL in next few years in line with expected lower earnings.

This is expected to be partially offset by the cash flow positives of the three-year fixed product. While we'll book a prudent provision to recognize the inflation risk in three-year fixed, by flattening out the price paid by the customer, we would receive higher levels of cash at the start. It's not a reason why we will do this, it is not a reason why we write the product, but it is relevant to overall product economics. In terms of Travel, we've recently injected GBP25 million of cash into the Travel holding company to support the installment payments on the two new ships. I do not expect that to be a recurring feature of our financing and indeed, expect the Travel business to start repatriating cash from the end of next year.

And last, we see this year as the peak for capital expenditure on IT with a significant improvement next year as the major heavy lifting projects move towards completion. In summary, we will see a lower level of cash conversion for the '19/'20 financial year, for some of the reasons I've just mentioned. However, for the years beyond this, we will expect to convert at least 85% of our EBITDA into operating cash including the debt service commitments paid directly by the cruise business.

So let me now move to what this means for our leverage and our debt. As already mentioned, although absolute levels of debt are in line with expectations, lower earnings will put pressure on our leverage ratio and this is happening at the same time as we will over the next 18 months add another GBP500 million of debt, relating to the two new ships. One of my priorities for the last few weeks has been to ensure that we have the financial flexibility to execute on our new strategy.

This has meant taking the difficult decision to reduce our final dividend to 1p per share, a step which will save us GBP50 million in cash. It has also meant discussing with our banking partners, amendments to the covenants in our term loan and revolving credit facility. And in this respect, I'm very pleased that we've been able to agree new covenants based on a new definition, which excludes the cruise debt and of course the cruise earnings. While the cruise debt is not legally ring-fenced from the core group, we do view it as economically ring-fenced in that the cruise cash flows should be more than sufficient to meet the cruise debt commitments both in terms of interest and loan repayments.

Our intention here is to hold at least half a turns of headroom at peak debt levels including allowance for certain adverse trading scenarios and for us to then see a rapid reduction in leverage in the next few years. I see a number of the bank teams in the audience today and I would like to thank them for my -- for their support.

Let me now put this in the context of the dividend. While I recognize that our leverage ratio in the short term is going to be higher than anticipated, we have a number of real credit positives: First, as already mentioned, we have a good track record of reduced -- reducing debt and expect an ongoing cash conversion rate of more than 85% of EBITDA. Second, we don't anticipate any financing needs in the next few years. And by the time the credit facility matures, my expectation is that we will not need to renew it. Third, we have headroom to our new covenants including in reasonable stress scenarios. And fourth, we expect the ship debt to reduce quickly from peak levels. In establishing the right balance between reducing leverage and cash returns for our investors, we have therefore set a target payout ratio of 50%. This should enable us to reduce the ex-ships leverage ratio to below 1.5 times and to reduce of the overall Group leverage ratio to around 2 times over the next few years.

That wraps up my presentation. And with that, I'll now hand back to Lance.

Lance Batchelor {BIO 6884486 <GO>}

Thank you, James, and thank you, the rest of the team as well. Look, we've not shied away from making some tough decisions today, but I hope you can see and you will appreciate why it's important for us to make the changes that we've announced today to get Saga onto a sustainable long-term growth trajectory. The whole team has embraced the need for change and they've worked very hard to get us to a point, where we can now execute.

We're also confident that our people and our customers are excited about the new approach and the new products. That's going to be the true catalyst that returns Saga to its rightful place as an organization that leads the way in the over-50s market and that grows profits and then allows it to deliver attractive returns to shareholders. That is what I and the Board and my management team are now determined to achieve.

So that completes our formal presentation. We'll now take questions. I'd really appreciate it if you can wait for the mic, clearly state who you are, address your questions to me and I will pass them around the rest of the team. We may also get some questions coming in over the phone. Thank you.

Questions And Answers

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you. Jonny Urvin, UBS. And Lance, I'm sorry to ask this question. It's a difficult one, but I guess, how would you reassure your shareholders over the coming days and today that this is the right management team to execute on this reinvigorated strategy.

A - Lance Batchelor {BIO 6884486 <GO>}

Yeah.

Q - Jonny Urwin {BIO 17445508 <GO>}

Secondly, I am just thinking back to the 2017 profit warning, you guys were the first ones to come out and really acknowledge that the market was under a lot of pressure. And I just wonder today the change to renewal practices and the three-year fixed. I mean, is this the same thing and this is an indicator that the market is in real trouble, given the FCA pricing investigation and you think there's significant change to come. Thank you.

A - Lance Batchelor {BIO 6884486 <GO>}

All right. Thanks, Jonny. Well, look I think, that first question is absolutely a fair question to ask and I'm glad you have asked it. So look firstly, we're on a journey here. We inherited a business five years ago at IPO that needed substantial change and we've been on that journey, we've reduced the leverage significantly. We've replaced the IT, we've ordered and built the first of the new ships, we've launched membership. We're now turning our attention to the big one, which is Insurance and as you all know, that's the largest part of the business.

And I'm absolutely delighted that I've got a Board and a Chairman, a CFO and in, Gary, a Head of Division, who are all real subject matter experts on UK insurance and then what people like myself and Robin and Stuart can bring to the party is a deep understanding of the consumer need, of what Saga customers really want and we've married those two to create what I think today is really breakthrough announcement in UK insurance.

Time will tell whether we have the right strategy. I completely understand the frustration and the disappointment of an investor base who have been waiting to see what Saga is capable of, but I believe that the move that we're taking, the strategy that we've announced today is absolutely the right one and I think we've got the right team to deliver.

To your second question around December '17. I think December '17, for those of you who remember, we announced a modest profit warning at that point and some concerns about the progress of our own broking business. I think that was the first real warning signal to us that we had a problem and that we needed to drive some change and we spent 2018 stabilizing volumes, which have been declining for some time and I think we learned some very painful and interesting lessons in 2018.

We discovered once and for all that Saga is not a commoditized, volume price comparison website player and we spend a lot of time with our customers and with our new membership base, understanding from them, what is it they really want from Saga? What is our place in the market and do we have a right to play in the market? And the answer was an absolutely clear, yes, and the 18 months or so that we have spent designing, building and testing the new products that are launched today is the output of that.

I don't think it necessarily indicates broad distress in the UK market. I don't see the evidence of that. I'll let others in the market comment on that for themselves, but I do think that the market is changing. I think that the commoditization, the digitization, I think that UK consumers are increasingly savvy about how pricing works and we know from our interaction with members and from the 6,000 policies that we've already sold that our customers are absolutely delighted with the idea of flat pricing over the next three years. It will be interesting to see whether other players in the UK market mimic this over time. Andreas?

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

Yeah. Good morning. Andreas van Embden from Peel Hunt. Just two questions, also around pricing, it seems to me just reading between the lines across your presentation that you've been mispricing an insurance product over a number of years for -- a product that you feel don't have enough quality for your membership base and that's the reason you didn't grow. So you now think that by correcting that pricing mismatch, that that's going to lead to growth. And I just wanted to sort of challenge that, in terms of the pricing mix between the renewal pricing and the new business, how big was that gap? And do you really think that this new pricing mechanism is going to close that and generate profitability.

A - Lance Batchelor {BIO 6884486 <GO>}

So I am going to --

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

And the second question is --

A - Lance Batchelor {BIO 6884486 <GO>}

I thought that was two questions, Andreas. Go ahead. Yes.

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

Sorry, the second question is, what will that do to your average premiums over time? Will they be declining over time or not?

A - Lance Batchelor {BIO 6884486 <GO>}

So I'm going to suggest that the first part of your question is taken by Gary, who talked a little bit about the historical learnings over pricing. Have we been pricing wrong? And then that afterwards we'll take that as a financial question, and James, will take the second part of your question. Gary?

A - Gary Duggan {BIO 18331803 <GO>}

Yeah. And I wouldn't go as far as to say we were pricing wrong. I think we were pricing in line with -- to a large extent with the rest of the industry. I think it's been pretty clear from all the conversations and the research we've been doing with our customers in particular with our demographic, that they would appreciate a different approach to it. And kind of going through the hassle of, kind of, shopping around every year and getting various quotes is difficult for our customers and it's not something that they particularly enjoy doing.

So I think, my comment over the three-year price promise, it enables us to kind of give a much better-quality product and service to customers that will avoid them having to do that. So I don't think necessarily we've been approaching it in any different way than anybody else in the industry in terms of how we price new business and renewals. But I think the industry needs to change, as I've said, the FCA have said, the industry needs to change. This is our response to the change and I think it's a very positive response to the change, because it's about rewarding loyalty moving forward, which I think will create a more sustainable future for the -- not just our business but for the industry if they're approaching this in the way that we have.

A - James Quin {BIO 18345789 <GO>}

I mean, I think, in terms of the financials, I mean, I think, as mentioned in the -- in the presentation, this is -- the point of three-year fixed is not for us to extract more margin from our customer base. It is to get people to come to us direct because in terms of what we are expecting with three-year fixed essentially the expectation here is that we grow the top-line, but at on average the same average margin policy.

In terms of what it will do for average premiums, I mean, there is two parts to that, I mean, first, we're selling a premium product, so there is obviously an uplift between the standard and the premium product. And then there's a further uplift, which would be the fixed price element. I don't think at this stage, we'll probably go into what that fixed price is. We're not talking enormous amounts of money. But of course, for that, then we're giving something to the invest -- to the customers incredibly tangible, which is when you come back next year, your renewal letter will just have the same price, unless you have had a claim or IPT has gone up. So I think the point here is, it's a draw for people to come to us on a direct basis. It's a reason why people will pick up the phone to us and essentially today if they do that then it's very much more a price-led proposition. So what we're trying to do is get people to come to us direct rather than go onto the aggregators.

A - Lance Batchelor {BIO 6884486 <GO>}

Ben?

Q - Benjamin Cohen {BIO 21227414 <GO>}

Yeah. Hi, there. It's Ben Cohen at Investec. I had two questions. The first, I suppose, looking more at home and others, specifically health, I just wonder your confidence level in the margin, the gross sort of margin as a proportion of written premium that you're taking in those lines, particularly in health in the context of one product provider, very long-term customers there, very high commission levels. How sure are you that this is sustainable in the new world.

And the second, just a point of clarification on the dividend. So you're looking to get to a 50% payout ratio in the medium-term, does that suggest that sort of for this coming year, wherever the earnings are, you will be looking to make a 50% payout or do you need to actually see that some of these initiatives are bearing fruit before you commit to that? Thank you.

A - Lance Batchelor {BIO 6884486 <GO>}

Thanks, Ben. I'll ask James to field both of those.

A - James Quin {BIO 18345789 <GO>}

Yeah. So, I mean, I think, it seems like, I think, within the first one, it seems like there is two questions, which is, one, are margins sustainable? And there's probably a particular point on PMI. So I think in terms of why the margins overall are sustainable from the reduced base that we expect to get to in the 2020, '21 year. I think there's three things. So the first one is, when we've essentially rolled forward the experience of last year. We are assuming that our new business margins will reflect that experience. So we are not -- there is no sort of hockey stick improvement in new business profitability. We are essentially rolling forward based on the average of what we encountered last year for this year and the year after. So essentially that's the first piece of it.

The second piece is, I mean, as you can see we are proactively taking action on renewal pricing for long tenured customers. We think that it is us leaning into the challenge. We think we are making what is a very sensible provision for that in what we're going to do.

And I think we feel that -- as I say, we're getting ahead of the change. Could the FCA go much further, could the industry go much further? Possibly, but we think we're doing what we need to do there. So I think those are the two main reasons why we are seeing margins are sustainable. The third element though is the fact that what we are certainly not assuming is that there is any sort of hard market or anything like that. So we are assuming that every day inflation more or less keeps track in terms of gross rate and net rate. So the market environment is assumed to be a very consistent one essentially.

I think in terms of the PMI product specifically. So we have a very good PMI product, it's got some really differentiated features in it. And within the renewal pricing actions, there is a component of that, which does relate to PMI. It's not the biggest part of that by any means. So we think again going back I guess to the same answers I gave before, which is, we think we're taking the actions that are the right actions and we think that we are doing what we need to do and frankly that will position us quite well.

In terms of dividend, I think that -- if you take the guidance that we've given, the GBP105 million to GBP120 million, that averages out to about 8p. If you take half of 8p, it gets you to 4p. So I think you can see that we've looked to -- well, we've reduced the dividend for last year into a level that is consistent with where we would be with the GBP105 million to GBP120 million range.

Q - Edward Morris {BIO 16274236 <GO>}

Thank you. Ed Morris, JP Morgan. First question, could you just help us step through the profit outlook for the sort of, year after the current one. You're talking about a GBP20 million improvement in broking profitability. Can you just confirm, is that on a three to five year view. And I think earlier in the presentation, you mentioned a further GBP10 million headwind in broking. So if we sort of set the cruise ships aside, underlying, are we expecting profit to increase from the new level that you've outlined in '19/'20. And the second question is just relating to the three-year fix. Can you just clarify, is this something that will exclusively be an AICL provided product or will your panel members effectively be able to stand behind some of these policies and I may have a follow-up question depending on the answer.

A - Gary Duggan {BIO 18331803 <GO>}

Okay. Thanks, Ed. I'll take the second one and then hand over to James for your first. So the answer is that our panel has the ability to underwrite against these policies. That allows us to cover as much of the market as possible. And from that perspective, it's no different to underwriting any other policy. And just -- they are underwriting for one year and that renewal, we go back to the panel as we usually do to look at who would write for the second year and for the third. And then, James, on the first part?

A - James Quin {BIO 18345789 <GO>}

Yeah, I mean, I think just to add on that second one is well. So when we've been looking at the sort of the accounting approach, we have a quote from AICL as to what it would cost -- what they would charge in terms of the net rate, for both home and for motor. When we come to sort of work out the cost, we've taken that and we've added a bit of a margin on and that will then determine how we defer income. So again, we're looking to be somewhat prudent, but at the moment, the risk will sit on the broking balance sheet.

Q - Edward Morris {BIO 16274236 <GO>}

So sorry, just a very quick follow-up if I may then on that, if the broking businesses then not risk-less in the sense that there is a possibility that you could make more or less money than you expect, is there any likelihood that that could change your capital requirements for example broking at the moment is not regulated under solvency. Does it become an insurance business? Thank you.

A - Robin Shaw {BIO 20138547 <GO>}

Yeah, it's a good question and one we thought about, so -- and I mean we don't think that it does change the capital requirements. I think it probably means we may hold a bit more cash in that business than we do today. So I think there's a probably a small element of a cash piece that we will need to keep back. I mean I think one thing to emphasize here is I think going back to what I mentioned before. It's that we've run various stress scenarios based on inflation outcomes, based on history. We've selected, I mean, obviously, one in 50, I mean there isn't many data points to judge, but I think we've taken what we think is a very prudent point at saying around sort of 20% one-time step change instantaneous increases in inflation for either motor or home and I think what we -- the way we've modeled that risk then is that that would have less than a 10% impact on in-year broking earnings. So yes, you could get a slightly less lower dividend out of a -- the services business than you would do, but it's not a -- we're not running a capital risk in that sense.

And I mean, I think -- and perhaps the other point to mention is, I mean at the moment, we've written 6,000 policies, but [ph] I don't think that exposes us to any meaningful risk. As that business grows, I mean, we will look to either insure it or reinsure it. And whether we do that directly out of the broking business or via AICL, that remains to be seen, but I think the point there though is that what we've done in the planning and so the margin guidance I've given you is looking to incorporate how much that would cost and on a reasonably prudent basis. So when we're saying that we can hold margins flat, that is assuming that we would essentially pass on this risk to insurers on reinsurers and whether that's AICL or a combination of outside parties, that remains to be seen. AICL is the obvious choice obviously for the motor.

A - James Quin {BIO 18345789 <GO>}

But so you do -- your other question was asked. So maybe I should have included the walk for 2020/'21 and -- as well, but the -- so you're right, I think that the -- there is a sort of roll forward effect from '19/'20 into '20/'21 and that is captured in the margin that we've talked about, so we're saying that the margin goes from GBP80 to -- sort of between GBP72 and GBP75 for this year and then between GBP67 and GBP70 next year and you can do the math there. We are at 1.9 million policyholders or 1.9 million policies times GBP5 equals GBP10 million.

So the -- that is covered within the guidance that we've given you. In terms of what we would expect between '19/'20 and then 2020/'21, yes, there is that step-down that comes through margin, but also, that's where we expect to start the policy count growing as well and if you then look at a 5% policy count, if we then hold overheads flat, we've got a 50% cost-income ratio, you get about a 10% growth in that. So, I would see, the next couple of years as more about stabilization in terms of broking, but absolutely when we gave you the GBP20 million, that was GBP20 million from this year, not some other lower number.

Operator

Thanks. We are going to come to Nick next.

Q - Nick Johnson {BIO 1774629 <GO>}

Good morning. Nick Johnson from Numis. Just one high level question, first of all is, could you just say how important the three-year fixed product is to stabilizing broking margins, just a bit of context around that given it's an unproven product -- if you could just give us a feel for how much of the stabilization project is based on that.

And second one, in terms of detail, the three-year fixed product, can you just explain the scenario where a customer gets a better quote or shops around after two years to three years and gets a better quote, are they able to exit one of the penalties? Can you just explain that side of the model, please?

A - Lance Batchelor {BIO 6884486 <GO>}

So I'll take the first part and then ask Gary to take the second. So the answer to your first question, Nick around how important is it, is it is one of a number of ingredients to the strategic restructuring that we're announcing today. It is not by any means the only part of it. We know that it's exciting to our customers, we know that the long-term economics on it look very solid. We know that it truly differentiates us in the market, but actually a critical part of that is us going back to the direct channel rather than focusing overly on the PcW channel. I think we learned some lessons last year where we dialed up the volume we went after in PcW. We don't have to do that. Even last year, about half of all the new customers who came to Saga still came direct and that was without us advertising, without us selling a differentiated product and so the shift back gently towards a direct channel, we don't require a massive shift, but a gentle shift back in that direction backed by differentiated products of which the three-year is just the first, there's more to come, is very important to us as well. And then, Gary?

A - Gary Duggan {BIO 18331803 <GO>}

Yeah. Thanks, Lance. And so, whilst we call it a three-year fixed policy, it still is annually renewable by the customer. So the customer still has the opportunity to shop around and move somewhere else if they choose to do so. And so they're not kind of locked in. And the good news from the customers' perspective is they buy the product at a certain premium in year one. They have confident acknowledge that if they do shop around, the worst case scenario they can just keep the policy that they've got now and the premium is not going to go up. So it gives them that kind of confidence factor about the maximum that they will have to pay in years two and three based on what they paid in year one. I think that's what makes it attractive to a lot of customers and certainly why it's researched really, really well with our customers.

Q - Joanna Parsons {BIO 1558226 <GO>}

Thank you. Joanna Parsons from Canaccord. Two questions, please. You talk about the growth in the demographic or your demographic. Can you give us a feel of what your market share of that demographic is today versus what it was five years ago. And then what you -- what your target is for that? And secondly, in terms of the -- and I think it was from 50 years onwards in terms of what you consider to be your demographic.

A - Lance Batchelor {BIO 6884486 <GO>}

Yeah.

Q - Joanna Parsons {BIO 1558226 <GO>}

Given the way that 50-year-olds feel today, do you think that this, you would ever need to -- or you should consider a different brand name for that part of the demographic. Do you think the Saga brand name, you talked about, old-fashioned and whatever, although trying to change that. Do you think that actually you would benefit from having a product within your tree which had a different name.

A - Lance Batchelor {BIO 6884486 <GO>}

Sure. I'll take both those. So on the market share question, we've got market share data for the insurance industry, but it's small sample and it's quite volatile, and I don't entirely trust it. But what it tells us, is that if you go back 10 years, we had a market share in the over-50s of motor high single-digit or thereabouts. And we're now down at 5% or thereabouts. So we have lost market share as I said in my introduction steadily over a decade. Bearing in mind, of course, that the demographic is growing all the time. So even if you just held steady, you would lose market share. But we've done worse than that, and that is what's prompted the radical change of direction today.

And then to your question around age and demographic. It's important, I think, to remember the history of Saga. Saga was founded as a company for the retired and that meant for 65 years old, and for most of its history, it was a business for the 65 pluses and it was only when the brand entered the insurance sector about 20 years ago, that the cutoff was moved to 50 in order to make it possible for people in their '50s to buy home and motor insurance and to widen the scope. The truth is, when you talk to consumers in the UK, and I think, we in the room, we'll recognize this. It's a brand for 65 year olds. Now we do attract people in their 50s and we're delighted when that happens, because we build a relationship with them, we can show them the amazing service that we have. And by the time they are in their 60s, we hope that they'll migrate across to travel products as well. And to the other products in our suite.

But we're not trying to turn this into a brand for 50 year olds. We recognize that the sweet spot for Saga is generally mid-60s. The average age of a new Saga customer is 61 and that number hasn't changed over many years and we don't believe a secondary brand is the right answer for us, what we believe is right, is to offer different better products under the Saga brand name at competitive prices wrapped in fantastic service and if we do that, we know that there are lots of people in their 50s who would love to own home and motor from us, and then come on holiday with us when they are little bit older. Lady at the back.

Q - Ruchi Gupta {BIO 5316030 <GO>}

Thank you. My name is Ruchi Gupta from Western Asset Management. My question is about peak leverage including the shipping debt, when do you expect the peak leverage, which time, which year and if you could just give me the development of peak level -- of the leverage for next two years. And secondly, have you spoken to rating agencies about your new strategy and the new profit outlook? Thanks.

A - Lance Batchelor {BIO 6884486 <GO>}

Thank you. James?

A - James Quin {BIO 18345789 <GO>}

And -- yeah. So let me take the first one. Yes, we have spoken to the ratings agencies and I think they are due to issue something fairly imminently. So obviously that will come out, I'm guessing, probably, today or tomorrow, or something. So, yes, that is all we've had a number of discussions with them, we have shared our plans with them, so absolutely.

In terms of peak leverage: So it depends on when you're talking group peak leverage or the ex ship debt leverage. So including the ships, I mean, obviously, the peak leverage is after the second ship comes on stream in August 2020. So in terms of reporting date, the peak leverage at the Group level would be January 2021, and I think, the message I would give you there is, if we include cruise earnings on a pro forma basis, we will be looking to try and/or not try, we will be looking to hold that peak number below 4 times, so that's all in, including the ships, including everything else.

And as I say, the -- and in terms of the including -- inclusion of the -- all of the pro forma cruise earnings, I don't think it will make a lot of sense to judge six months of cruise earnings against all of the cruise debt. So I mean I think that's why we would do that and of course, we've got a high level of visibility on the forward bookings as well. In terms of ex-ships picture, the peak is going to be sooner than that. It will probably be at the end of this year. So January 2020 and that is where we would look to hold the peak leverage below three times on an ex-cruise basis. So with half a turns of headroom to the covenant.

A - Lance Batchelor {BIO 6884486 <GO>}

Time for one more question I think, from -- anyone who hasn't asked. I think you got another and then just to be fair, Ben, I'll give you one after that. Yeah.

Q - Unidentified Participant

Thank you. So just a quick one on the three year fixed. So just thinking about how you're pricing now. So you discount year one, then your price walk up year two, year three to sort of get to where you need to be. Implicitly you're saying that this is margin neutral, so from that, can we assume that the new business pricing goes up by enough to offset the reduction from the renewal pricing that you would have got, first question.

And then secondly, just thinking about doesn't this just make you more cyclical. Because if I'm an equity investor, I want to earn you guys basically when claims inflation is coming down, pricing is coming down because you're locked in and then I want to sell you when that's switching.

A - James Quin {BIO 18345789 <GO>}

So I think -- I guess on the second part of that, I mean it will then choose a new element of volatility up to a point, but I think within relatively narrow confines. And of course, if we then lay that risk off to the insurers and the reinsurers and we build the cost of doing that into the plan, then actually that risk is -- it won't be our risk anyway.

Q - Unidentified Participant

And you build the cost of that into the premium as well, that you're charging initially.

A - James Quin {BIO 18345789 <GO>}

Yeah, that's exactly right. So it's -- we build what we think it will cost us to basically insure or reinsure that risk. So that's built into the cost of the product. It's also built into how we thought about the planning as well. So, this is -- so, I think that's a really important point because, yes, right now that risk sits on our balance sheet, but we've given ourselves the financial -- sort of the financial flexibility in our planning that should we choose to, we can either insure all or part or some of the peak risk. I mean, there's a number of different ways you could look at it. And absolutely do I expect that we would buy no insurance for this, definitely not.

So we would definitely look to pass some of that risk on. It's just it then becomes a choice. In terms of the cyclicality element, actually, there are some dampening features as well because if obviously a customer comes in, they buy the three-year fixed product -- prices then soften a bit. So they actually decide to lapse the policy and buy another policy, then of course, we get an extra piece of premium in the first year that would give us a cushion against this. So they're -- there are some inherent dampening effects there, and I can tell you that, I mean, although, we are planning for this to be margin neutral, if inflation is in line with our expectations, it is margin positive, very clearly margin positive as well.

So I think that the overall element is the risks are being well-controlled and that's before we would look to lay the risk off, which again I think we were doing, but I think more sort of philosophically, the reason that we're doing it is actually to give people such a strong reason to come to us direct whether it is via the phone or on the website. That they would do that rather than going on the aggregators and that's one reason why the economics look so much different.

And in terms of the overall economics, as I say, there are moving pieces. On the one hand, we get paid for the inflation piece, we also get a -- we are selling a better product as well. On the other hand, it will require us to spend more money on advertising than we do today on direct mail. So there are some natural balances. But I'll say really the message is, we think it's margin neutral on cautious inflation assumption, but it's giving people the reasons to come to us direct.

A - Lance Batchelor {BIO 6884486 <GO>}

Now we've blown through our time here, I'm going to let Ben, ask his question, we are then going to take a 5-minute break, because we have all been in the room two hours. We will then -- we'll have stopped the official presentation, but we are staying and we're happy to answer any questions that any of you have got, so come meet us down here in five minutes' time. But first Ben, your last question.

Q - Benjamin Cohen {BIO 21227414 <GO>}

Yes, thanks. I just want to ask on the strategy, when you did the review, did you consider divesting different parts of the business and maybe you could talk about why you think still the structure with two cruise ships, an insurance broking business, all of the debt that you're carrying, why that is the right structure when it's not clear, it's been the right structure over the last five years? Thank you.

A - Lance Batchelor {BIO 6884486 <GO>}

So the Board has a number of conversations over the years that we've been a public company about the logical structure that makes up Saga. What's interesting is, when you talk to our customers, to our members as they now all are member with over 1 million members at the center of the brand, for them they don't see it as illogical that Saga would provide both insurance and travel to them. Those are two parts of their lives and if we get it right, it helps them to enjoy their retirement, which is what the company is all about.

I think there is an ongoing question about the relative pros and cons of it being owned within the same legal entity, what we've started to see with a strong database at the center with brand advertising that builds the whole brand, not just part of it, with cross-sell starting to build up through membership into Travel, which is a real financial benefit from us. With the ability to go out and talk to partners in the membership space and attract them to want to offer products and services to our members. I think there's actually a growing coherence that argues for a logic to the business holding together. The honest answer is, time will tell. We have to prove to you that we can do as well in Insurance as we have been doing in cruise and that's our objective over the next year or two and I think you need to judge us over the next year or two on whether that makes sense from your point of view as well, we believe it does. Right, we're going to take a five minute break. Thank you for your attention. Understand, if you want to slip away and we'll see you in a few minutes time. Thank you.
