Q2 2015 Earnings Call

Company Participants

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

Other Participants

- Brian Robert Meredith
- Doug Young
- Geoffrey Kwan
- John Charles Robert Aiken
- Paul Holden
- Shubha Khan
- Tom MacKinnon

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp. Second 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.

I will now turn the call over to Samantha Cheung, Vice President of Investor Relations, you may begin your conference.

Samantha Cheung {BIO 19462616 <GO>}

Thank you, Mike and good morning, everyone and welcome to our second quarter 2015 earnings call. Thank you for joining the call today. A link to our live webcast and background information for the call is posted on our website at www.intactfc.com under the Investor Relations tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also apply to our discussion on this conference call.

Joining me today are Charles Brindamour, CEO; Louis Marcotte, CFO; Patrick Barbeau, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Mathieu Lamy, SVP of Claims.

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

Charles Brindamour {BIO 7012323 <GO>}

Thanks Samantha. Good morning, everyone and thank you for taking the time to join us today. Earlier this morning, we announced our second quarter net operating income of $210 million or $1.56 per share. We generated strong growth while improving our underwriting performance with a combined ratio of 91.6%, more than one point better than in the same quarter last year. In the current low interest rate environment, our investment team did a good job of generating $104 million of investment income, largely in line with last year, while staying within our risk appetite. This, combined with our improved underwriting performance, helped grow our book value per share by 8% from a year ago and generate an operating ROE close to 17%.

Our performance continues to be industry leading in terms of ROE as demonstrated by our 700 basis points outperformance at the end of Q1. This certainly should continue to support our objective to grow our net operating income per share by 10% per year on average over time. As I mentioned, we had strong direct written premium growth, driven by all lines of business, delivering a 6% increase, including one point from our recently closed acquisition of Canadian Direct Insurance.

Our initiatives to grow the business organically are paying off as well. Our recent product launches, new marketing campaigns and a number of improvements in the digital experience for our customers, all help offset pressure from declining rates in automobile Ontario. While this is a good quarter, we expected slightly stronger underwriting performance, given the low catastrophe activity and healthy support from prior year claims development.

The deterioration in the current accident year was in large part driven by a prolonged winter in Atlantic Canada impacting both personal and commercial lines. We obviously don't see this as a deterioration in the underlying performance of the business.

So let me give you a perspective on our business now. In personal auto, with a combined ratio of 90.3%, we grew our premiums by 6%, including CDI, given the number of improvements for our clients, as well as a better competitive landscape. Favorable development on prior year claims offset an uptick in frequency driven mainly by an increase in small claims. So no concerns there. When it comes to the industry, we expect it'll continue to experience slightly negative growth in personal auto.

Rates are variable across the country with premiums increasing in Alberta and Atlantic, remaining very stable in Quebec, while decreasing in Ontario. We believe rate reductions in Ontario should continue to be in line with government's cost reduction measures.

Today, the industry has decreased rates by 6.1 points in Ontario, and we expect further rate decreases in 2016 from auto reforms introduced in the latest provincial budget.

Our interpretation suggests that they'll produce three to five points in net cost reductions. We expect to continue to be in a strong position to pursue our growth ambitions in that market.

In personal property, we grew by 8%, including CDI in hard market conditions. We rolled-out new products such as our lifestyle advantage. And our relative competitive position continues to improve, given our early rate actions in this market.

As mentioned earlier, our combined ratio of 92.7% in that line was negatively impacted by snowstorms in Atlantic Canada continuing well into April and May. So, overall, our view on the personal property market has not really changed, as we expect the industry to experience upper single-digit growth.

Our Home Improvement Plan is now fully implemented and this in combination with ongoing initiatives, should allow us to continue to outperform the industry in that line. So let's look at our commercial lines of business now. In combination with a firming commercial P&C market, our actions generated a 4% growth in premiums. From a profitability perspective, commercial P&C had a strong 9 points improvement in combined ratio to 91.8%. We had higher customer retention and stronger new business activity. So environment continues to improve and we expect to see mid-single digit growth at the industry level.

In commercial auto, we grew premiums by 6%, driven by good performance in regular lines as well as in trucking. That said, the loss ratio worsened by close to 10 points during the quarter. Due to a number of one-offs including the large losses, leading to a combined ratio of 94.4%. While the industry remains quite competitive in commercial auto, our value proposition is gaining traction.

We ended the quarter in a solid financial position with $564 million in excess capital after completing our successful acquisition of CDI. This is a clear example of reinvesting our capital to support our growth initiatives. Our integration efforts of CDI are underway and should be completed within 24 months. This in no way will interfere with our ability to pursue other consolidation opportunities in the near to mid-term.

So 2015 is quite a busy year for our employees from coast-to-coast, as we roll out new products, new technology interfaces, as we streamline and invest in our brands and continue to consolidate both distribution and manufacturing. So as to build an experience that's second to none for our customers. So on that I'd like to highlight the efforts of our claims team, who grabbed the top position in J.D. Power's latest Canadian auto claim study.

In conclusion, while our performance was good this quarter, we're not spending still. We continue to execute on a number of robust initiatives to ensure we outperform the industry ROE by at least 500 basis points every year and grow our net operating income by 10% per year on average over time, as we've demonstrated in the past.

With a competitive landscape conducive to growth a strong financial footing and a talented group of people from coast-to-coast who do make a difference, we're confident with our prospects for the second half of 2015 and beyond.

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

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles. Good morning, everyone. Our top-line growth accelerated in Q2 to 6% on an underlying basis and 5% on an organic basis that is excluding CDI. All lines and all regions contributed to this growth with a good mix of units and premium increases. Underwriting income grew 23% in the quarter with a 91.6% combined ratio. Our profitability initiatives had a positive impact on our results, but we also saw higher favorable prior year claims developments, lower expenses and cat losses, which fortunately offset the impact of a long and severe winter in Atlantic Canada. The impact of this long winter is estimated at 1.4 points of combined ratio. All of which hit the underlying current year loss ratio.

Net investment income was stable at $104 million as the benefit of incremental investments was offset by lower yields. We expect net investment income to be relatively constant going forward. On expenses, we lowered the ratio to 30.7% mainly on reduced variable commissions.

Net distribution income in the quarter grew 13% to $34 million due to the expansion of our distribution operations and it's higher profitability. We remain on track to hit our run rate of $100 million in distribution income in 2015. The tax rate of 21.7% is seven points higher than the year ago, when we benefited from the resolution of specific tax files. When excluding this item, our net operating income per share growth in Q2 this year would have been 9%, a better reflection of our actual results in the quarter.

Let me add a few comments on our underwriting results. The personal auto business delivered strong organic growth of 4% on a 5% increase in insured risks. Our investments in our brands and in the digital experience combined with favorable market conditions have been instrumental in driving unit growth across the country. Our combined ratio show a 1.2 point improvement in the quarter. On one hand prior year development improved 4 points from last year, which was unusually low. On the other hand, the higher underlying current year loss ratio reflects an uptick in frequency mostly driven by an increase in small claims. Overall, a good quarter in personal auto. In personal property, we also saw solid organic growth of 6% on rate increases and 2% unit growth. This is a nice turnaround from last year's unit losses. We also improved the combined ratio to 92.7%, despite absorbing two points of negative impact from the severe winter in Atlantic Canada.

On the commercial auto side, our combined ratio deteriorated 15 points to 94.4% due to higher claims severity and unfavorable prior year claims developments. As recent quarterly combined ratios have been higher than expected, we are monitoring the results closely and expect to return to a combined ratio closer to 90%. The combined ratio in commercial P&C improved by 9 points to 91.8%, despite incurring 3 points from the Atlantic winter. We are pleased with the continued improvements in the underlying current year loss ratio. Higher favorable prior year claims development also impacted the combined ratio for the quarter.

Finally, we expect that there are approximately 2 points to 3 points of combined ratio improvement remaining to be earned from our commercial P&C action plan targeting a low 90%s combined ratio on a sustainable basis.

Finally, a few comments on our balance sheet. At quarter end, investments amounted to $13.4 billion, 4% higher than a year ago. Our portfolio remains of high quality, well diversified and the asset mix is stable. Our portfolio generated lower gains than in Q2 last year on weaker capital markets and increasing yields. We've recorded $32 million of impairments in the quarter and our non-operating results also include $21 million of gains realized on broker transactions.

At the previous earnings release, we mentioned a potential $15 million headwind from changes in the April federal budget related to the tax treatment of certain dividends. The rules are not yet final, but we continue to believe we can offset most of these lost earnings, while maintaining our prudent risk management approach.

We ended the quarter in a strong financial position with an estimated MCT of 200% and excess capital of $564 million despite our all cash acquisition of CDI. Our debt to total capital ratio stands at 16.8% at the end of the quarter.

In conclusion, we reported solid top line growth, 23% higher underwriting income, and an adjusted ROE of 16.1%. When excluding the tax noise, operating earnings are up 9%. These results are clearly positive, and I would like to thank our employees for delivering such a performance. They are committed as we are to improving our results even further in the future.

Finally, between our talented teams and solid balance sheet, we remain in a strong position to pursue strategic investments in manufacturing and distribution inside or outside the country. In the meantime, our investments in our brands, technology and consumer experience are paying off.

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

Samantha Cheung {BIO 19462616 <GO>}

Thank you, Louis.. Mike, we will now open the call up to questions. Thank you.

Q&A

Operator

Your first question comes from John Aiken from Barclays.

Q - John Charles Robert Aiken {BIO 21267604 <GO>}

Good morning. Looking at the distribution revenue, solid uptick year-over-year. Now, obviously with your $100 million target, the confidence behind that, you do believe this is sustainable, but can you let us know what the amount you've invested in distribution acquisitions year-to-date and what the runway is for continuing consolidation within the industry?

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. So we're up-to-date $58 million for six months invested in the broker network, and I would say it might double by the end of the year, that would be the amount for this year. It's a bit - it's not clearly even every year, some years are more active than others. We had north of $200 million last year, but this year I would say $100 million is probably the right level.

A - Charles Brindamour {BIO 7012323 <GO>}

And that's just capital that you're talking about?

A - Louis Marcotte {BIO 18040440 <GO>}

Yes.

Q - John Charles Robert Aiken {BIO 21267604 <GO>}

Yeah. And Louis, what's driving the decline year-over-year, I mean, I know there's going to be some fluctuations, but are you seeing competition for brokers or is it just that the available number of brokers is actually slowing down?

A - Louis Marcotte {BIO 18040440 <GO>}

So I would say it's more. There is increasing competition in the market. I would not say - I would say consolidation is probably heating up, but there is more activity in the market and we had a bit of a backlog that sort of came through last year, and now I think the market is heating up and competition is increasing a bit.

Q - John Charles Robert Aiken {BIO 21267604 <GO>}

Great. Thanks for the color. I'll re-queue.

Operator

The next question is from Tom MacKinnon from BMO Capital.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks. Good morning, Charles, a question for you, like I assume on the acquisition front you're still looking for 15 points to 20 points market share to change hands in the near-term to mid-term. And I was wondering if you can elaborate a little bit as to what type of acquisition you'd be interested in the Canadian market? Would it be someone of perhaps more sizable or similar mix or would you look for smaller kind of niche players, like the CDI or both, or maybe you can remind us as well as your accretion and your IRR targets as well?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. Thanks for your question, Tom. I think that our view on opportunities has not changed. I think the thesis has played out in the past few years and continues to play out. This perspective that there will be 15 points to 20 points that will change hands started with the 25 point to 30 point perspective and this actually happened. So there is - well, that's clearly 15 points to 20 points less. The ROE of the industry has not improved materially. That, from our perspective, is a catalyst that's super fragmented, you have foreigners in there, banks, mutuals, there's lots of activity. I think the global M&A that started to take place in the past six months from our perspective might also be an additional catalyst. So all-in, the thesis is not changing.

So when it comes to our philosophy from an M&A point of view, I would say that first and foremost, our thought process is to get bigger in the areas where we're good, as opposed to add all sorts of fringes around. And I think that's pretty much been what we've done with the few exceptions and that's our first and most important objective. And why is that the case? Well, if you outperform because of data segmentation, claims management and so on, the best way to create value here is to do that on a bigger platform. So a big scale national plays very high up on the list.

Then when you look at the second angle of M&A is how do you accelerate your strategy? And how do you use M&A to accelerate your strategy and this is where clearly we've expressed an ambition to double the size of our direct platform, double the size of our operated distribution and become a bigger commercialized player. So on these elements, and I think we can do to accelerate these strategies that do not necessarily depend on acquisition, but that acquisitions can accelerate, we will act upon that. CDI is a very good example of that.

In November I told the investors at the Investor's Day that we wanted to double the size of our direct platform to make sure we have fairly deeply presence from coast to coast. CDI did exactly that, but it's not like we're venturing in a new business, we were deep in Alberta, pretty deep in BC. We have a very strong direct platform to start with, so CDI is a very nice complement to our direct platforms, in areas where we have lot of expertise, whether it's data, whether it's claims, and a lot of talent already and so this hasn't changed.

As you know, I have a keen interest in adding to our distribution platform and these are much smaller transactions, but there's lots of them to be done. There's lot of opportunities in the market, and I think that our team in helping brokers grow their business has demonstrated that they can actually contribute to those broker entrepreneurs business model than BrokerLink which has now surpassed $1 billion of premium, has been very effective at integrating many acquisitions and I expect they will continue to do that going forward.

So when it comes to financial thresholds, which was the last part of your question, that perspective has not changed. I mean, we want to make sure that these acquisitions generate $0.15 on the $1 at least, that's sort of what caps off where we'll stop and that has not changed. And I would say that, this is true in all business units, in all lines have of business and in distribution same thing. And the acquisitions that we're making in distribution have to stand on their own as distribution operations as opposed to being subsidize by our manufacturing operations. And that is what I think explains the fact today that we are headed towards a $100 million pre-tax of distribution earnings because we're focused on being really good at distribution, not just being a supporter of our manufacturing operation.

Q - Tom MacKinnon {BIO 2430137 <GO>}

That's great. Thanks for the color. And just one other question, now that the home insurance action plan is now fully implemented, what level should we look at the combined ratio for personal property kind of leveling off going forward?

A - Charles Brindamour {BIO 7012323 <GO>}

I'll let Patrick, share his perspective.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. As we've mentioned, I guess in the past part of – well, the main objective of our Home Improvement Plan was to be able to operate the personal property line of business below 95% even in periods where we would experience higher catastrophic and that view has not changed. We're satisfied with the impact we've seen of our plan and it's fully rolled out now. We're staying alert because we're seeing trends like we've seen in Atlantic and making more smaller target changes, but our views and our targets have not changed.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thank you.

Operator

Next question is from Shubha Khan from National Bank Financial.

Q - Shubha Khan {BIO 16255963 <GO>}

Thanks. Good morning. So first question I had was on the draft 2016 MCT guideline and specifically what you will think might be the impact on your MCT ratio if the proposed revisions are implemented as currently proposed. And how you might want to respond to OSFI's call for public comments?

A - Charles Brindamour {BIO 7012323 <GO>}

Shubha, I'll ask Louis, our CFO to give his perspective on that.

A - Louis Marcotte {BIO 18040440 <GO>}

Thank you. So this is a fairly recent, new proposal that's out there, we're happy with the direction this is going because it is recognizing the fact that companies hedge their risks. And so we're viewing this as a positive move forward on OSFI's part. It's still early to say, we do think it will have an impact, a positive impact on our capital level. And at this point, it's not as big as the one we're seeing for the 2015. So you'll remember we have 21 points phasing in over three years and we expect the impact to be smaller, but we're still measuring exactly what it will be for us, but it certainly will not hit the 20 points, it's probably in the 10 points to 12 points range impact. But at this point, we're not sure whether it's going to phase in, and whether there is some impact that we have not fully measured yet and we'll keep you updated as quarters pass and we are more firm on it.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I'll make two comments, Shubha. First of all, the 2016 is very preliminary. So I wouldn't count on any impact at this stage. I think we need to see this thing manufacturing. But at the high level, we're very supportive of the work that OSFI is doing on the capital front because they're becoming more sophisticated, they're becoming more risk based and certainly, this is how – this is in line with how we see risk and where capital should sit. So we applaud them for their efforts on that front.

Q - Shubha Khan {BIO 16255963 <GO>}

Got it. That's helpful. Just switching gears to Ontario auto. I guess you guys have delivered higher rate reductions relative to the industry, based on your slide presentation. I'm assuming most of that is probably down to UBI or telematics or what have you. And I'm just wondering how much of the rate reductions that you've delivered to-date come from or are driven by UBI? And given that the product has been out in the marketplace for roughly a year or more now and you've had an opportunity to assess the demand and what have you, how much more could UBI help in reducing rates in Ontario auto?

A - Charles Brindamour {BIO 7012323 <GO>}

Okay. I'll ask Patrick to give you a perspective on the rate environment in Ontario and maybe touch on reforms as well briefly. And then I'll give you a high level perspective on UBI and what we're seeing on that front.

A - Patrick Barbeau {BIO 18476397 <GO>}

If I start with the difference you're stating between the amount of rate decrease and cat tests taken compared to the industry. So far the main reason is because we proactively recognized some reforms that were part of Bill 15 before the rest of the industry. That's what explained that first gap I guess to start with.

In terms of overall reforms, as we discussed at the end of the last quarter, the latest budget in Ontario contain new reforms that were announced. And they are, in our point of view, very good in terms of potential cost reduction. We're still waiting for the final regulation around those, we expect them to come out in the coming weeks or months. And the effect of those or the reflection of those cost reduction into the rates of Intact and the rest of the industry is probably going to be effective in the first half of 2016.

In terms of our rates that we've taken so far, about two points - close to two points came from the UBI initiative. If we look at our take-up rates right now on new business, it's close to 40% with an average discount of 10%. So ultimately it could go up to four points overall, but that will take many years before we get there.

A - Charles Brindamour {BIO 7012323 <GO>}

Because that's largely a new business initiative at this stage, but there is meaningful traction on that front and this is really good for us. It's a good tool to attract very good customers and this contributes to the efforts of the government to provide a better deal for good drivers. So I feel our objectives are aligned on that front and we're pleased with the UBI progress.

A - Louis Marcotte {BIO 18040440 <GO>}

And it's contributing to our unit growth in Q2.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes.

Q - Shubha Khan {BIO 16255963 <GO>}

Okay. So if I've understood correctly, so two points of the 9.6% delivered so far have come from UBI and you expect it to go to 4% or you think it could go to 4% over a multi-year period going forward, right?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

Q - Shubha Khan {BIO 16255963 <GO>}

Okay. Thanks. That's all my questions.

Operator

Next question is from Geoff Kwan from RBC Capital Markets.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi, good morning. Just wanted to follow-up on Tom's earlier question on the M&A side. Just trying to - more of a conceptual philosophical question is, are you guys - would you guys be comfortable partnering up with another insurer if you found an acquisition target and you guys would, say, take the Canadian business of a global insurer or would you prefer to just do it of just if there is a clean kind of auction of a Canadian business if it came up for sale?

A - Charles Brindamour {BIO 7012323 <GO>}

So we're not very keen on auctions is the first point I'll make. We're much keener on working with people with whom we have relationships. We're afraid (30:47) complexity, if we trust people with who we work, and other than very clear financial objectives, we're very flexible as to how we can put a deal together.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. The next question I had was just obviously there's been a lot of forest fires in Western Canada, and it looks like it hasn't really had much of an impact and it seems generally confined to more rural areas, it's continued through into Q3, any comment on kind of exposures or lack of exposures from your perspective?

A - Charles Brindamour {BIO 7012323 <GO>}

I'll ask Mathieu Lamy, who is the – in the business of fighting fire, so why don't you give us your perspective, Mathieu.

A - Mathieu Lamy {BIO 15207469 <GO>}

Yeah. The exposure is difficult to measure in those situation because it's an all or nothing. The risk of an event like Slave Lake a few years back is possible, but we think it's very low at this point, but that said the possibility is there. And so far, I'd say, the fire came close to our customer – uncomfortably close to our customer, but the firefighting effort has been very successful at keeping the fire at bay. So, so far very, very, very minimal damage we have.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. And the final question I had is more kind of a bigger picture? There's been more and more news around driverless cars and just wanted to get any color or insight, do you have big picture down the road on what this might mean for auto insurance?

A - Charles Brindamour {BIO 7012323 <GO>}

Geoff, I think that if you take a long-term perspective, say within the 10-year to 20-year horizon. This will be an important factor. And train has left the station as far as we're concerned because the technology exists. I think the speed at which this will happen depends on a number of layers. There is the speed at which the technology will be marketed broadly by manufacturers. There is the speed at which the regulators will create a framework for it to take place. There is the speed at which people will actually embrace this new approach to transportation.

And I think that this has in combination with the emergence of the sharing economy, which from our perspective is much bigger than autonomous cars. This has the potential to really reshape how people move from point A to point B. Clearly, autonomous cars will have a favorable impact on the number of accidents and in theory could shrink the risk pool in automobile insurance to a certain degree. That being said, we're in the business of ensuring people moving from point A to point B. We're the largest first lines carrier, we're the largest commercial lines automobile carrier. And we're equipped to reshape the product and the offer to continue to lead in sort of providing protection to people in when they move from point A to point B and that's very much how we look at that issue. We have research on the topic, but I would say in terms of research, we're much more focused on the sharing economy and how people share assets together and replace traditional means of moving, living, sleeping, et cetera.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Great. Thank you.

Operator

Next question is from Paul Holden from CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Paul

A - Louis Marcotte {BIO 18040440 <GO>}

Good morning.

Q - Paul Holden {BIO 6328596 <GO>}

Drill down a bit on the organic growth you're putting up since it's starting to accelerate. So I've tried to do a little bit of math backing out the CDI from the direct-to-consumer premiums written specifically and coming up with a growth rate there and then comparing it to the broker channel, sort of what I'm getting is, broker channel organic growth seems to be accelerating, while the direct-to-consumer is kind of running around historical norms of say 8% to 10%. So I'm wondering if I'm doing my math right and what it is specifically that's driving the growth through the broker channel?

A - Charles Brindamour {BIO 7012323 <GO>}

I think in the broker channel, Paul, all lines of business are contributing. I would say that the area where the delta is the biggest is personal automobile. And in personal automobile, we have a number of pressure points in the past 12 months to 24 months. The competition was really quite intense in the province of Quebec and had some pressure there. And the Ontario automobile market, we came out following the initial round of rate cuts being meaningfully more conservative than the rest of the market, and adjusted our position as we gained comfort.

What happened in the last year though is that the environment has improved from coast-to-coast, and this came at the same time, as we rolled-out a number of initiatives whether it's marketing, whether it's products, whether it's technology launches (36:40) in the last few months. So that combined with an improving environment has lead to a significant change in automobile insurance in particular in those two provinces, which represent the biggest markets in which we operate.

So I would say, for me that's the biggest delta between 18 months ago and where we're sitting today. And when we look at the environment, we're pretty comfortable that that pace can be sustained for some time. Then I think in home insurance, and that's more true in the broker channel than the direct channel, the market is catching up. And so we have moved from an environment where units were shrinking, you will recall, a year ago by two points, now we're in positive territory with the units, we're actually seeing four points of growth in units. So this is a major delta. So that to me is how we've moved the needle in the broker channel.

Q - Paul Holden {BIO 6328596 <GO>}

Do you think that there are certain large competitors that historically have been more price aggressive and based on public rate changes, they seem to be somewhat less aggressive on price. Do you think that's had any influence on organic growth for yourself and perhaps for other players in the industry?

A - Charles Brindamour {BIO 7012323 <GO>}

I think to a certain extent it has. Some people are good at having one month of both feet on the accelerator, the next month both feet on the breaks. I do think that what you're describing might pickup in the second half and first half of next year where large influential players taking more cautious stance on things, but I don't want to get into specifics here. I mean, these are signs of an improving environment, and I would say we see that in more lines of business, in more jurisdictions today than we did six months ago.

Q - Paul Holden {BIO 6328596 <GO>}

Okay, okay. That's good. And that kind of actually is a good lead-in into my next topic of conversation, which would be the core loss ratio. So I understand the explanation related to the Atlantic provinces, but it's a relatively small piece of the puzzle in terms of geographic exposure, and then we're also seeing large reserve, favorable reserve development. Does that suggest that we're still seeing a fair amount of conservatism built into current reserving in 2015?

A - Charles Brindamour {BIO 7012323 <GO>}

Look, I think, when you have a track record of healthy favorable development over time, one has to assume that indeed as you build up your reserves on your new claims, your past approach to reserving is reflected in your new claims. So I think, it is a fair statement. I think, it is important as we've talked about in the previous quarter to understand that the sort of higher than normal favorable development we've experienced in the past year or two year has a number of factors in there that one should not necessarily assume you'll see at perpetuity, so to speak and we've talked about this in the previous calls. But I will say, it is a fair statement, Paul to say that, if you have a very strong track record of favorable development that you're cautious when you set up your reserves on new claims in the current accident year. That's why just focusing on the current accident year loss ratio and adding expenses misses a portion of the genuine performance of the business.

Q - Paul Holden {BIO 6328596 <GO>}

Right, right. Then my assumption would line up with that in terms of – I mean, you're increasing organic growth, at the same time it look like your core loss ratio is going up, but maybe there is some other factors have played there, okay. And then final question just in terms of your investment portfolio, you remain comfortable with the net energy exposure in the book?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I'll let Louis comment, but I want to come back on your current accident year point here.

A - Louis Marcotte {BIO 18040440 <GO>}

We do have – Paul, it's still in the same space as a percent of total and we're comfortable there at this point in time.

A - Charles Brindamour {BIO 7012323 <GO>}

So back to your question Paul because I think it's an important one. It's one that we're spending time on every week because a big portion of what we do is to spot trends to make sure that the current accident year performance does not deteriorate. And when you put organic growth in the same statement, one could say, well, are these guys doing things to grow the business that will deteriorate the underlying performance? And would say absolutely not as far as I'm concerned.

Let's move the needle on the top-line this quarter, and it's very clear there is a not an (42:21) empirical evidence that this is the case. It's technology deliveries that have generated more response, additional investments in advertising that has pushed our general expense up a little bit. New product launches, I mean these product launches are priced with similar ROE as the core business and then market-by-market conditions that have made as such that people are catching up to some of the positions we've taken in the past of two years.

So I will say that the top-line is not coming at the expense of the underlying loss ratio, that's the first point. The second point, on underlying loss ratio, when I think about it, you have 1.5% of Atlantic storms and prolonged winter and late reporting of claims. So that's about – that's a little more than half of the deterioration, in fact, more than half. Then what is left? There's two other factors as far as I'm concern that explain the deterioration in the underlying loss ratio. One is an uptick in frequency in personal auto of small claims. So Patrick and I and some of the regional actuaries looked at that and I think that is our one-offs. These are weather patterns, there's nothing in there that lead us to say, let's change how we price (43:57) the business or let's change the product.

Commercial auto we stared at for a long time because I mean it's a 15 points deterioration and that's pretty big. Combined ratio is 94.4%, so in itself it's not a bad combined ratio, but we know that business performs much better than 94.4% and what explains that is a number of one-offs. A few IBNR adjustments and some large losses. So there is no clear trend emerging there. And where we have pockets of issues, we have action plans backing those pockets of issues. So certainly very long answer to say that growth is not coming at the expense of the underlying loss ratio.

Q - Paul Holden {BIO 6328596 <GO>}

Okay, good to hear, that's great explanation. Thanks for your time.

Operator

The next question is from Doug Young from Desjardins Capital.

Q - Doug Young {BIO 5640851 <GO>}

Hi, good morning. Just a first question. I wanted to confirm the impact from the winter storms in the Atlantic Canada. Sorry, Louis, did you say it was 1.4 points on the combined ratio?

A - Louis Marcotte {BIO 18040440 <GO>}

That's right.

Q - Doug Young {BIO 5640851 <GO>}

Okay. And then second, Charles, you gave a little bit of detail on commercial auto and just trying to get a little bit more detail. You said there is an increase of frequency of smaller losses, there is weather events, I think there were some large losses. Can you give a little bit more granularity on what's going on with commercial auto and is this - has there been issues this quarter? I think there were some issues even last quarter, correct me if I'm wrong. So I'm just looking to see what's going on on the commercial auto side with a little more granularity?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So Alain will take this one, but just to be clear, the uptick in frequency in small claims is in personal auto, not in commercial auto. But Alain, why don't you share with us your perspective.

A - Alain Lessard {BIO 21962461 <GO>}

Well, I think the first thing I would like to say, Doug, is going back to what Louis said, we think that this line of business operates more in closer to 90% compared to, let's say, mid-80%s a few years ago. And that's not a deterioration of our margin, it's an overall deterioration of the market. That currently is trending to high-90%s. Basically, our performance is - historical outperformance is about 8 points. It was 15 points in the first quarter of 2015. So we still have a strong performance in that.

If I look more at the quarter with that in mind, what we saw in the second quarter pays us very small increase in frequency of about 3%, but that increase is overall in Canada. When we look at it by provinces, we saw a decrease in Quebec, some increases in Ontario and Alberta, and a very large increase in Atlantic due to the winter storm. And that – what it does is Quebec doesn't have BI coverage, so we have a very low severity in Quebec compared to the other provinces where we cover BI. So that has led in average to an increase in severity and that has for the current year probably had an impact of about three points, four points of combined ratio, and that's over the last year that was very, very low at 53%.

We also saw some deterioration in the prior year. We are at 6.4% than (47:23) last year, and that's coming basically from two sources. One is some very old claims of AXA and Jevco, where we saw a huge increase and some large losses to a tone of about 2 points, 2.5 points and we also saw less closure of claims in the second quarter to about 100 less claims closed. And it's when the claims are closed that we release the reserve, so that has an impact of another 2 points. So those are all basically unrelated elements that basically appeared all in the second quarter, so we don't see any trend there. That being said, I would say we continue to monitor the situation closely and as we did in P&C where we invested in reviewing our pricing algorithm using all the data, techniques and expertise we have, we're doing the same thing in commercial auto. We're targeting implementation of those early 2016.

Q - Doug Young {BIO 5640851 <GO>}

And I think it was mentioned in the release as well, just around competitive trends in trucking, is that an area where you're seeing increased competitive pressures?

A - Charles Brindamour {BIO 7012323 <GO>}

We're growing in trucking, okay, because that was probably in the very competitive environment segment where we saw the market kind of changing and going on the firm side, okay, that contributed in the first quarter four points of growth for commercial auto. In the second quarter it contributed about 2 points of growth as we saw a slowdown on that growth and some players coming back but staying very disciplined. So it's an area we want to grow, but it's an area we want to grow with making sure we have the expertise and at no, let's say no reduced contribution or no pricing – we are not letting go our pricing. I'm sorry, I'm trying to find the right word, but we're not jeopardizing anything on the pricing side, we're keeping to our very disinclined pricing action on trucking.

Q - Doug Young {BIO 5640851 <GO>}

Okay, great. Great color. Thank you very much. And then just lastly on Ontario auto, there has been more developments obviously with the budget around the cat definition. Were there any additional – I know you released some reserves in the first quarter, was there any additional reserve releases that came around the reforms in Ontario auto in the second quarter?

A - Charles Brindamour {BIO 7012323 <GO>}

Not really or not in any significance, I would say.

Q - Doug Young {BIO 5640851 <GO>}

Okay, great. Thank you.

Operator

The next question is from Brian Meredith from UBS.

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

Yeah. Good morning, everybody. Most of my questions have been asked but, Charles, I'm just curious, on the M&A front, when you think about the U.S., what do you think competencies in areas of data segmentation that Intact has that's transportable to the U.S. and where you can still earn kind of a same type of return you earn in Canada?

A - Charles Brindamour {BIO 7012323 <GO>}

I think the – so when we look south and think through where we have something to contribute. Our biggest thought is that the relationship we have with small-to-medium size enterprises here in Canada, we have one in four, we ensure one in four small-to-medium size enterprise. We have a service model that is geared towards that segment -- range of products geared towards that segment and we've taken the actuarial discipline in commercial lines to a point that I would say is even further than in personal lines. And these elements, when you map that over what we see happening in the U.S. and super fragmented nature of small-to-mid sized business in the U.S. would be one area where we think there might be an opportunity for a firm like Intact.

I think standard automobile insurance in the U.S. is not necessarily a place where we think we could win. Quite frankly there are really good players out there. We like to benchmark what we do with what some of these guys do, and I think here the GEICOs and the Progressive and not sure that there was much of an appetite here to go and compete with people like that. Just like I hope they have no appetite to compete with us here in Canada.

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

Great. Thank you very much.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

A - Samantha Cheung {BIO 19462616 <GO>}

Thank you, everyone, for participating today. The webcast will be archived on our website for one year and a telephone replay will be available at 2 PM today until Wednesday, August 5. A transcript will also be available on our website following this call.

Our 2015 third quarter results will be released on November 4. And with that, thanks again and enjoy your day. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

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