Company Participants

- Alain Lessard
- Charles Brindamour
- Darren Godfrey
- Louis Marcotte
- Patrick Barbeau
- Samantha Cheung

Other Participants

- Brian Robert Meredith
- Doug Young
- Geoffrey Kwan
- John Charles Robert Aiken
- Kai Pan
- Meny Grauman
- Paul Holden
- Tom MacKinnon

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Intact Financial Corp Second Quarter 2016 Earnings 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. Thank you.

Samantha Cheung, VP of Investor Relations, you may begin your conference.

Samantha Cheung {BIO 19462616 <GO>}

Thanks, Chris, and good morning, everyone. Thank you for joining our call today. A link to a 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; Darren Godfrey, SVP, Personal Lines; and Alain Lessard, SVP of Commercial Lines; and Patrick Barbeau, SVP of Claims. We'll begin with prepared remarks followed by a question-and-answer session.

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

Charles Brindamour {BIO 7012323 <GO>}

Good morning. Thanks, Samantha, and welcome to Darren who is new in his role and Patrick, whom many of you have heard before or met before in these calls where he was SVP, Personal Lines before and he's now SVP, Claims, and that's very consistent with our view that we should move talent in the organization and develop people accordingly. And so I want to welcome these folks into their new roles for this morning's call.

Before we get in the second quarter's results, let me first make a few comments about the Fort McMurray wildfires. This is the costliest insured catastrophe in Canadian history, and the impact on the residents and their families will certainly be long-lasting. Our folks in Alberta have gone above and beyond to respond to our customers. And we have to recognize that the recovery effort will take years.

As of today, most automobile claims have been closed. Solutions for the rebuilding of homes are underway, and we're working with our commercial clients to put them back in business. We're fully committed to getting our customers back on track and we'll be on the ground for as long as it takes.

We announced this morning second quarter net operating income of C$0.83 per share despite absorbing the C$0.97 per share loss from the Fort McMurray wildfires. These results clearly show the resilience of our platform.

Our top line grew 5% in the quarter as new products, digital experiences and distribution initiatives paid off, particularly, in personal lines. On the commercial side, growth was dampened by the impact of the weaker Alberta economy.

We delivered an underwriting profit of C$16 million in the quarter with a combined ratio of 99.2%, which includes 8.8 points of losses from Fort McMurray. If we exclude the impact of Fort McMurray, the combined ratio would have been 90.4%, with strong results in property lines and commercial auto, but results below expectation in personal auto.

Our operating ROE was healthy at 14.6%, particularly in light of our strong capital position and the impact of the wildfires. We ended the quarter with C$857 million of excess capital and our book value per share grew 3% year-over-year to C$40.57.

In terms of our performance, we beat the industry's ROE by 620 basis points at the end of the first quarter. Our underwriting results largely drove this outperformance. In short, while our troops continue to work very hard to help our customers recover from the wildfire, I'm pleased to see the resilience of our platform in dealing with the costliest natural disaster in Canadian history.

Let's now look at our results by line of business. So personal auto grew 6%, thanks to our growth initiatives, which include our telematics offer, our quick quote engine, as well as a number of branding and distribution activities. The combined ratio deteriorated by 6.1 points to 96.4% excluding Fort McMurray, driven by mild increases in frequency and severity, flat earned rates and lower prior-year development. Rate increases have been effective in Alberta since April 1 and additional ones have recently been approved in Ontario. I expect these reductions combined with our claims strategy will offset recent cost pressures.

When it comes to the industry outlook for auto, we continue to anticipate low-single-digit growth in the coming 12 months. In general, given a rationale competitive environment, we anticipate that claims cost inflation across the land will lead to moderate rate increases. In Ontario, most of the remaining reforms were implemented on June 1.

In personal property, we grew our premiums by 9% as rate increases and growth initiatives were deployed in firm market conditions.

New products such as our Lifestyle Advantage and our Enhanced Water Damage Package have been very well received by customers. Our combined ratio of 82%, excluding 24.7 points of losses from the Fort McMurray wildfires, benefited from lower claims frequency and the effectiveness of our profitability actions.

I'm particularly pleased to see that our year-to-date combined ratio of 94.7%, even after Fort McMurray, is consistent with our desire to operate this business sub-95% even in bad times.

In terms of industry outlook, we expect firm market conditions in this line of business with mid to upper-single-digit growth over the next 12 months.

Commercial P&C premiums declined 1% year-over-year as rate increases were offset by headwinds from a slowing Alberta economy. This line delivered a combined ratio of 87.5% excluding 10.7 points of Fort McMurray losses. The underlying current accident year loss ratio improved 11 points from last year mainly due to lower large losses, profitability actions and better weather in the Atlantic.

Commercial auto premiums grew 2% in the quarter as the impact of corrective measures, including rate increases, were partially offset by economic conditions at Alberta. The combined ratio improved substantially to 88.5% excluding Fort McMurray, thanks to favorable prior-year development and the effectiveness of our actions. That said, we're continuing with our corrective measures, aiming for a sustainable low 90%s combined ratio.

With respect to the outlook for commercial lines, while experiencing meaningful pressure in Alberta, the market conditions across the land are still conducive to rate increases, which should lead to low-single-digit growth in the coming year.

So as you can see, it's been a busy quarter and our operations have responded very well. But I'm also pleased with the progress we're making on our strategic initiatives. On June 28, the Superintendent of Alberta approved our new ridesharing insurance policy, the first of its kind in Canada. Our commercial policy with Uber became effective July 1 in that province. A few days later, the insurance regulator in Ontario approved a similar solution. These steps are a clear sign of our leadership position in the sharing economy.

On the claims front, we received very good feedback following the launch of the Intact Service Center in Calgary earlier this year. We recently launched our second service center in Ottawa and we expect Montreal and Toronto in late 2016 to early 2017.

And finally, I'd like to congratulate our teams at belairdirect who ranked the highest in customer satisfaction amongst home insurers in Atlantic, Ontario, and Québec according to J.D. Power's latest survey.

So, in conclusion, we've had a challenging quarter. But I'm happy with our performance both financial and operational. We absorbed the worst cat in Canadian history and yet remained profitable with a very strong balance sheet. Our growth initiatives are paying off and are driving solid top line growth. Our property lines are performing well. Commercial auto improved substantially, but we have some work to do on personal auto.

In addition, we've seen material progress on our strategic initiatives particularly with regard to the sharing economy. So we're confident that our strategy will continue to help us outperform the industry's ROE by at least 500 basis points and grow our net operating income per share by 10% per year over time. Our focus on providing our customers with an experience that's second to none and our drive to be a top employer coupled with our financial strength places us in a very good position to benefit from this environment in which we compete.

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

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles. Good morning, everyone. Although our company was hit by the costliest disaster in Canadian history during the quarter, our operations generated C$114 million in net operating income after absorbing C$127 million in net losses from Fort McMurray.

Our operating ROE was 14.6%, while we maintained a very strong capital position with C$857 million of total excess capital. Our operations are clearly showing the resilience both in terms of earnings generation and capital strength.

A few comments on Fort Mac, we reported gross losses from the wildfires at C$409 million, approximately 10% of the total industry losses as reported by IBC. This is consistent with our estimated market share in the city. If we exclude losses from Fort McMurray, other cat losses amounted to C$18 million, a level similar to Q2 of last year.

We reinstated all areas of reinsurance that were used in the quarter such that our coverage remains the same for the balance of the year. The reinstatement premiums amounted to C$27 million, and it is important to note were recorded as a reduction of earned premiums, therefore, impacting our underwriting ratios.

Moving on to operations. On expenses, nearly half of the 1 point increase in expense ratio in the quarter to 31.7% is due to the impact of the reinstatement premiums I mentioned earlier. The remainder of the increase was primarily due to higher commissions, taxes, and variable compensation.

Our investment portfolio continues to deliver consistent investment income, unchanged from last year at C$104 million. Although average net investments increased 3% to C$13.2 billion from mark-to-market gains and cash flows generated from operations, this benefit was offset by a lower reinvestment yield. We continue to expect a mild erosion of net investment income going forward.

Net distribution earnings grew 26% in the quarter to C$43 million due to improved profitability of our brokerages and additions to our broker network. We invested another C$66 million in our distribution network in Q2 and continue to expect 10% growth in net distribution income for the full year.

We reported net investment gains in the quarter of C$28 million, a sharp reversal from last year's losses of C$29 million. Favorable equity markets led to realized gains on our equity portfolio, and declining yields led to gains on the fixed income portfolio. Impairment losses of C$13 million in the quarter were C$2 million lower than last year. Our effective tax rate was 16.9% in Q2, lower than usual due to the greater proportion of non-taxable dividend income relative to underwriting income.

In summary, we've reported quarterly EPS of C$0.67, which was C$0.80 lower than last year. Excluding the C$0.97 impact from Fort McMurray wildfires, EPS grew 12% year-over-year on stronger underwriting and distribution results. Our investment portfolio and distribution activities provide stable earnings when underwriting results are challenged, adding to the resilience of our platform.

Finally, a few comments on our financial position. Our balance sheet remains very strong. Our MCT stands at 212%, after reflecting the 8-point impact from Fort McMurray, which was offset in part by 4 points from the phase-in of MCT guidelines and from favorable capital markets.

Our total excess capital amounted to C$857 million at the end of the quarter, while our debt to total capital ratio was 19.3%. Our investment portfolio's unrealized gain position increased materially from Q1 to C$150 million with contributions from all asset classes.

We executed on our buyback during the quarter, purchasing some 140,000 shares for a total cash outlay of C$12 million. Between the launch of the program and the end of Q2, we have spent C$32 million on the buyback with an average price per share of C$87.19.

Finally, to optimize our buyback strategy, we entered into an automatic purchase program to facilitate purchases at all times, even during blackout periods. Our capital deployment strategy remains unchanged, and while our priority is to invest in growth opportunities, buying back shares at time when the market price may not fully reflect intrinsic value is a responsible use of our capital.

In conclusion, with strong underlying results in property lines and substantial improvements in commercial auto, we are focusing our efforts on improving results in personal auto with similar discipline and energy. Our earnings have proven the resilience, thanks to the strength of our insurance operations, our focus on innovation, the growing role of distribution, and the great work that our in-house investment team is doing.

We continue to believe consolidation in the domestic P&C industry will continue, both in manufacturing and distribution, and we will continue to be active participants. With a strong balance sheet and a talented team, we are ready to tackle opportunities as they arise.

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

Samantha Cheung {BIO 19462616 <GO>}

Thank you, Louis. Chris, we are now ready to take your questions. In order to give everyone a chance to participate, kindly limit your questions to two per person. And if there's time, you may log in again.

Q&A

Operator

And the first question is from Kai Pan with Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Good morning and thank you. The first question is on property insurance. You've mentioned about 9% premium increase. How much of that – if you can break down between rate versus exposure, what's roughly the breakdown?

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning. Darren, do you want to take this one? So we're talking in rhythm.

A - Darren Godfrey {BIO 19791482 <GO>}

Yep. So, obviously, as you mentioned, our direct premium written increased by 9.3% in the quarter. Of that, 7.7% was due to increase in written units. On top of that, obviously, we've got some insurance inflation. There's some rate actions still flowing through the book and a slight mix change, downward mix change that's driving the overall plus 9% increase in direct premium written.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Between some insured increases and rates, you have about 6 points and the mix is 4 points the other way. And that is explained by different speed of growth by jurisdiction, but also potentially faster speed of growth in condos and apartments, which have lower average premiums.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. So my question is really, given what's happened in – unfortunate events that have largest losses in Canadian history, so do you see further increase you see – you see rate increase, will that be just going even higher from current levels, or it just simply stay at current level, but for a longer period of time?

A - Charles Brindamour {BIO 7012323 <GO>}

I think it's important to talk about the industry when we talk about the outlook versus our own rate direction. But I'll let Darren give his perspective on the industry's outlook.

A - Darren Godfrey {BIO 19791482 <GO>}

Yeah. It's unclear at this point in terms of the longer term impact from a Fort Mac standpoint. Obviously, with respect to reinsurance renewal, there's still time to tell on that one. However, I think, it's fair to say that we expect that this event may extend the firm conditions that we're seeing currently in personal property. Again, timing-wise, it's not exactly clear right now, but definitely we think that the rate increases that we see in the industry and the growth that we see in the industry we expect to continue in the short to medium term.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think that's right. It is a firm environment, and therefore, this adds to a firm environment and interest rates have not gone up in the last quarter. So I think the conditions are there for potential extension of firmer conditions in that line.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you. My second question on personal auto side, you mentioned about the mild frequency and severity increase. This is sort of like within your expectation or is a surprise? And could you talk a little bit more about it, and any pricing action you are taking? Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Why don't I ask Darren to shed a bit of light on that frequency and severity bumps in the quarter and maybe then rate direction?

A - Darren Godfrey {BIO 19791482 <GO>}

Sure. Absolutely. Thanks, Charles. So from a frequency standpoint in the quarter, largely driven by two weather events, a snow event in April in Ontario followed by a similar event, in the May long weekend in Alberta. Both of those drove frequency higher. If we were to exclude those two particular events, frequency was actually relatively flat in the quarter when comparing Q2 of 2016 back to Q2 of 2015.

In terms of the severity itself, there's a couple of things that play there. One is actually tied back to the increase in frequency that I just talked about. So due to the increase in frequency in Alberta and Ontario, there was a change in mix, change in the number of claims by province. Obviously, Alberta and Ontario tend to have a higher severity due to the product features in the order of products in those two provinces.

So as we got more claims in those two provinces, that drove then the national severity higher as well. We also experienced a bit of a blip in the Atlantic from a severity standpoint. Again, some context here obviously. As you're going to remember, back in Q2 of 2015, we were still experiencing the tough winter in the Atlantic, which drove an exceptional increase in claims being reported, but small event (21:34) claims.

So that essentially drove the lowest severity back in Q2 of 2015. Now as we look into Q2 of 2016, we're back in more of a normal pattern, consistent with our five-year average, so that's actually driving an increase in severity in the Atlantic. So it really is the Atlantic impact, but also a change in the mix between Alberta, Ontario and the other provinces in the country.

A - Charles Brindamour {BIO 7012323 <GO>}

Before we go into future redirection, I guess, when we looked at the severity this quarter, there was not a jump in a province that was a cause for concern. It was rather a mix by province that led to an increase in the average severity across the land. And therefore, not necessarily reinforcing the inflation trend that we've observed in the previous quarters.

A - Darren Godfrey {BIO 19791482 <GO>}

So from a rate standpoint, we were pretty much flat in the quarter. We had some reductions obviously in Ontario being offset by increases in other provinces. So as we look at the very different provinces, we have rates increasing in Alberta. We have just applied and received approval for a rate increase in Ontario. We have rate increases flowing through in the Atlantic, and probably, for the first time in many years, some rate activity in Québec, as well, too. So that's all in reflection in terms of some of the claims inflation that we've seen in the past. And we feel as if that those actions together with the underwriting actions and claims actions, we'll address some of that inflation that we've seen in past quarters.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you very much.

A - Charles Brindamour {BIO 7012323 <GO>}

That's exactly right. Thanks, Darren.

Operator

The next question is from John Aiken with Barclays. Your line is open.

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

Good morning. The improvement on the underwriting income that we saw on the commercial auto, it does look like net claims are coming down. Net earned premiums have been caught reasonably stable over the last four quarters. Are we seeing some stabilization in terms of the frequency and severity that you'd seen in the past quarters? Or is this actually some tangible impact of the actions that you've taken over the last while?

A - Charles Brindamour {BIO 7012323 <GO>}

Alain, why don't you break down what happened in the quarter and give a sense of direction?

A - Alain Lessard {BIO 21962461 <GO>}

Yeah. So, well, like I say, 90% combined ratio in the quarter, we're very pleased with that, but like we said, we look at this line of business on a 12-month basis. So we're going to continue our action, because we're not there to our 90% objective yet. So we're continuing on the action and the corrective measure we're taking.

Relatively, in terms of severity and frequency, that was relatively stable over the line. We've got a bit less large losses in the quarter, but for the record here, and we're coming back in a certain week to a much more normal prior-year development. We had in 2015 positive prior-year development. And now, we're more back to a more normal in the 3% zone.

And as we mentioned last year, we were affected by the exchange rate correction of the reserve. That being said, our plan just started this year in terms of corrective measure. So the part that is earn in the (25:10) average premium, that will take time. We still have a very little portion of that plan that is earn and we're continuing to take the corrective measure. It's going to take probably nine months to 15 months to get that to see we've earned everything on the plan and the corrective measure we stated and put in place.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think the direction is good. Very pleased might be an overstatement.

A - Alain Lessard {BIO 21962461 <GO>}

Yeah.

A - Charles Brindamour {BIO 7012323 <GO>}

I think we're pleased with where this landed. One of the things that I like to look at to get a sense of direction is the difference between the average rate written in the quarter versus the average rate earned in the quarter. And so we've earned in the quarter 2.3% rate increase in commercial auto, and we've written in the quarter about 4.5% rate increases. And so this gives you a sense that there is rate momentum building. Now, this is just the average.

Obviously, the plan that Alain has put in place with our teams across the land are not average rate increases. They're actually very targeted. And so the impact of very targeted action do not translate into what you see in the average rate. You actually get a better pickup than that because you risk-select as you do that.

So, I think, encouraging direction in the second quarter, a lot of focus still on the commercial auto action plan, even greater focus, I think, in trucking, which is an area in need of greater correction, and looking good, I think, for the next 12 months to 18 months.

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

I apologize if this was actually in the formal commentary, but what has the impact been from the pricing actions on the number of units within commercial auto?

A - Alain Lessard {BIO 21962461 <GO>}

There is probably – the units in commercial auto are down by about 3%, okay? But it's like very – when we look at units in commercial auto, things can vary a lot between premium and unit. We have policies out there that are at basically C$500 or C$600, and we have other policies and program that can be in multi-million dollar. So the price action, I would say, would have to decompose everything between (27:38) fleet trucking to see the exact impact. There is some impact on the price actions coming from the action we're taking, but it very – like we say, we follow that mostly on the premium side, because there's too much volatility. Premium by premium on action and the way we referred (27:59) also policies.

A - Charles Brindamour {BIO 7012323 <GO>}

I think the way to think about this is fleets tend to cloud the unit count from quarter to quarter. But when Alain talks about a 3% drop in units in the quarter, it's important to keep in mind that Alberta's drop in units would have been double that in the quarter, and therefore, a very significant driver of that number.

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

Understood. Thanks. I'll re-queue.

Operator

The next question is from Geoff Kwan with RBC Capital Markets. Your line is open.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi. Good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Hi, Geoff

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Just I have a question on the ridesharing initiative you got in Alberta and Ontario, just how to think about the impact on premiums. And then also similar to that, is it fair to think that this is something you're looking to do as other provinces roll out similar programs?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. I think that anywhere where private enterprise is allowed to operate, which is unfortunately not in every province, we'll be happy to look at solutions like that because Canadians are embracing those sort of services and we want to be a facilitator of that product.

I'll let Alain talk about sense of quantum or how we're thinking about that. Go ahead, Alain.

A - Alain Lessard {BIO 21962461 <GO>}

Okay. So I think our policy like we said earlier in the call, is really one single policy that will cover basically all Uber driver and passenger. It's based basically on kilometers. It's not a price based on units or car or things like this. It's really based on the amount of kilometers driven by the Uber driver. And that will be recorded not as a one policy, one premium for the full-year earn over 12 months. It will be recorded every month as we receive kilometers from Uber and reports on that part.

So this is how we accomplished. So it will be earned as it will be written. I think that's important to understand. It's very early – the amount of premium will be very much affected by the popularity of the ridesharing and how much people are using Uber. So it's very early to tell how much premium we'll look at, that will be in a better position to report on that at the next quarter. But we expect that will be material in terms of when we look at the commercial auto volume next quarter.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Yeah. I think it will be material, right? As opposed to not material?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think that when we look at opportunities like that, there's a long-term angle and there's a short-term angle. And as we've talked about before, we think that sharing economy is a heavy trend that is taking place now and that will have big influence on our industry over the long run. And that's why we've tried to be on that trend fast and that's why we're partnering with these folks.

There is a business opportunity in the short term. It'll start to materialize in the third quarter. I think we ought to think about this in tens of millions of dollars for now and when we get more visibility at the end of the third quarter, I will give you a better picture of where that is headed.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Thanks. And just the other question I had was, this push that you guys are making within the specialty lines. Just wanted to get a sense on how you're thinking about like targets that you'd like to achieve and within what timeframe are you thinking about that.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So specialty lines is an area where we're under represented at the industry level. And so this has been, I would say, a meaningful drag on our aggregate outperformance. As you know, we think about outperformance line-by-line, product-by-product, but this is a segment that's been, for us, generating sub-90%s combined ratio five years in a row basically. So I think we've decided to reorganize to gain more exposure to that segment, better organize ourselves to build on the expertise that has delivered a strong track record in the past, and as folks who wake up in the morning and think about specialty lines. And that's what this new division is all about.

And I think we want to make sure that brokers across the land know that we're a top player and we have tough people in that space. And so, that, I think, is the main idea here. And the idea, I think, is to own a bigger, if not, a much bigger portion of the underwriting profit pool that exists in that space.

So, I'll let you add some color, Alain.

A - Alain Lessard {BIO 21962461 <GO>}

Yeah. All right. I think it's important to also understand that we're not starting from zero. It's not like we're a non-player in specialty lines. We're starting with a volume right now when we look at all the lines we define as specialty lines of anywhere between C$650 million to C$700 million. We have an aspirational goal to get to eventually C$1 billion, but I think the first aspect is really to leverage what we have because when we look at our specialty lines across the country, our representation and our presence is very, very different province by provinces.

So our first goal is to make sure that whatever is available in terms of expertise, product in one province is also available everywhere. So we will leverage the expertise that we have across Canada and build on that expertise by adding people, recruiting experts in those line, adding products and build, like Charles said, the broker and client awareness of that.

And it's also important to think that we're going to do that with the same rigor and discipline we've done and we've applied to our regular business to maintain our combined ratios, sub-90%s, going forward.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think success will be judged by a portion of the underwriting profit pool that we'll be able to grab in that space. And I think the additional focus on that division hopefully will help improve our track record in that space.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Great. Thank you very much.

Operator

The next question is from Meny Grauman with Cormark Securities. Your line is open.

Q - Meny Grauman {BIO 15238080 <GO>}

Hi. Good morning. Just wanted to follow up on the ridesharing. Now that you have these programs in place and for when the customers in the car, but then also when the driver is waiting. Is it sort of mission accomplished and you have a product suite for this ridesharing phenomenon or is there – I guess I want to ask, what's the next steps here? Is there another challenge in this new area that you need to come up with a solution for or you basically have dealt with this? I don't know if you call it a problem or just a new development in your space?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, I think it depends if your question is focused on Uber, per se. But for us, the opportunity is much bigger than what's been announced recently. I think the opportunity is how the sharing economy is basically changing insurance to a certain extent, not just in ridesharing, but also in car sharing and home sharing and expertise sharing. And our thought process is to lead with solutions as startups will come and basically broaden the sharing economy.

And Turo was a really good example of that, which is a great car sharing model that's very popular in the U.S. and that started to operate in April. Here in Canada, we're also partnering with them to find insurance solutions. So I think that the Uber solution is step one of many steps in what we think is a pretty broad range of opportunity, specifically with regards to Uber, Alain or Darren, I'm not sure – other than going to other jurisdictions, what else there is to take?

A - Alain Lessard {BIO 21962461 <GO>}

Well, I think what we saw – I think the first thing is automobile is very much regulated on the product side at the province level. So I think we have now a product available in Alberta, a product available in Ontario. I think there will be discussion in other jurisdiction to go in that same direction. So, yes, there's still work to do on that side. And I would say, probably, that – that was the biggest implementation, but the reality is these model will continue to evolve. And this is like the first iteration of the product. I think we can expect some adjustment going forward as both us, the industry, the regulator adapt and learn more about the sharing economy. But, I would say, the main for us was really getting the first product out.

Q - Meny Grauman {BIO 15238080 <GO>}

Thanks. And then if – yeah?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, in all of this, the traditional boundaries of personal versus commercial are being challenged. And telematics also is bringing a whole new set of ways to think about how to provide protection as people move from point A to point B. We lead in personal. We lead in commercial. We lead in telematics. So we feel we're very well placed in, at least, on the automobile side of things to find business opportunities as the world change.

Q - Meny Grauman {BIO 15238080 <GO>}

Thanks for that. And if I could just ask a question related to the Fort McMurray wildfires, so the losses came in below the range that you initially published. And I was wondering whether that is just a normal function of just you had an estimate and reality doesn't always just line up with an estimate, especially early on? Or was there anything else that you would highlight maybe that was a more active response that mitigated some of the losses that you initially thought you would take related to that event?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And, I think, just for folks to understand the pieces here, these fires emerged on Tuesday. You will recall that our first quarter earnings call on the Wednesday. We started to image through satellite the damage on Thursday, overlaid our exposure through geocoding on Friday. And Monday morning, we issued a press release that said that we thought that this would be between C$1 and C$1.20, and I think three months into it - or two-and-a-half months into it we're seeing - it's actually C$0.97, so that is the process. I will let Patrick give his perspective on why it's C$0.97.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. Thank you. So you described it well, Charles. This is the process we use to come up with the estimate of a C$1 to C$1.20. All these exercises, it was clear with image the area that were fully destroyed. So the total losses were fairly easy. We had obviously the information on the cost to rebuild. And that piece stayed the same up to now. But obviously, together, total estimate we need to make a few assumptions on other stuff like what's the amount of content, what portion of - partial losses would be around that fully destroyed area.

And it's within those assumptions that when we were able to reenter the site in June and inspected all of those offices, we had a bit of a savings compared to our initial estimate. So it's really into those other partial losses, how much - we have a bit of lower amount of smoke damage that we estimated initially. The smoke damage was less than what we assumed. So this is what has driven the estimate down.

In terms of gains in how fast we responded, for sure, this exercise bringing up satellite imagery using geo-coding has allowed us to get the operations well prepared for the response, but also plan in advance the vendors and the capacity we'd need on the ground. So we're at a point where most of the auto claims are closed. And, for sure, since you pay a replacement cars during that process and also additional building expense as you repair the houses. The faster you put our clients back on track also has savings for us.

Q - Meny Grauman {BIO 15238080 <GO>}

Thank you.

Operator

The next question is from Doug Young with Desjardins Capital. Your line is open.

A - Charles Brindamour {BIO 7012323 <GO>}

Hi, Doug.

Q - Doug Young {BIO 5640851 <GO>}

Good morning. So I'm going to go back to personal auto. And, Charles, it sounded like you were disappointed in the results in the quarter. And then, if I look at the response just around the frequency with the two weather events and I can wrap my mind around that, and then on the severity it sounds like it's more mix-related.

So I'm wondering where the disappointment really ebbs from. Is there some pressure you're feeling in Alberta on the BA (42:09) side, in Ontario on the accident benefits side? Or is there additional challenges or issues that you're struggling within auto? And then, if there is, can you talk about it and what you're doing to address it?

A - Darren Godfrey {BIO 19791482 <GO>}

Yeah. Well, I think 96% is disappointing. Period. And whether it's - you can explain it - whether it's a trend, whether it's mix issues, 96% is just not a great combined ratio in automobile insurance. And we express it to you the way we see it.

Disappointing is different from being concerned, and I think it's a difference I would make. It's not like we looked at the quarter and felt, oh, my God, this is bad. That's not – it's disappointing because the absolute outcome is not as good as what we would like. But the trends we've observed in the country were not reinforced necessarily in the quarter, but we applied credibility to the trends that we've been observing for a few quarters or a year plus in some jurisdictions.

And I think Darren alluded to that earlier, bottle injury (43:29) inflation in Alberta, we've talked about that for some time. We've taken actions both from a pricing and from a claims management point of view is certainly issue number one.

I think the Ontario environment has been in the rate reductions and a reform world for four (43:50) years. There's been inflation building up in the system, which we need to tackle, and same thing in the Maritimes. Québec is slightly different. Québec has been a fairly stable cost environment in a rate decrease world.

So I think we use inflation from coast to coast, but I think in Québec, it is a question of restoring rates to a level that encompasses new investment income and the new environment. There's been a bit of physical damage inflation, I think, in Québec. And no change really in the charter. We're just acting on our plan in each of these jurisdictions, but disappointed with 96%. Period.

I'd like to ask Patrick to give a bit perspective on some of the action plans because, yes, we talk about rates, but rate is not the only way to deal with inflation. And, in fact, you do create an advantage when you over-index other than rates how do deal with inflation. So why don't you, Patrick, give us a perspective for some of the nature of the action plans that you have in mind?

A - Patrick Barbeau {BIO 18476397 <GO>}

Thank you. I will start with Ontario. You might recall that now four years ago, we have reshaped our claims operations to address some of the trends we were seeing in AB and BI and this was around making sure we had teams focused on the BI special handling units and we're looking at those cases, and also on AB to make sure we'd keep the minor injury within the guidelines of the regulations.

So this has been very – or quite successful or effective in managing the claims inflation in Ontario. And since then, with the trends we've observed in Alberta as well as in some of the Atlantic provinces, we've exported those same approach in addressing, because you might recall in Alberta, for example, a couple of court decisions that allowed chronic pain to be used as a reason to bring claims outside of the minor injury cap, which has created more activity on the BI side. So that's certainly one source of the inflation we see in Alberta.

Since then we have increased our staff level on the BI claims handling team to be more proactive in handling those claims and keeping them within the minor injury regulation. We have built our special handling team similar to what we have in Ontario, and our protocols and guidelines to manage chronic pain, concussion, those types of claims. And we have also increased the staffing for surveillance activity. So those are examples of what we've done in BI and we're following the same path also for Atlantic.

On the physical damage, there was also an important benefit that we capture because of our management of supply chain, leveraging our size and getting involved into the purchasing of parts, for example, our ways (47:16) that we add limit the inflation. And also our new national claims system is another way to not only have gains on the expense side, but also in managing the indemnity, control better the indemnity. So all of that are contributors to tempering the inflation in auto.

A - Charles Brindamour {BIO 7012323 <GO>}

Good. Thanks, Patrick. And I think we talk about the rates that we've taken and what we expect at the industry level across the land. But I think segmentation is really important here. And maybe I can ask Darren who's been what, a month on the job now or two, to talk about some of the way we leverage segmentation, to tackle some of that inflation.

A - Darren Godfrey {BIO 19791482 <GO>}

Absolutely, Charles. So when we talk about taking rate increases across the very different provinces, these are not flat rate increases for all customers. They're heavily segmented using further refinements in terms of the variables we have available. For example, UBI that we've had introduced as well has brought about more segmentation power. So, yes, we are driving rate increases across the portfolio, but we're through segmentation able to tilt our portfolio to further gain margin to help address some of the – and to combat some of the inflationary pressure that we're seeing.

So as we move forward we're continuing to advance on segmentation. We're continuing to look at more data, more variables, greater techniques in terms of – to continue to refine our segmentation to really identify those inefficiencies in the marketplace that we can take advantage of.

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks, Darren.

Q - Doug Young {BIO 5640851 <GO>}

Perfect. Well, maybe I'll take a step back and go 10,000 feet up. Charles, you put up C$0.83 and Fort Mac was C$0.97. And so, C$1.80. And I know things will ebb and flow from quarter to quarter. But assuming there's no similar type of catastrophic events, is C$1.80 on average what we can expect? Again, quarter-to-quarter fluctuations happen. But is C$1.80 a reasonable run rate or is this kind of – in your view, was this a – if you back out Fort Mac, was this a particularly good quarter or is there upside?

A - Charles Brindamour {BIO 7012323 <GO>}

I think that I hate to speculate off a quarterly base. I will say this. I think the cat burden, excluding Fort Mac was probably lower than what we anticipated. So I think you ought to put that in your thought process. We put the spotlight on Fort Mac, because this is the costliest natural disaster in the history of the industry. But the remaining cat loan was slightly better than what we anticipated. Therefore, I would say caution multiplying or extrapolating the quarter, I think that there's been favorable trends that were present in lines of business.

But I would say, our action plans have been paying up in the quarter. So, for me, if you exclude Fort Mac, I wouldn't say this was an extraordinary quarter. I think that things are moving in the direction that we're aiming for and we're disappointed with personal automobile.

Q - Doug Young {BIO 5640851 <GO>}

Perfect. Thank you.

Operator

The next question is from Tom MacKinnon with BMO Capital. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. Thanks very much. Two questions, just going on a little bit more on the Alberta BI claims pressures that we talked about a couple of quarters ago. Can you give us an update as to anything that's happened with respect to the regulatory front there or anything that you've guys done through rate hikes and other specific things to tame that and how far along we are in the process? And just a little bit more color on the results there.

And then, so elaborate a little bit more on the service centers, the initiative you have here as you roll them out, how should we see that impacting the bottom line, maybe in terms of claims cost or expense ratios or whatnot there? Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

Okay. All right. Let's start with Alberta BI, I will ask Patrick to give you a perspective on this and if Darren wants to chime in. And then, on service centers, maybe you can take that one as well, Patrick.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. So, on BI, a lot of actions or discussions on the regulatory front in the quarter, but nothing that has been finalized in the sense that there is a number of regulations that are due for renewals; in fact, eight or nine of them in the province. And through IBC and discussions with the regulators, we have identified, which one we thought were more – could potentially more actively help the situation on the BI inflation and those are the ones on which they are focusing right now to renew and bring improvements. But that will come more in the latter part of the year, probably effective beginning of 2017.

But it's a good sign that they are opening up this discussion with the industry. And we can provide support in how we think this will help the situation. So minor injury guidelines regulation is on top of that list. The main one that was challenged, as I said, was some of the reason for the decision.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Darren, do you want to add anything on this?

A - Darren Godfrey {BIO 19791482 <GO>}

No, just it's encouraging, but it's very early days in terms of the process. We have a deadline of the end of August to provide commentary back to the superintendent. So we're very active around the minor injury definition, pre-judgment interests and a few other measures that we've discussed before. Obviously, then it needs to get through the political process after that space, so...

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think...

Q - Tom MacKinnon {BIO 2430137 <GO>}

And the rate hikes you put in that business, so are they – I know you've talked about them before. Just any kind of update on how far we're through in that process?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. It's two years in a row, by the way, that we've been active on that file. So, recap, Darren, maybe for Tom of rate action (54:07).

A - Darren Godfrey {BIO 19791482 <GO>}

Yeah. So we took rate action back in April of 2015. And then we followed up in May of this year with another 8% on top of that as well. We've probably pushed, I would say, cumulative, sort of 12 points, 13 points in the last couple of years. We're doing some other things in terms of looking to manage the quality of business, underwriting, et cetera, to essentially look to gain further margin there as well.

We'll look to potentially take more rate increase as we need to on that one.

A - Charles Brindamour {BIO 7012323 <GO>}

Depending on how things pan out. I think that the folks in Alberta in government understand the issue well. I think we also have to understand that they have a lot of things to deal with. We also have to understand that there is a new government. In fact, that's been there for less than a year or so. I think we're working with these guys to make sure that the Albertans have a stable automobile insurance product. But we're not counting on that, to be honest. And, therefore, we've been very proactive from a claims management point of view segmentation as well as pricing, and we'll keep doing that in the coming weeks and months if that trend persists.

Why don't we talk about service centers?

A - Alain Lessard {BIO 21962461 <GO>}

Yeah. So, as Charles said, we just opened our second one in auto in July. Overall, the service centers' main objective is to improve customer satisfaction and to, in the process – because it reduces cycle time. It's easier for clients, more convenient one-stop process.

Overall, from an economic perspective, there are gains when you reduce the cycle times. And because we have a streamlined process also, we have gains on the indemnity itself. But overall this is our – at this point, we look at it; the two will probably be about the same. So, the additional cost of running the centers should be about in line with the savings we have on those indemnities. So that, and overall, gains on the bottom line but clearly a lot of gains from a customer satisfaction perspective.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, well that's it. We're trying to up our game in terms of changing our customers to get back on track when it comes to car insurance. Obviously, strategically speaking, our role with the supply chain is changing by having better control of where the repair process is sourced, where the parts are sourced, and that's, I think, in time where the economic upside will be. But in the near-term, as we test our skills, the clear objective is to raise the bar in terms of what Canadians can get when they have an accident.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Thanks very much.

Operator

The next question is from Paul Holden with CIBC. Your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. So first question is related to personal auto and what I want to ask in the context of all the information you provided on price increases and actions to mitigate cost inflation, you continue to increase the number of units at a pretty good clip, 5% year-over-year this quarter. So just wondering in addition to maybe what you've already said, what makes you comfortable growing that number of units in that business at such a pace?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, I think the – you have to keep in mind that that growth is not freight (58:00) driven. That growth is driven by distribution activities. That growth is driven by telematics. It's driven by the fact that it's easier to get a quote; it's faster to get a quote from us. It's driven by the fact that our direct platform is now present and established from coast to coast. We can pound from a response marketing point of view on that front. And that, Intact Insurance also is promoting itself more and to a greater extent. And I think that this in my mind is a way to grow without using your margins basically. And it's a sustainable way to grow as opposed to reduce rate.

Personal automobile is a really good business and the fact that we're disappointed with the Q2 results doesn't mean that we don't want to grow in that business. I don't think we would sort of shortcut rating adequacy to grow though. That's not something we're prepared to do. That's not how we run the business in general, and certainly, in a period where you have trends in the system, I think you need to find other ways to grow, then price and manage your claims to tame that inflation and that's exactly what we're doing.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Got it. And then sort of similar question on personal property. If we look at the unit growth there, 8% year-over-year for the quarter, running ahead of personal auto and as we know those two products are often sold together, but clearly better growth in personal property in terms of units. So just wondering what's driving that extra growth in that line of business.

A - Charles Brindamour {BIO 7012323 <GO>}

Darren, what's your thought?

A - Darren Godfrey {BIO 19791482 <GO>}

Well, I think in addition to what Charles talked about in terms of investments in our marketing efforts, branding, et cetera, we've been very active from my product development standpoint in this particular line of business. Obviously, most recently, with our Enhanced Water Damage Package, good acceptance from the marketplace. It's – that alone is driving some additional top line for us as well. But in terms of our broader product suite and rounding out our product suite beyond homeowners has been very, very successful to-date and should continue in the short to medium term.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And I think – I mean, the thing one should not underestimate is the synergy that exists between our distribution activities and the success of Intact Insurance. And I think the highlight for me this quarter is the fact that our distribution business is doing very well both from a top line and from a bottom line point of view. And they're a very big contributor to our growth to, at least, Intact Insurance's growth in personal lines. So, maybe the way you can sort of talk about your observations in terms of our distribution operations, both from the top and bottom line.

A - Patrick Barbeau {BIO 18476397 <GO>}

Sure. So, as you noticed, the quarter earnings were very generous in terms of the distribution earnings. So, up nicely from last year. And we attribute that to both the improved profitability of the brokerages themselves, that was most of the increase. And then the fact that we've added brokers over time, which is generating additional brokers.

I did mention that we are – we've added or invested more in the quarter, C$66 million in the network, which will eventually drive further earnings in the future, as well as top line growth in the future. But between past acquisitions and the current brokerage, and the fact that we are branding with our brokers as well is also having a positive impact on the top line.

So when you combine the growing network, the fact that we're branding with them, that we're better integrated is supporting the growth that we're seeing in the unit counts and - personal lines particularly. So it's having a positive impact both top line and bottom line.

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks.

Q - Paul Holden {BIO 6328596 <GO>}

Got it. Thank you.

Operator

The final question is from Brian Meredith with UBS. Your line is open.

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

Yes. Thanks. Just a couple of quick ones here. Charles, just back on personal property, just so I understand this, are you just trying to take advantage of the continuing firming rate environment to grow that business? Are you okay with your underlying profitability in the business right now or you're trying to continue to improve your underlying profitability?

A - Charles Brindamour {BIO 7012323 <GO>}

We're seeing that our current price points, so to speak, is leading to better retentions. And this is a sign that the current environment is indeed firm. And to the extent that we can have a competitive offer out there and work on our average rate position, we will do it. And that's what we're doing. And I think, as Darren explained the top line movement earlier, I said there's about 6 points of sum insured as well as rates. I mean, this is a sign of that.

I think we're rolling out very good products at the moment that people are embracing and that we're very comfortable in terms of what it does from a rate adequacy position, and very happy to sort of sell as much of that product as possible just because of what we think it does to the overall performance of that line of business.

So, we're trying to be opportunistic in the marketplace that we think is conducive to gaining margin, because this is a business that we've gone from underperformance five years ago to about 4 points of outperformance now. There is uncertainty around - or volatility around personal property, and I think it is a good business to have buffers to do well in bad times. And I think this quarter's results reflect a little bit of that perspective we've had for a number of years now.

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

Great. A quick one for Louis. The Cornerstone acquisition, will that have much of an impact on distribution revenues?

A - Louis Marcotte {BIO 18040440 <GO>}

So, that was a Q3 acquisition. BrokerLink...

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

Right.

A - Louis Marcotte {BIO 18040440 <GO>}

Completed that acquisition, so a very nice transaction. We don't expect that will have a huge impact this year. It will start towards probably Q4, but I would say it will have a positive impact next year. So it's one of many in the plant. You might not notice itself, the impact of that transaction specifically, but it will certainly feed into the growth of distribution income next years.

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

Great. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

There are no further questions at this time. We'll turn the call back to the presenters.

A - Samantha Cheung {BIO 19462616 <GO>}

Thank you, all, today for your participation. Following this call, a telephone replay will be available for a period of one week while the webcast will be archived in our website for a period of one year. A transcript will also be available later in the day in our quarterly financial archive. Our third quarter 2016 results will be released on November 2. And with that, thanks again, and this concludes our call for today.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.