# Q1 2018 Earnings Call

## Company Participants

- Alain Lessard, Senior Vice President - Commercial Lines
- Charles Brindamour, Chief Executive Officer
- Darren Godfrey, Senior Vice President - Personal Lines
- Ken Anderson, Vice President - Investor Relations and Treasurer
- Louis Marcotte, Senior Vice President and Chief Financial Officer
- Patrick Barbeau, Senior Vice President - Claims

## Other Participants

- Doug Young, Analyst
- Geoffrey Kwan, Analyst
- Jaeme Gloyn, Analyst
- John Aiken, Analyst
- Kai Pan, Analyst
- Mario Mendonca, Analyst
- Meny Grauman, Analyst
- Meyer Shields, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

## Presentation

### Operator

Good morning. My name is Emily and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp. First Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

Ken Anderson, Vice President, Investor Relations and Treasurer, you may begin your conference.

### Ken Anderson {BIO 16846692 <GO>}

Thank you, Emily. Good morning, everyone, and thank you for joining the call today. A link to our live webcast and published information for this call is posted on our website at intactfc.com under the Investors tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on this conference call. Joining me here in Toronto today are Charles Brindamour, CEO; Louis Marcotte, CFO; Darren Godfrey, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Patrick Barbeau, SVP of Claims. We will begin with prepared remarks followed by the Q&A.

With that, I will turn the call to our CEO, Charles Brindamour.

## Charles Brindamour {BIO 7012323 <GO>}

Thanks, Ken. Good morning, everyone, and thank you for joining us today. Yesterday evening we announced first quarter net operating income of CAD0.81 per share after reflecting a CAD0.70 impact from the exceptionally severe winter weather experienced across Canada. Our US specialty business added approximately CAD0.07 to NOIPS, posting solid underwriting results and driving a 16% increase in our net investment income. Top line growth was close to 20% driven primarily by OneBeacon. Our Canadian business grew north of 1% with strong growth in Commercial Lines. Rate actions in auto ahead of the market tempered Personal Lines growth.

The overall combined ratio was 99.2%. Our US operation showed solid results with a combined ratio of 95.3%. In Canada, the combined ratio of 99.8% included approximately 5 points from the severe winter weather. However, the fundamentals of our personal property in Canadian commercial business remain very strong. Personal auto performance remains a focus and our corrective measures are gaining traction.

Book value per share grew 10% over the past year. Operating ROE was 12.4% despite close to 2 points of drag from the severe Q1 weather. And we ended the quarter with a total capital margin nearing 1.1 billion. To be clear, 12.4% operating ROE is not an acceptable performance level for IFC, and we're focused on our action plan to return the ROE to the mid-teens.

When it comes to industry results in 2017, despite temporary underperformance in auto, overall we outperformed the benchmark by over 6 points of combined ratio. This drove an increase in our ROE outperformance to almost 700 basis points last year; and looking ahead, with the early actions we've taken to improve auto, we expect to remain well ahead of our long-term objective of 500 basis points in the near and mid term.

Let's look in more detail at our results by line of business, starting with Canada. So personal auto growth remains muted as our rate actions taken ahead of the market resulted in top line pressure as anticipated. The combined ratio of 106.4 was well above expectation due to the unusually severe winter. While weather was a factor this quarter, it's not an underlying concern. Adjusting for seasonality, the combined ratio run rate has improved mildly to about 98% at the end of the quarter.

Physical damage inflation remains the main driver of recent underperformance and as our primary focus. Initiatives implemented to-date have improved rate adequacy, portfolio quality, and claim frequency and severity trends related to bodily injury and psychological injury. However, cost pressures related the physical damage persists. That's why we've continued to meaningfully raise rates across the country. Segmentation initiatives continue to improve the portfolio quality and claims management actions focused on cost and the time taken for repairs are being rolled out. We're executing on our plan and remain committed to bringing personal auto's combined ratio back to a mid-90s run rate by year-end, consistent with our track record in this segment over the past 5 years and 10 years.

The outlook for auto is improving in our view. Industry rate increases accelerated in the first quarter across the country. We see continued expansion of the Facility Association and industry reassuring pool, as well as our non-standard auto business. This validates our view that the market is firming fast. The industry grew 4.5% in 2018. So this environment supports our profitability improvement plans and we see mid-single digit growth for the industry continuing in '18.

In personal property, premium grew by 2%. Rate increases and favorable market conditions were tempered by unit declines due to our rate action in auto, which impacts bundled policies. The combined ratio in property for the quarter of 88.3% was very strong despite the severe winter. Our actions over time have been successful and proven to be sustainable. Personal property is performing and positioned very well for the future. The outlook is also favorable. The industry grew close to 6% in '17 as elevated weather and CAT losses supported continued earned market conditions. We expect mid-single digit growth this year as the industry continues to adjust the changing weather pattern.

Looking to commercial in Canada, our top line was up 5% as we saw strong growth in specialty lines and improving momentum in commercial P&C. The combined ratio of 99.5 was elevated due to the winter weather, which led to unusually high water and fire damages. However, I'm pleased with the underlying fundamentals of this business. The overall industry outlook for commercial is also improving with mid-single digit growth expected in 2018. Our pricing and segmentation actions continue to pay off and this business is positioned for growth and a sustainable low 90s or better combined ratio moving forward.

Turning now to result for our US commercial segment. Premiums of 321 million bolstered top line growth significantly. On an organic basis, growth in the profitable segments of the business was strong at mid-single digit level. We saw declines in segments undergoing profitability improvement as planned and expected. The combined ratio of 95.3 is an improvement of 2.1 points over the last quarter, including modest favorable prior year dev. Strong progress is being made on synergies and we will provide more details. We're monitoring this business closely and advancing towards a low 90s combined ratio to deliver mid-single digit run rate accretion to net operating income per share by the end of '19.

The specialty team is beginning to capture the upside opportunity from expanding the distribution of OneBeacon's profitable lines. Brokers are responding enthusiastically to our ability to serve new customers across the border, north and south. And we're starting to see the potential from our broad distribution network in Canada too. We've at over 1,800 submissions on new technology and entertainment products, which were launched just a few months back. Looking at the industry outlook, market conditions remain quite competitive in the US since the transaction closed, but continue to evolve better than slightly anticipated with upward pricing trends in certain line. Overall, we expect low-single digit industry growth for US specialty in '18.

Turning to strategy, we're investing to lead us consumer, data and technology trends transform our industry. So our digital teams continue to enhance our online and mobile platforms, and that's resonating with customers. In fact, 83% of underlying quotes in our direct are now via quick quote, and over a-third of our direct customers are registered on client center. 42,000 of Intact insurance customers registered for client center in the first quarter and active claims have been viewed online over 10,000 times. So these are concrete proof points of our progress and leadership, and customer-driven transformation.

In conclusion, the weather led to disappointing results in the quarter. Our employees from coast to coast responded to get our customers back on track, and I want to thank them sincerely as they really make a difference. Market dynamics are now beginning to shift in our favor. Commercial lines in Canada are performing very well or taking advantage as growth momentum emerges. Our strategies continue to pay off in personal property. In personal auto, we're ahead of the market on rates and taking all steps necessary to bring the combined ratio back to the mid-90s, and we will keep cranking up actions until we get there. Profitability in our US franchise is off to a solid start to the year, and we're moving fast to capture growth opportunities.

IFC's financial position is strong and gaining momentum. With the strategies we have in place together with our actions and discipline, we expect to deliver on our financial objectives to outperform the industry ROE by at least 500 basis points and grow our net operating income per share by 10% per year over time.

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

## Louis Marcotte {BIO 18040440 <GO>}

Thank, Charles. Good morning, everyone. For the first quarter, net operating income was CAD120 million, almost unchanged year-over-year despite absorbing some CAD40 million of additional weather-related losses compared to Q1, 2017. OneBeacon contributed CAD15 million in underwriting income with a solid 95% combined ratio and net investment income was up 16% in the quarter. Our balance sheet remains strong with over 1 billion in total capital margin and debt to total capital at 23%.

Let me add some additional color on key elements of our first quarter results. Firstly, the weather, as Charles mentioned, we estimate that the severe winter impacted our combined ratio in Canada by almost 5 points or 130 million pretax. This represents the amount of losses we incurred over and above our historical patterns. This amount includes both CAT and non-CAT weather events. These events took the form of winter storms, drastic temperature shifts, as well as extreme and persistent cold temperatures.

For example, Montreal incurred 12 days when there was rain while snow was still on the ground. This is 70% higher than the historical average. During those days, we saw a rise in claims related to water seepage in homes or buildings, as well as auto collisions. Another example, there were 50% more consecutive days with temperatures below minus 20 degree Celsius in Calgary and Edmonton in 2018 compared to the average. This drove elevated claims for pipe bursts, heating-related fire losses and auto collisions. Again, these winter conditions led to pre-tax losses of approximately 130 million, above historical patterns; or 40 million more in weather-related losses than the challenging conditions experienced in Q1 2017.

Having said that, weather is a driver, but it is not an excuse for our Q1 results. Our business is to provide coverage to our customers and help them get back on track when they need us. If such conditions persist, we will take pricing and product actions, and we would expect firm conditions to continue in the property lines. In the meantime, we are maintaining our CAT guidance at 275 million per year.

Turning to our Canadian lines of business. The combined ratio in personal auto was 106.4%, but included an estimated 5 points of unusual weather. If we exclude excessive weather and remove about 3 points of seasonality, the combined ratio drops to 98%, which we would consider to be our current run rate. This is still high, but within range to achieve our mid-90s run rate by the end of the year. At the end of Q1, our written rates were up 4.5% and our earned rates up 5.6%. We expect earned rates to grow at this pace for the remainder of 2018.

Auto, prior year development was unfavorable 0.7 points. This is not a concern. As we continue with our improvement plan, we expect close to zero PYD in personal auto until we are more confident that our plan has fully matured. Our property and commercial lines in Canada remain very strong. We're extremely happy with 5% commercial growth. This is the strongest performance we've seen in over three years. We expect continued momentum in commercial for the remainder of the year.

The Canadian expense ratio remains low at 28.9% and stable year-over-year. Our teams have diligently managed expenses to invest in technology and productivity, while maintaining an industry-leading expense ratio. In 2017, of our 6 points of combined ratio outperformance, 4 points came from loss adjustment and general expenses. In addition, we are pleased to see that both channels have outperformed the industry in terms of expense ratio. Distribution income was strong at 24 million, in line with our expectations for the fourth quarter, which historically represents approximately 15% of annual distribution income. We remain on track to hit our 10% growth objective for 2018.

Now, turning to US specialty. The addition of OneBeacon bolstered IFC's premium base by 19% in the quarter. Given the seasonality of written premiums in both Canada and the US, we expect the addition of US specialty will drive mid-teen growth for IFC in Q2, and close to 20% in Q3. The underlying current year loss ratio of 59.1% was healthy and well aligned with our expectations at this point in time. I'm very pleased with the profitability actions being taken in the US. Prior year claims development was favorable by 1.3%, a turnaround from last quarter. It is important to note that our low 90s objective for US specialty does not rely on favorable PYD.

On expense synergies we realized approximately CAD4 million in Q1, most of which benefited the combined ratio. The actions taken to-date on synergies have brought the annual run rate to $20 million, close to our CAD25 million target expected in 2019. We expect OneBeacon's expense ratio for the rest of the year to be similar to Q1's.

Net investment income increased 16% in Q1 to 122 million, mainly due to the addition of the OneBeacon portfolio. After completing the integration of that portfolio and our normal rebalancing activities, and considering the impact of rising rates, we are raising our guidance for investment income growth in 2018. We now expect net investment income to grow 12% in 2018, being an increase of approximately CAD50 million pre-tax over what we reported in 2017.

This quarter's tax rate is well below expectations at 14.2%. This is related to the income mix in the quarter, which had a higher proportion of dividend income and US specialty earnings than usual.

Now, looking at the strength of our balance sheet, we ended the quarter in a very strong financial position with a total capital margin of 1.1 billion. In Canada, our MCT was 201%; and in the US, the RBC regulatory capital stood at 411%, both well above minimum required levels. Our debt to total capital ratio was 23% and we're still on track to reach our 20% target in 2019.

In conclusion, despite a challenging winter, the fundamentals of our property and commercial businesses in Canada are strong and OneBeacon is developing very well. In personal auto we are being diligent and persistent in our actions to improve profitability. We intend to maintain a strong capital position to capitalize on any growth opportunities that we see in manufacturing or distribution in Canada. With our talented employees, robust operating platforms and sustainable competitive advantages, I'm fully confident that we will outperform the industry ROE by at least 500 basis points and continue to deliver value to our shareholders.

With that, back to Ken.



### Ken Anderson {BIO 16846692 <GO>}

Thank you, Louis. In order to to give everyone a chance to participate in the Q&A, we would ask that you kindly limit yourselves to two questions per person. If there is time at the end, you can requeue for follow-ups. So, Emily, we're now ready to take questions.

## Questions And Answers

### Operator

(Operator Instructions) Your first question comes from the line of Tom MacKinnon with BMO Capital Market. Tom, your line is open.

## Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks very much. Couple of quick questions here. One, if you can elaborate on what's happening in terms of personal property. We're getting a little bit of a slowdown in terms of the growth in direct premiums written. You mentioned some of the -- I think the stuff used to grow in the 4%-ish range, now it's down to 2% growth. You mentioned some impact as a result of bundled policies. How should we be looking at this? The profitability looks a little bit better, but the top line looks weaker. And how should we be thinking about this? Is it on a temporary basis in terms of the top line being little bit lower and when do you expect that to kind of pick up again?

## A - Charles Brindamour {BIO 7012323 <GO>}

Let's start with that question, Tom. So, Darren, why don't you share your perspective on growth in home insurance?

## A - Darren Godfrey {BIO 19791482 <GO>}

Yeah, I think, you're right there, Tom. I think that when you look at the quarter itself, we continue to generate that 3% increase in rates in the quarter, but where the pressure obviously came, as you alluded to, was on the unit side, so we were down a couple of points on the units. And it very much is in alignment with our auto action plan, given the higher penetration of bundled policies. And as we've moved well ahead of the marketplace, as you know, on the auto side, there is some overflow on to the residential as well.

So I would expect moving forward as we're seeing momentum from the industry on the auto side that should release some of that pressure that we're seeing right now from a growth standpoint on the auto and on the res, but we're not quite there yet. So it will still feel a little bit of pressure in the short-term.



## A - Charles Brindamour {BIO 7012323 <GO>}

And we're quite keen on that business, it's been performing well with the combined ratio of little above 91% over five years, including Fort Mac and the Calgary flood. So this product is very well positioned, we'd like to grow more, but automobile matters. The other element of drag, I think, Darren, in the top line in the first quarter is the fact that we've grown faster with tenants and condos than with home. Those two segments are very profitable. We're also keen to grow in that space.

## Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And then a follow-up with respect to personal auto. You've highlighted a 98% run rate, if you exclude the weather-related losses and some seasonality. How do you anticipate -- can you just refresh us as to -- remind us how you think you can get this to being a mid-90s run rate by the end of the year, that seems to be at least another 3 points pick-up over the next couple of quarters. So what's in the hopper that that's going to help that?

## A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, thanks, Tom. I'll let Darren take that one as well.

## A - Darren Godfrey {BIO 19791482 <GO>}

So as we outlined at Investor Day, there really is the three components to the plan. First one being, rate, obviously. We continue to receive approvals on further rate increases in 2018, and obviously, we're earning the impact of increases from 2017 as well. So there is 5 points of earned rate, obviously, not just in the quarter, but we expect over all of 2018. So there is definitely momentum coming from a rate standpoint.

The other piece of the plan is obviously from an underwriting, from a risk segmentation, risk selection standpoint. Again, we are tilting our action plan towards PD pressure both from a segmentation and from a risk selection standpoint, ensuring the quality is there from a new business and from a renewal standpoint. There's a couple of points there. And then, obviously, Patrick and team are working very hard from a PD standpoint, from a claims action plan as well too. So there's another point there. So the numbers that I quoted there is, obviously, for all of the 2018 impact.

Obviously, what remains is the loss cost trend to offset some of those improvements. So we are confident and we remain committed to driving towards the mid-90s run rate towards the end of this year. And as I said, we believe we're at 98 right now. We're confident in our ability over the coming three quarters that each of those actions, as I've outlined, will continue to drive us towards that mid-90s by year-end.

## A - Charles Brindamour {BIO 7012323 <GO>}

It might be worthwhile for Patrick to give a bit of perspective on your action plan in claims and just give a bit of color what's going and whether we're making progress.

## A - Patrick Barbeau {BIO 18476397 <GO>}

So, as I mentioned in the last few quarters, the claims action plans are focused on three main elements. So we've deployed better tools to the front line to make sure we guide our clients more rapidly to the right process, so whether it's total loss or a car that can be repaired, that's one part of our action we have implemented as well. Tighter controls in the estimating process itself in terms of what types of parts and methodology to use to repair cars. And we've adjusted a few processes that are helpful to minimize costs around rentals, storage fees and so forth.

And the good thing with action plans on physical damage is on the claims side is once you implemented, you get the full benefit of it about 90 days after implementation, you don't need to wait for renewals, obviously, to come in. So in Q1, we are starting to see some traction, concrete traction from some of those actions. For example, we have reduced the cycle time on total assets by a full two days, which allowed us to save about 10% on rental cost and storage fees. And we're seeing on the average estimate of the repairs for pending claims go down between 2% and 3% compared to the last two quarters. So good signs for what we'll be earning from those actions in the coming quarters.

## A - Charles Brindamour {BIO 7012323 <GO>}

It is a line of business that has volatility. It's all hands on deck. We're poking at our action plan on a weekly basis with Darren, Patrick and view of our colleagues across the land and we'll crank it up if we feel we need to as we go along until we get to the mid-90s. There's no doubt we'll get there.

## Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks for that.

## Operator

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

## Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi. Good morning. Just wanted to follow up on the personal auto side. I mean, it seems to me the tone around personal auto and the conviction around getting to mid-90s seems a bit stronger today than say six to nine months ago. Is that a fair assessment? And I don't know, if it's -- if you can say on a, say, a scale of 1 to 10 where that level of conviction is today versus, again, say, about six to nine months ago.

## A - Charles Brindamour {BIO 7012323 <GO>}

So I think the difference between six to nine months ago, on one hand, we've seen a pick up on physical damage trends in the last year. On the other hand, the bulk of the action plan is in the pipeline now. And I think what Patrick is talking about six months ago, we were starting to think about, now we're starting to see results. And therefore, our degree of confidence is up a notch, because the actions that we have in the pipeline are there. Putting a number between zero and ten, we keep our ability to forecast for pricing as opposed to expressing feelings with numbers, but certainly the actions are in place. We have levers we can work with. The market is firming up meaningfully right now, and I think, gaining traction.

The interesting thing, Geoff, the industry results came out last month and it was interesting to notice that on one hand we outperform from a combined ratio point of view by a full 6 points, which is a huge outperformance. On the other hand, we're not in auto. And this has turned upside-down over two years. So we know it's not anti-selection or anything like that. It is a difference of view.

And the thing we've concluded is that we are far more cautious about liability than the rest of the industry at this stage. And when I look at other coverages, we do have outperformance. In liability, we've taken a pretty cautious stance, which I think, puts us in a decent position, as I look ahead in our ability to outperform the industry, going forward. Rates are running, claims actions are in the pipeline and the market is improving. Therefore, we feel better than we did six months to nine months ago, but I won't hide the fact that there is a high degree of anxiety in the organization, and that will be the case until we're back to our historical track record in that segment.

## Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Thank you. And then just the other question I had was, I don't know if -- I know we're only about a month-and-a-half in, any color or thoughts on CAT weather-related stuff? Obviously, we had the the freezing rain out in Ontario and Quebec, there's been some windstorms out here in Southwest BC. And then, maybe, are you able to talk about exposures, I don't know if that's too granular, because there's some concern out here in the BC interior with the snowpack being at the levels are at the rates that they are.

## A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, there's been indeed what you've described have been a number of storms. I'll Patrick who is in the business of getting people back on track give you his perspective on that.

## A - Patrick Barbeau {BIO 18476397 <GO>}

Yes, Geoff, you're right. We have faced a few events since the beginning of Q2, that's normal though to see more catastrophe in Q2 than Q1. In reality, we had three events, we had a windstorm in early-April, we had a late winter storm, that's Ontario, again in the latter part of April; and just last week another significant windstorm that's again Ontario in the portion of Quebec. Our claims team across the country have worked very hard to, again, get our people back on track fast and our response has been very good.

On the other end, even if the high level of water in many rivers across Canada has hit the media. On that front, it's been fairly quiet, we haven't received a lot of damage or new claims. So five weeks into Q2, we have faced a significant volume of CATs are coming up from CAT, but it is really too early to tell if CATs overall will have an abnormal impact on our results of Q2.

## Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Thank you.

## Operator

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

## Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning. First question just follow-up on the personal auto side is that, seems like you have 3 points improved over the next three quarters. I just wondered given your action plan, how much cushion do you keep for yourself for unexpected events, for example, whether or not and what do you see the biggest risk of achieving those target?

## A - Charles Brindamour {BIO 7012323 <GO>}

I think the bulk of the cushion in my mind, as we described the action plan, is in the improvement of the profile of the portfolio, because from a risk selection point of view, there's lots we're doing. The rate increases were taking our -- segmented rate increases, there not average base rate increases, there are highly segmented. And the mix between new business and in-force has shifted dramatically in the past year. And I think, when I look at the plan that Darren has laid out, the underwriting or quality profile of the portfolio is probably the one where Darren is more cautious in his assessment of the impact, I would say, would be the main area. Darren, anything you want to add?

## A - Darren Godfrey {BIO 19791482 <GO>}

No, I think that I think maybe the other area just from a claim standpoint that I think that -- as Patrick outlined, we're starting to see some early signs on the PD side. So I think there is potential there, but nothing that we're prepared to bank on at this point in time, but it may potentially -- I mean, I think at the end of the day, the -- as I mentioned, it's all about, for us, I think, is the loss cost trend that we'll experience in 2018. So to the extent that we can be tempering, that's where we've made quite some cushion.

## Q - Kai Pan {BIO 18669701 <GO>}

Thank you. And my follow-up question is on the PYD in the personal auto, adversely 70 basis points. Could you talk little bit more about that? Is that related to -- because you mentioned your action plan one of the sort of headwinds is increasing pressure on BI and AB. Is that same issue you had last year? And also your guidance 95, I assume, is not including any reserve development which imply a 71% of underlying loss ratio, which you haven't seen that like since 2012. I just wonder how do you bridge that gap without favorable reserve releases.

## A - Charles Brindamour {BIO 7012323 <GO>}

Go ahead, Darren.

## A - Darren Godfrey {BIO 19791482 <GO>}

Yeah. So I think, when we look at the PYD in the quarter, the claiming, as we noted in the MD&A, it's primarily coming for some certain large losses. We would view the, obviously, disappointed that it's unfavorable in the quarter, but of quite some context, we're talking CAD6 million of unfavorable PYD, we would see that as noise in the quarter. I mean, clearly would rather be the other way than unfavorable, but this is normal noise on some larger older claims that we can get from quarter-to-quarter, doesn't reflect any recent unfavorable court decisions or anything of that nature. So it's not consistent with what we've seen in some past quarters that we've talked about.

Obviously, we don't give guidance by line of business, but from an IFC standpoint, going forward, now with adding OneBeacon, we still remain in the 2% to 4% range from the PYD. But with obviously, some noise from quarter to quarter now, we do probably expect to be in the near-term, little bit on the lower side of that, because of rising interest rates, but that create some offset in the current accident year.

With respect to personal auto itself, as you've highlighted, our improvement plan does not assume any form of favorable PYD. And I think it's fair to say that as we continue with our improvement plan, we'll expect to see close to zero PYD in personal auto until we're more confident that our plan has well and truly fully matured.

## A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And I think, Kai, your assessment is right, low-70s is sort of the zone where we need to take this. We were in the low-70s right until '15, actually, where a big portion of the performance you're seeing in the underlying loss ratio in '16 and '17 is reserving position we've taken on the current accident year based on the trends we've observed. And so, we've got lots in the pipeline to take us there. As I said, we will crank up the actions until we get there. There is no structural issues here. It's a question of calibrating the option -- the actions. And I think what we have in the pipeline is pretty robust.

## Q - Kai Pan {BIO 18669701 <GO>}

Thank you so much for all the answers.

## A - Charles Brindamour {BIO 7012323 <GO>}

Okay. You're welcome.

## Operator

Your next question comes from the line of John Aiken with Barclays. Your line is open.

## Q - John Aiken {BIO 6329080 <GO>}

Good morning. Just wanted to take a look at the CAT losses in the quarter. I mean, we're down essentially a-third from a year ago, but we obviously had more significant weather impact. Is this -- was this a conscious decision of Intact to change the mix of business or is this just something a classification issue that popped up in this quarter?

## A - Charles Brindamour {BIO 7012323 <GO>}

No. I think that the winter conditions were extreme in many parts of the country and it's led very strange patterns with -- in January and February in particular massive jumps in frequencies across all lines of business. And at the end of Feb., frequencies were up 15%, just to put things in perspective, in average across the board. So dramatic winter conditions and we felt it was important to make sure that we isolated that to understand the performance of the business.

I'll let Louis share his perspective on this.

## A - Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles. So clearly, the threshold for CATs is 7.5 million, that has not changed. What we saw, as Charles said, the spike in frequency, and that triggered on our side the review of what was going on. And we actually went out and mapped every spike of frequency on a daily basis to weather patterns in the regions when those occurred to come up and identify really what were the drivers; and this is where we're coming up with a bit more granularity in terms of the weather events that have driven spikes in frequency, but have not individually been large enough to be classified as a CAT. But there is no change in classification. It's purely the way the weather developed over the country. And we can tie it with claims activity, and that's what we've done and classified a bit each of those weather patterns to provide a good information on the drivers of the results.

## Q - John Aiken {BIO 6329080 <GO>}

That's great. Thank you.

## A - Charles Brindamour {BIO 7012323 <GO>}

And also to -- yeah, and also to inform our own decisions about the business (inaudible).

## Q - John Aiken {BIO 6329080 <GO>}

That's great. And then, as a follow-on, how much of the growth outlook for Canadian commercial does that come from new business or business lines attributable to OneBeacon, are you able to give us some order of magnitude?

## A - Charles Brindamour {BIO 7012323 <GO>}

Our guidance on commercial lines top line at the industry level is for the industry, and therefore, would not include upside in relationship with what we're doing on tech, entertainment and our cross-border desk. That being said, the market is changing, we're seeing in our own number meaningful swings, while continuing to increase rates. And I'll let Alain who is the tough guy on that to give you his perspective.

## A - Alain Lessard {BIO 17592535 <GO>}

So, John, if you look at the growth on the P&C side, about 60% of the growth in the first quarter is coming from our regular business and about 40% is coming from specialty business, where we saw growth north of 10%. And the growth in specialty line is coming from all sorts of situation, but mostly from E&O, farm, niche business. Basically, lot of the stuff we've invested a lot last year, we're seeing some pick-up of the growth on the specialty lines from the new lines of business we introduced past OneBeacon. But we think that this will pick up more in the second, third and fourth quarter this year.

On the regular business, the 60% growth is coming from both new business and retention, basically, we believe we are in a market that is slightly firmer, because we see more quote request, our closing ratio has improved by about 3 points, our retention ratio has improved by about 4 points. So all of that is driving growth on the new business side and on the retention side. And that's despite passing on still rate increase to the tone of 2% on renewal and keeping our new business rate at the same level they were last year.

On the auto side, I would say the growth is coming from three segment; 40% is coming from our sharing economy, where the popularity is still improving; 30% is coming from the specialty line, mostly trucking on the verge of FTE rate increase were passing mid-teens; and 30% is coming from regular auto where we saw the same situation as commercial P&C and increase in new business by about 40% and an improvement in retention by about 3 points. So that's how we saw the growth in the first quarter.

## A - Charles Brindamour {BIO 7012323 <GO>}

A clear change I will say over a three-month horizon, very clear. And I think I'd love to take credit for some of the actions that we've taken, but there is a tailwind building up here.

## Q - John Aiken {BIO 6329080 <GO>}

Great. Thanks, guys.

## Operator

Your next question comes from the line of Meyer Shields with KBW. Your line is open.

## Q - Meyer Shields {BIO 4281064 <GO>}

Thank you. Good morning. Two quick questions. One, Louis, you mentioned that if the current, I guess, adverse winter weather conditions persist, then you'll take rate. Did that mean we have to wait for another year or two of that winter weather or are there signs about weather forecasting for the winter that you can see during the rest of the year?

## A - Charles Brindamour {BIO 7012323 <GO>}

There is no signs that this is recurrent, first point. Second point, rates are going up in auto across the board. And therefore, we're sort of cranking rates at a pretty hefty pace at this stage. If we feel that there is a structural changes in weather pattern, we'll adapt, but we are far from having reached that conclusion at this stage.

## Q - Meyer Shields {BIO 4281064 <GO>}

Okay. No, that's helpful. And then second, you talked about slowing Canadian personal property growth, reflecting bundled customers; that makes perfect sense. Is there a difference in their profitability profile versus the rest of the property book?

## A - Darren Godfrey {BIO 19791482 <GO>}

On the property book, no, they're pretty much -- there's marginal difference at this between the two of them.

## A - Charles Brindamour {BIO 7012323 <GO>}

The big difference is retention. And so, this is a business that's running, as I said, five-year average, 91% combined, 80% -- 80s sort of combined ratio in the past three years, four years, and a bundled product retention is meaningfully better than what we would call a mono-line. And so, from an economics point of view, this is a very attractive combination. The downside is when work is needed on automobile, you're putting pressure on the other side. But still, I think that the retention edge, economically speaking, is quite valuable to us.

## Q - Meyer Shields {BIO 4281064 <GO>}

Right. Okay. Perfect. Thank you so much.

## Operator

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

## Q - Mario Mendonca {BIO 2450557 <GO>}

Good morning. Charles, what -- in the 95% or, say, call it, mid-90s combined ratio for personal auto that you're targeting, what loss cost inflation rate are you building into that guidance?

## A - Charles Brindamour {BIO 7012323 <GO>}

We're building in that guidance 4%-ish loss cost inflation.

## Q - Mario Mendonca {BIO 2450557 <GO>}

And where would you say it was, say, in 2017 and early 2018 so far?

## A - Charles Brindamour {BIO 7012323 <GO>}

So early-2018, so far, if you look at the severity in aggregate, 41, severity was flat basically. There is a bit of noise. If you remove the noise, you see that there is roughly 3 points to 4 points of trend, and Darren, at Investor Day, I think, said 3.7% is the number I recall you quoted. We're not really seeing that in Q1, when you look at it in aggregate. When you remove the favorable noise and severity, you see that indeed the inflation in the system is between 3 points to 4 points so far this year, and sort of in that pipeline last year.

## Q - Mario Mendonca {BIO 2450557 <GO>}

So you'd need to see something well north of 4 -- or something north of 4% inflation, lost cost inflation to invalidate your guidance? I guess, what I'm getting at is what sort of things could cause that to playout.

## A - Charles Brindamour {BIO 7012323 <GO>}

I think that -- so first of all, your read is right. I'll let Darren talk to that and then I'll complement if needed.

## A - Darren Godfrey {BIO 19791482 <GO>}

Yeah, I think the other thing just to be -- so yeah, as I say, we're in a 3 to 4, we quoted 3.7 obviously on the Investor Day. I think that we got to remember that there is an offset there as well, which is on drift. So as the portfolio with new business and so forth, we actually get a lift of 2 points, is what we call vehicle drift, so that's like an offset versus a trend. So we're really talking a net two is sort of how the math would work. Where is the risk in the plan, as you've identified, it is in that assumption, it comes back to severity trend. As I say, right now, if I go back to '17, we saw flat frequency, if I look at '18 so far, frequency is up, but when we back out the weather impact, frequency is slightly down. So we don't really see significant risk there at all from a frequency standpoint. So very much is a severity conversation.

## A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And I think, Mario, when I think about severity, what could take it past 4 points, well, you could have a court decision -- now, I'm sort of, blue-skying with you. You could have a court decision this year that would change our view meaningfully on claims going forward. And because the current accident year, a big portion of it includes an actuarial assessment of severity, we changed our view on severity, because of an external event like a court decision that might push severity up a bit. That's an example of something that could go wrong.

The speed at which the car pool is changing has an impact and the amount of new cars we are riding has an impact on the aggregate inflation. Now that has an offset with the drift that Darren is talking about. But as we said during the last quarter, a part of what is causing severity at the moment more than what we anticipated originally, is the fact that the inflation for newer models is much greater than what we had planned for, that's reflected in the 3.7.

The other thing that could change inflation as a one-time before now and the end of the year, might be a reassessment of the past, meaning that as

you price, you basically take the past and you bring it forward. And the current accident year performance in particular in long tail lines like liability would include a portion of actuarial assessment. And if the actuaries would look at the past and say, we were wrong a bit there, that might push their assessment of the current accident year's performance and reserves that need to be booked, and that would flow through severity. Now, this is a bit actuarial and granular, but these are three concrete examples of how things could be above 3.7%.

On the latter point, when I look at the industry's result, as I've mentioned earlier, and I look at our liability performance on more recent years compared to our peers, the stance appear, the Intact stance appear to be far more cautious than the rest of the industry, which means, I think this is at least a data point that says that the odds of being up on liability, which is the coverage that can influence severity because of the past, I think, are probably smaller than what they would have been a year or two ago.

## Q - Mario Mendonca {BIO 2450557 <GO>}

Yeah. That's helpful. One final thing. How do we measure, you say, that success would be a mid-90s run rate. But let's put that and say, if we can, something that we will be able to observe in Q4 '18, what combined ratio in Q4 '18 would be consistent with achieving a 95% run rate?

## A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, for me, 95% is the only thing that you'd need to look at in the last few months of '18. So you can say, Q4, you need to take into account your own assessment of the seasonality of automobile Insurance in Q4, and that can be a point or two in the last quarter.

## Q - Mario Mendonca {BIO 2450557 <GO>}

So, something like 97 or so in Q4 would be consistent with 95% run rate?

## A - Charles Brindamour {BIO 7012323 <GO>}

I think that's a fair statement.

## Q - Mario Mendonca {BIO 2450557 <GO>}

Thank you.

## Operator

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

## Q - Doug Young {BIO 5640851 <GO>}

Hi. Good morning. Just, Louis, I just noticed you've reported in the non-operating results an underwriting loss of CAD15 million related to the OneBeacon exited lines. And so I just want a clarification. I mean, I assume this is a program in architect business, I presume, but I just want to confirm this is not included in the 95.3% combined ratio. And I understand why it wouldn't be, because you want to show kind of on your ongoing business what your results are, but I just wanted to confirm that first off.

## A - Louis Marcotte {BIO 18040440 <GO>}

Confirmed. You're absolutely right. So that --

## Q - Doug Young {BIO 5640851 <GO>}

And then --

## A - Louis Marcotte {BIO 18040440 <GO>}

The results of those two lines that we abandoned [ph] and it is 15 million in non-operating.

## Q - Doug Young {BIO 5640851 <GO>}

And then, what's the combined ratio on those exited lines? And where I'm trying to go with this is, how long can it take for these to run off? Are these are like by the end of this year that 15 million should be gone, that program in architecture business should be up or is there a lingering liability tail that comes with these businesses that could continue to go on for a few years?

## A - Charles Brindamour {BIO 7012323 <GO>}

Not material, Doug. I think, you'll have a single-digit, sort of, million drag. But keep in mind that those two lines have reached the point at which the adverse development cover will pickup a portion of the pressured outcome there and they are being run up the book as we speak. So that business by the same time next year will be completely gone.

## Q - Doug Young {BIO 5640851 <GO>}

And what's the -- I mean, just to finish off, what's the combined ratio on that exited business or how big is the earned premium and I can do the math on that.

## A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, that would be well in excess of 100%, that's why we've exited those lines. And, Alain, earned premium left?

## A - Alain Lessard {BIO 17592535 <GO>}

There's about, I would say 20 million, 25 million of earned premium left for the rest of this year, and like the first two months of 2019.

## Q - Doug Young {BIO 5640851 <GO>}

And was there any adverse development in the quarter on that?

## A - Darren Godfrey {BIO 19791482 <GO>}

So there would be some. So you talked about the tail risk here. So the business is running off. There is a book of liabilities, which has been provided for the adverse development cover will cover some of those pick-ups. So the residual part is what could hit the book or the result -- non-operating results in the future. But that's why Charles is saying it's not, we don't expect any materiality -- material elements going forward on that book.

## A - Charles Brindamour {BIO 7012323 <GO>}

And we took a cautious stance as we wound down those two lines.

## Q - Doug Young {BIO 5640851 <GO>}

Yeah, I just wanted to get a sense, but I'm getting the full picture, but I -- and maybe I'll follow-up on a few other things, but that's it from me. Thank you.

## A - Charles Brindamour {BIO 7012323 <GO>}

Okay.

## Operator

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

## Q - Meny Grauman {BIO 15238080 <GO>}

Hi. Just a question on M&A specifically what you're seeing in terms of valuations for brokers, are multiples going up, is there more competition for these kinds of businesses?

## A - Charles Brindamour {BIO 7012323 <GO>}

So, there's a lot of noise and anecdotes. And the reality is that between the deals we partner with entrepreneur and brokers, and the deals we do ourselves with broker link, we're seeing very similar multiples and valuations. And we haven't seen any meaningful inflation in the past 18 months actually, people talk about that. We have reviewed that last week when we looked at the average of all the deals we've done either broker-linked or third-party brokers in the provinces in which we operate, there is no clear inflation worth talking about. There's lot of opportunities out there. Pressure in automobile insurance certainly contributes to that as well, because of the market is firming up. It is tougher to be a broker as well. So it generates activities. Certainly, our experience over the past decade or two and we're standing ready to capitalize on that.

## Q - Meny Grauman {BIO 15238080 <GO>}

Thank you. And then, if I could ask just a follow-up question on the topic of bundling, and that's -- what share of the personal property customer base is bundled and how is the trend changed over time?

## A - Charles Brindamour {BIO 7012323 <GO>}

Darren?

## A - Darren Godfrey {BIO 19791482 <GO>}

Yeah, it's roughly half and we really haven't seen much of a trend. Over time, I think that -- in the most recent history, anyway, it's relatively flat.

## A - Charles Brindamour {BIO 7012323 <GO>}

It's been varying between 50% and 55% over time.

## Q - Meny Grauman {BIO 15238080 <GO>}

Thanks a lot.

## Operator

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

## Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning. Just wanted to go back to the conversation of cost inflation and personal auto with the comments being that severity and frequency roughly flat. So if I look at the year-over-year change in the underlying on personal auto, again, is roughly 2.3 points higher year-over-year, with 1.7 points coming from weather and pools, which suggests you saw about 60 basis points of negative trend with 5.4 points of positive earned premiums. So just wondering -- maybe I'm missing something there, but suggest [ph] to me that either claim severity or frequency was up quite a bit year-over-year.

## A - Darren Godfrey {BIO 19791482 <GO>}

The one thing I would add that, Paul, so you're right, the 1.7 that does relate to weather. There is a pools impact there as well too year-over-year, even though pools were still favorable in the quarter. But, if we to strip out the weather, strip out the changing pools, we'd actually see a slight reduction in the current accident year.

## Q - Paul Holden {BIO 6328596 <GO>}

Okay. But then even to that point with the earned premiums up 5.4%, clearly, there is an offset from, again, whether it's cost inflation or severity, no?

## A - Darren Godfrey {BIO 19791482 <GO>}

Yeah, no, I think that one thing to consider -- so when we talk about the 5 points of earned rate and so forth, that is rate increases that we were to reflecting new business and renewals. Because of our segmentation strategies, as Charles alluded to, our rate changes are heavily segmented. There's quite a shift in mix happening in the portfolio right now. So whether that be in terms of -- we highlighted a reduction in new business, often we will see a tilt in our retention ratio based on the size of the renewal increase. So ultimately what we realize from a rate increase is less than what we've actually received approval on. That will ultimately does lead to quality improvements in the portfolio, and then ultimately lost cost improvements as well. There's a number of different factors at play here.

## Q - Paul Holden {BIO 6328596 <GO>}

I see. Okay. So it's not as simple as just doing that math, okay. Second question then. So, we can go to the rate filings and see that Intact got its 5 points, as you had previously communicated. The marker however only took roughly 2 points, at least, in Ontario in Q1, and that includes the 5 points from Intact, so rest of the market, something lower. Why -- like why do you think it is that your competitors, who, as you pointed out, are having even more problem, personal auto, are moving this low to take rate? Is there any kind of pushback from the regulator or are they just slow and asking for rate, like what's the issue here?

## A - Charles Brindamour {BIO 7012323 <GO>}

So, if you look at 24 months, now you're talking about Ontario. If you look at 24 months, our rates are up 12, the industry is up 6. So the data point that validates what you're seeing. And if you look at the last 12 months, we are closed to 5, the industry approaching 4, cumulative on 12 months. So the industry started to move. And when you realize that you need to move because there is a trend, the filing process takes 6 months. And that's why a sense of urgency as soon as you see a green shoot of inflation is important, which is what we've done two years ago or in the summer of '16. So I think there is the time needed to recognize the trend, there is the time needed to file, and then when people start to file at the same time the regulatory process tends to be a little heavier. And I think, Paul, you would explain a portion of the difference you're talking about with those three levers.

The fourth point in which, in my view, there is uncertainty is the fact that we have taken a view on the liability in particular in Ontario and then in a few jurisdiction that is more cautious than the rest of the industry. And we're acting on our conviction here, there is a difference of view, and time will tell who is right or who is wrong. Our stance has been, we're acting on our conviction, we're playing it safe, and the liability is a longer tail line of business in and we'll see in time. But I do think, Paul, that when you study province-by-province, line-by-line, coverage-by-coverage, the industry's behavior, they're really starting to move, it's just you cannot turn on a dime to change rates, and that's why we started to move two years ago.

## Q - Paul Holden {BIO 6328596 <GO>}

Okay. So the message there is, we should see larger rate increases at the industry level in the next couple of quarters?

## A - Charles Brindamour {BIO 7012323 <GO>}

I would expect so, and I would expect that to be the case across the land.

## Q - Paul Holden {BIO 6328596 <GO>}

Okay. Great. Thank you.

## Operator

Your next question comes from the line of Jaeme Gloyn with National Bank. Your line is open. Please go ahead.

## Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yeah, thank you. Just one quick follow-up on the question around underwriting results from exited lines. So it was 10 million in Q4 and 15 million in Q1. Just to clarify, that 15 million, we'll expect to see something like that through the end of 2018? And then in 2019, it's going to be minimal at that point. Is that the right time frame to think about it or has it blown the threshold now, so that losses should be minimal starting in Q2 '18?

## A - Charles Brindamour {BIO 7012323 <GO>}

That's a better way to look at it. I think, there was a clean up as we close those segments. And now I think a chunk of it is in the adverse development cover. The earned premium, as Alain's talked about, is dropping the business' run up and you shouldn't see that sort of non-operating impact in those quantum in the next quarters, no.

## Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. Great. And then, also talking about costs, non-operating costs, I'm looking at the integration of restructuring costs running about, let's say, 30 million here over the last three quarters, what's the timeframe for that subsiding or -- and at what level should we expect it to run over the next few quarters to the year?

## A - Alain Lessard {BIO 17592535 <GO>}

So I'm expecting a drop over the forthcoming quarters quite significant. This was -- I would say, a quarter one heavier load and I would expect that to shrink meaningfully over the -- to next three quarters. So maybe in the 30, 40, overall by the end of the year in total. But I -- it's heavy loaded in the first quarter.

## A - Charles Brindamour {BIO 7012323 <GO>}

In line with our --

## A - Alain Lessard {BIO 17592535 <GO>}

Expectations, yeah.

## Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. And last question for me just around the investment income. Obviously, an uptick here in the market based yield that was earned on the portfolio, but I also noticed an extension in the duration of the portfolio from 3.5 years to 3.8 years. Can you just explain some of the factors that are driving, I guess, what is higher net investment income than what was previously guided at the Investor Day?

## A - Alain Lessard {BIO 17592535 <GO>}

Absolutely. So I would say three drivers here. We've -- as we do normally in the first quarter, we re-balanced the portfolio, we fine-tuned our Canadian mix according to our efficient frontier. We stick to the same risk envelope, but the team fine-tunes it on an annual basis. And I would sa that's one-third of the upside. Then the OneBeacon integration, so moving their mix to what we're used to including the duration so you'll remember the fixed income portfolio of OneBeacon at the shorter duration. We moved that a bit and that drives really the increase. So everything were --

## A - Charles Brindamour {BIO 7012323 <GO>}

Increasing duration.

## A - Alain Lessard {BIO 17592535 <GO>}

Increasing duration, yeah. So that's the second factor. And then, in the quarter, taking a bit advantage of the increasing yields, there was some trading on the board -- bond portfolio to capture the upside from the yields. So of the increase in the guidance we provided this morning, it's one-third, one-third, one-third, taking advantage of yields, taking the -- optimizing the OneBeacon portfolio to our standards, and fine-tuning the Canadian mix are the drivers.

## Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. Thank you.

## Operator

We have no further questions at this time.

## A - Ken Anderson {BIO 16846692 <GO>}

Well, thank you, everyone, for joining us today. Following this call, a telephone replay will be available for one week and the webcast will be archived on our website for one year. The transcript will also be available on our website in the Financial Reports & Filings archive. Also we'll be hosting our Annual Meeting of shareholders at 11:30 AM this morning at the Art Gallery of Ontario here in Toronto. You may also join this meeting via live webcast from our website. Lastly, our second quarter 2018 results are scheduled to be released after market close on Tuesday, July 31st. Thank you again. And this concludes our call for today.

## Operator

And this does conclude today's conference. You may now disconnect. Have a great day.