Q4 2011 Earnings Call

Company Participants

- Charles Brindamour, CEO
- Dennis Westfall, Director of IR
- Mark Tullis, SVP and CFO
- Martin Beaulieu, SVP, Personal Lines

Other Participants

- Andre Hardy, Analyst
- Bryan Brown, Analyst
- Doug Young, Analyst
- Mario Mendonca, Analyst
- Paul Holden, Analyst
- Shubha Khan, Analyst
- Stephen Boland, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Good morning. My name is Steve and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corporation's Q4 financial results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

I will now turn the call over to Dennis Westfall, Director of Investor Relations. Please go ahead.

Dennis Westfall {BIO 15155973 <GO>}

Thank you, Steve. Good morning, everyone. A link to our live webcast and background information for the call is posted on our website, www.intactfc.com under the investor relations tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on the conference call today.

Here with me today are Charles Brindamour, Chief Executive Officer; Mark Tullis, Chief Financial Officer; Martin Beaulieu, Senior Vice President, Personal Lines. And Alain Lessard, Senior Vice President, Commercial Lines. We will start with formal remarks from

Charles and Mark, followed by a Q&A session. Martin and Alain will be available to answer your questions during the Q&A session.

With that, I will ask Charles to begin his remarks.

Charles Brindamour {BIO 7012323 <GO>}

Thanks, Dennis. This morning we announced a Fourth Quarter net operating income of CAD152 million or CAD1.14 per share. That is 61% higher than last year reflecting an excellent underwriting performance. Our combined ratio of 92.7 is a reflection of strong underwriting results across all lines as a result of disciplined deployment of our strategy as well as relatively mild winter conditions.

From a topline perspective, we reported premium growth of nearly 50%, reflecting the addition of AXA Canada and a rebound in our organic growth. As anticipated, our earlier decision to restart marketing in the Ontario direct channel proved successful, generating growth of 4% in the Fourth Quarter versus a decline of 4% last quarter in this channel. Overall our underwriting performance and steady investment income resulted in an operating ROE of 15.3%, while book value per share increased 12% from a year earlier.

We ended the year in a solid financial position which enabled us to increase our quarterly dividend by 8% to CAD0.40 a share. This marks the seventh consecutive year of dividend increase for IFC's shareholders.

When it comes to our outlook for the industry, growth for the industry last year appears to have played out as we had anticipated. After nine months, the industry has recorded 6% growth in auto, primarily driven by Ontario; 8% in personal property in reaction to years of heavy weather-related losses; and 3% in commercial lines. As the drivers behind this growth will likely continue to impact 2012, we expect similar growth in the coming 12 months.

The low interest rate environment and reinsurance market conditions should support our outlook and will likely lead to firmer conditions over time.

From an underwriting perspective again after nine months, the industry is tracking to about a 102% combined ratio. For 2012, we anticipate some improvement in personal lines, resulting from reforms in Ontario as well as continued premium increases while commercial lines should remain relatively steady. Overall, we anticipate that the industry will report a breakeven underwriting result in 2012.

Turning to the industry's ROE, we do not expect material improvement in the near term from the current 7% level that it stood at through three quarters. Although underwriting might improved slightly, we anticipate this would be offset by the negative impact on investment income from the low yield environment.

Looking specifically at Intact Financial, we strongly believe we will continue to outperform the industry's ROE by at least 500 basis points, our stated objective.

When it comes to auto Ontario, in the reforms as well as our own initiatives to combat fraud continue to yield the benefits anticipated. Throughout 2011, we have referred to an expected loss ratio improvement of about 12 points within 18 months of reform. With only one quarter remaining in this timeline, we maintain our view that these benefits should materialize as outlined.

However, we remain disciplined in this market and maintain our caution for two reasons. First, we continue to believe that the degree of uncertainty of the potential outcomes in the mediation or dispute process warrants continued monitoring. Second, a court decision in December allowed the stacking of physical and psychological impairments when determining catastrophic injuries.

Although Ontario auto industry results for the first nine months of 2011 show meaningful improvement, we estimate that the combined ratio for the industry in that province is likely still ranging between 105% and 110%. As such, the level of approved rate changes for the industry announced in the past few quarters is a positive sign but further rate action is likely without further meaningful improvements in results.

Our profitability gap with the industry in that province remains strong at about 14 points, which affords us the flexibility to continue our actions to improve growth. Outside Ontario, while conditions remain stable, we are monitoring trends of increased pressure on existing legislation and reforms.

In personal property, losses from catastrophes primarily relating to a severe wind storm in Calgary during the quarter amounted to CAD24 million. Overall, cat losses totaled CAD32 million, in line with the bottom of our expected range, given the larger size of our Company post the acquisition of AXA. For the full year, the combined ratio in that line of business was 103.5% an unacceptable long-term level but one that included about 15 points of cat losses.

We continue to monitor and adapt the increasing level of severe weather occurrences in order to create a sustainable competitive advantage.

Pricing conditions in commercial lines remained very competitive. We expect modest improvement over time, likely to be driven by catalysts including continued low interest rates, firmer reinsurance conditions. And the fact that the industry's loss ratio deteriorated by nine points after nine months in 2011 in that line of business. However, we do not anticipate meaningful improvements in the short term.

Mark will provide an update on some of the metrics related to the integration AXA business. But let me make a few comments. Overall I would say that our integration is on track. I am pleased with the response we continued to see from employees, brokers. And customers. This is important because ensuring that brokers and customers embrace our offer and continue to receive top-notch service is really important, particularly during the integration phase.

Bear in mind that we remain in the early stages of the integration and the Fourth Quarter did not provide enough information to determine an ongoing success rate. We believe we will have a good visibility in three to six months as customers receive our product offering and the associated price changes that come with moving from AXA to the new offer from Intact Insurance.

I want to take this opportunity to thank our people from coast to coast for the huge effort going into our continued industry-leading service to both brokers and customers despite what is an incredibly fast-paced integration.

In conclusion, I believe the importance we place on underwriting results will continue to serve us well in the current low interest rate environment. Given the quality of our operational platforms, the flexibility provided by our financial position. And the combination with AXA Canada, we believe that we will continue to outperform the industry and strengthen our leadership position.

With that, I will turn the call over to our CFO, Mark Tullis.

Mark Tullis {BIO 4180270 <GO>}

Thanks, Charles. Today we announced strong operating income driven by improved underwriting results. Earnings per share of CAD0.62 were down from a year ago, reflecting restructuring and integration expenses as well as a contingent consideration payable to AXA France. On an adjusted basis, excluding acquisition-related items, we recorded EPS of CAD1.14, up from CAD0.96 a year ago.

As a reminder, our agreement for the acquisition of AXA included a contingent consideration which requires us to pay up to an additional CAD100 million based upon the development of AXA's 2010 year-end reserves. After our review of their reserves and on the heels of a favorable Fourth Quarter, we recorded a payable of CAD89 million. CAD48 million as an increase in the purchase price and CAD41 million as a nonoperating expense in the quarter. If the AXA business continues to develop favorably in the future, we would take additional charges to nonoperating income up to a maximum of CAD11 million.

Topline growth of 49% was excellent. We estimate that the addition of AXA Canada contributed approximately 45 points of the increase in premiums and the recovery in our organic growth contributed the rest. As Charles mentioned, AXA retention is holding up so far but it is early. So we remain cautious. In three to six months, we should have a much better idea of the true retention.

Slides 8 and 9 show results by line of business. In personal auto, growth in premiums benefited from the addition of AXA as well as a rebound in our organic growth. Our 93.3% combined ratio was almost 10 points better than a year ago, reflecting benefits from Ontario reforms, our antifraud measures. And relatively mild winter conditions. The improvement came despite less favorable prior-year claims development in part to reflect the recent Ontario court decision that Charles mentioned.

Growth in personal property was helped by what we estimate was a slight upturn in our underlying unit growth. The 88.6 combined ratio reflects our continued focus on improving the results in this line of business, mild winter weather and a more normal level of cats versus the elevated level of the past two quarters.

AXA's contribution was most evident in our commercial lines business as premium growth reached 78%. The commercial auto combined ratio remained strong at 93% and commercial P&C remained solid at 95.7% despite lower favorable claims development.

On the investment side, net investment income of CAD103 million in the Fourth Quarter was up 45% from a year ago as a result of the additional investments related to AXA. However, declining yields continue to offset the underlying asset growth and the market-based yield of 3.9% was down from 4.1% in Q4 2010. We expect the declining interest rates to negatively impact our market-based yields in the coming quarters.

Our financial position remained solid at the end of 2011 with an MCT of 197%, CAD435 million in excess capital and book value per share of CAD29.73, 12% higher than a year ago. We ended the quarter with a debt to total capital ratio above our target level. However, we intend to allocate most of the CAD300 million proceeds from the January 1 sale of AXA's life insurance business towards reducing our debt. As a result, our debt to total capital ratio is expected to be back in line with our target early in 2012.

As Charles mentioned, we have made good progress on the integration of AXA Canada. Essentially all business is now being issued on Intact systems and we are closely monitoring the renewal action of AXA customers. We maintain our CAD100 million after-tax synergies target and expect to reach this run rate progressively by the second half of '13 with an CAD18 million run rate already secured in 2011 and a CAD50 million run rate expected by the end of 2012.

During the Fourth Quarter, we recorded CAD42 million of restructuring and integration expenses, bringing the full year 2011 level to CAD71 million. Because of accounting rules, the amount expensed in Q4 was below our expectations but our overall view of these expenses has not changed. We expect the majority of the remaining integration expenses to be charged in 2012.

On the reinsurance front, we increased our cat coverage to bring the combined entity's coverage back up to our standard and we continue to expect short-term supply chain benefits to offset the CAD15 million cost of bringing AXA up to our standard.

In summary, our disciplined pricing, underwriting, investment. And capital management have positioned us well for the future. We continue to expect the acquisition of AXA Canada to be accretive to net operating income per share in 2012 and by 15% in the midterm. With the progress made to date on the integration, we are well on the way toward building a world-class P&C insurer.

With that, I will now turn the call over to Dennis.

Dennis Westfall {BIO 15155973 <GO>}

Thanks, Mark. Steve, we're now ready to take questions.

Questions And Answers

Operator

(Operator Instructions) Tom MacKinnon, BMO Capital.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Thank you very much. Good morning, everyone. Just a couple questions. One with respect to the CAD18 million run rate in the synergies. But at the end of 2011, do you know what the actual synergies would have been in the quarter? I can't imagine they would have been CAD18 million because the run rate probably at September 30 was pretty well zero. Do you know what that was in the quarter? I've got a couple follow-ups.

A - Mark Tullis {BIO 4180270 <GO>}

A little short of 10.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, with respect to the CAD15 million in the reinsurance, is that going to be already in the First Quarter results of 2012?

A - Mark Tullis {BIO 4180270 <GO>}

Yes.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Were there any supply chain benefits in the Fourth Quarter? How do you expect to get these supply chain benefits in over -- is it going to be an equal offsetting adjustment that we should expect over the CAD15 million cost?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, I think, Tom, if you start with the CAD15 million, it's ceded premium and ceded premium here kicks in January 1 on a 12-month basis. You will get the full CAD15 million additional spread over the full year.

I think it's important to point out that the overall cost of the reinsurance program went up by about CAD30 million. The other CAD15 million being general price increases on the ceded premium. So it's important to keep that in mind.

The supply chain benefits themselves, there might be a mismatch by quarter but clearly for the full year, the supply chain benefits will ramp up unlike the ceded premium, which is even throughout the year.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So we will just have it -- the net earned all things equal would be down about CAD4 million each -- lower about CAD4 million each quarter and we'll just see how the supply chain benefits rollout. Is that --?

A - Charles Brindamour {BIO 7012323 <GO>}

I think that's a good way to look at it.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Then finally, the difference in tax rate versus what you guys normally had just on the operating basis, how should we look at this going forward? It was closer to 28. You have been 22. I know it's a function of the investment portfolio you would have picked up from AXA and how much dividend deductibility was in there and also kind of a function a bit of the underwriting income you would have had. But how should we look at this rate on an operating basis going forward?

A - Mark Tullis {BIO 4180270 <GO>}

I know you asked operating. But let me answer nonoperating and then come back and do operating because the nonoperating, it is even a bigger. Our effective tax rate nonoperating in total was 34.3 compared with 21.7. There's three items in there relating to AXA, the 41 million contingent consideration is nondeductible. There's transaction fees of CAD12 million nondeductible and then we had a tax of CAD3 million that was a one-time sort of deal.

So if you adjust for those three items, if you look at overall tax rate, you get down to 21.9, which is fairly similar to last year's run rate. The big change in the operating is due to the mix between dividends and non-dividend income. So regular income. And there's really two components of that. One is last year in Q4 the underwriting income was a lot lower. So the higher underwriting income was fully taxed, sort of dwarfs the benefit we get from the dividends.

The other thing is the investments that we brought over from AXA had fewer dividend paying investments. Our plan is over time to migrate those more towards the Intact mix but you are not going to see an immediate change in that. So that's something you will see some movement through the year and into the next year. But you're not going to see a big cliff at some point.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Well the operating tax rate is effectively a reasonable run rate but you probably could come down as you migrate these investments?

A - Mark Tullis {BIO 4180270 <GO>}

Correct. So if the underwriting income stays at the current level, I would agree with that statement. There's always some noise from quarter to quarter. But the two big impacts are if we make more underwriting income, the tax rate will be higher. If we make less underwriting income, tax rate will be lower. As you pointed out, as we migrate the AXA investments over to more of an Intact policy, the tax rate should come down.

Q - Tom MacKinnon {BIO 2430137 <GO>}

No change in that -- even the effective tax rate just with declining statutory tax rates going forward, is there any movement there?

A - Mark Tullis {BIO 4180270 <GO>}

Yes. So we will benefit from that this year. So on top of the stuff we just talked about, yes.

Q - Tom MacKinnon {BIO 2430137 <GO>}

What is that impact? About 2%?

A - Mark Tullis {BIO 4180270 <GO>}

I think it's about 2% down this year, yes.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So all things being equal, if this was under 2012 tax regime, that 28% tax rate would have been a 26% on the operating?

A - Mark Tullis {BIO 4180270 <GO>}

That's correct and the 34.3% would have been 32.3%.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So maybe somewhere around a 26% is -- okay, thanks very much for that.

Operator

Stephen Boland, GMP Securities.

Q - Stephen Boland {BIO 5546446 <GO>}

Good morning, just sort of one question relating to I guess mediation and Ontario auto. You mentioned that you remain conservative with your reserving when it comes to the outcome of mediation. I guess we have heard recently that there's thousands of mediation cases backlogged and some of the measures that FSCO are taking are not really working very effectively. So is there a point where there is continuing or increasing pressure on the insurance industry to try and settle these cases and what's your thoughts on that?

A - Charles Brindamour {BIO 7012323 <GO>}

Let me first say that FSCO has put in place in the past three months a number of measures to improve the mediation process, which are having a favorable impact and I applaud the work that they have been doing.

But when it comes to mediation, you often settle before mediation. So clearly there's a lot of activity to try to accelerate settlement before mediation. But beyond that, we will have to go through it and make sure that at the end of the day the indemnity settlement is what we think is fair as opposed to focus on speed here.

So we are going with the flow, making sure that we give the best service we can in the meantime but certainly the amount of the fair indemnity is more important than the speed for us. And that's why the approach we are taking is one of caution in reserve because it pushes the ultimate settlement date a bit and as such one needs to take a cautious stance.

Q - Stephen Boland {BIO 5546446 <GO>}

Is there any impact with the two-year anniversary coming up with the reforms that arbitration also becomes a bigger risk or that cases get settled more through arbitration? What does that pose for with your outlook in terms of reserving as well?

A - Charles Brindamour {BIO 7012323 <GO>}

Exactly. I think you are touching on an important point and the point is that when you look at mediation and arbitration, a big portion of the backlog right now comes from claims dating back before the reforms. There has been a rush of claims in 2009 and 2010 and many of these are being mediated.

Then a portion of backlog is related to post reform claims. But it's clear that because you have about indeed a couple of years to file up to arbitration, it's clear that there are claims that are not yet reported that we are not aware of that will end up in mediation. And that's in part why our stance on this is one of caution. Martin, I don't know if you want to add anything on that but --

A - Martin Beaulieu {BIO 15316652 <GO>}

No. That's very clear.

Q - Stephen Boland {BIO 5546446 <GO>}

I guess I just want -- I have heard from some people in the legal department, healthcare industry as well, that the measures that FSCO are taking, the blitz days, the hiring and mediation firms, they don't expect that to be very effective in terms of sort of getting rid of claims. I guess that's positive for you because you are holding onto the cash longer.

Is that -- you said that some of the things that they have done have been effective but that's sort of contrary to what a lot of other people are saying.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. But look, I think the bottom line is that you've got at the industry level now probably close to more than 30,000 files outstanding and the measures that FSCO has put in place are providing acceleration. But the sheer size of the backlog is huge. So when you look at the whole picture, the measures of FSCO are effective to deal with a portion of it. But you're starting from a very, very large backlog to start with and that might be where your contacts are coming from.

But FSCO is definitely focused on it and they are working at it on many fronts, whether it's system, process, blitz days, as you say. And so on. And so I think we will go with the flow on this one.

Q - Stephen Boland {BIO 5546446 <GO>}

Okay. Thanks, Charles.

Operator

Doug Young, TD Securities.

Q - Doug Young {BIO 5640851 <GO>}

Good morning. Just want to start big picture wise, Charles. And you mentioned in your opening comments that there's two things that drove your improved results, obviously strong underwriting but obviously mild winter conditions and mild weather conditions. I'm just trying to get a sense big picture wise, is this a normal quarter or is there -- can you give us a sense of what the split between those two items -- I guess what I am trying to get at is the weather conditions obviously were more adverse earlier on in the year but in Q4 they were quite favorable. What was the impact from that in quarter?

I guess the second part of it is, is there any reason to believe the seasonality that you have shown us in past -- quarter seasonality will change going forward as a result of the AXA transaction?

A - Charles Brindamour {BIO 7012323 <GO>}

All right. So to put your finger exactly on weather and break the change in result is a real tough one, Doug, even when you have 190 actuaries. But let me just say that the most tangible sign of milder winter conditions is through what we observe in frequency changes in the Fourth Quarter. And when you look at our frequencies in the Fourth Quarter across all lines of business, we are seeing a drop in frequency north of 5%. And I would say that a meaningful portion of the current accident year improvement may be a little bit less than half would be driven by the frequency movement.

So if you are brave enough to say that frequency movements are driven by mild weather conditions, you have your answer, I think. I'm just not prepared to go that far. But clearly the frequency is correlated with winter conditions here.

Your second question was related to the impact of seasonality on the AXA portfolio and this is a good one and I will point to two big distributional shifts that might have an impact. The first one is that we have more Quebec business than we used to in relative terms because half of AXA's business was in Quebec and given the nature of the business at Quebec, it tends to be more seasonal than for the rest of the country in automobile insurance.

The second factor is the fact that AXA's business was -- half of the AXA's business was commercial lines and as you recall at the investor day, we pointed out that our commercial lines distribution actually increased because of the AXA acquisition. Commercial lines tend to be less seasonal in nature.

We haven't gotten to the extent of assessing what those two trends would have on seasonality. But one goes one way. The other one goes the other way. So I suspect it wouldn't make a big difference. But we will make a note of this one, Doug. And provide some visibility next quarter once we have a better grasp of what it will pan out.

Q - Doug Young {BIO 5640851 <GO>}

Okay, just going back to the first one, Charles, is there any way -- I mean, you say 5% give or take lower frequency -- is there any way to kind of give us a number of how that would go from a combined ratio perspective, what the impact would be? Or is that --?

A - Charles Brindamour {BIO 7012323 <GO>}

I think that would be too adventurous for me to do that at this stage.

Q - Doug Young {BIO 5640851 <GO>}

Fair enough. Then the other question I had was around just the integration costs from AXA and I think -- correct if I'm wrong -- it was indicated that the integration cost would be roughly 1 times what the potential cost synergies would be. And if I look at what you have said, the integration costs so far have been CAD71 million and that's roughly half of the total. I know this is pretax in the CAD100 million is after-tax. But -- so that would indicate that there's going to be CAD140 million of integration costs.

I guess I'm just trying -- curious, is that correct and why the change? Are you expecting to get higher synergies as a result of the higher integration costs?

A - Mark Tullis {BIO 4180270 <GO>}

Right. So I think we have always talked in terms of ranges. And we do expect when the dust clears we will have integration costs approximately equal to the pretax and the CAD100 million is an after-tax number. So the CAD71 million we are saying we are approaching the midpoint.

A - Charles Brindamour {BIO 7012323 <GO>}

Our view has not changed on that, Doug. I think CAD140 million after tax is very close to CAD100 million and CAD100 million is a fairly firm number of synergies, I think Mark could comment. So no change from our point of view there and I think Mark could comment on the timing difference here, which is --

A - Mark Tullis {BIO 4180270 <GO>}

So basically there is -- we know what all the synergy expenses are. To the extent we haven't expensed them, they are built into our budgets next year. So they are identified. We know exactly what they're going to be. So if we could do what we like, we would have accrued everything at year-end and just gotten it over with and we'd tell you what the number is.

The problem is in order to reflect them in the accounting you have to meet certain standards. So to reflect severance costs, you have to be at a certain stage in the severance. To reflect lease costs, you have to be at a certain stage in terminating the lease and subletting. So what we had booked is what we are allowed to book from an accounting point of view. We expect almost everything else will flush out over the next few quarters. There may be a little bit going into '13 but basically we thought we would be able to get a little more into Q4 that is going to get pushed into 2012.

A - Charles Brindamour {BIO 7012323 <GO>}

Primarily because of how operating leases are treated.

A - Mark Tullis {BIO 4180270 <GO>}

Correct.

Q - Doug Young {BIO 5640851 <GO>}

Just one last one. You mentioned as a result of your positive reserve developments, they were a little bit below percentagewise your historical average and I think one of the things you actually marked out was the whole idea that psychological and physical damages can be additive to get to your catastrophic claim. And I am just kind of in a sense of how worried you are about that because there's been a big flip-flop on that front. How significant is that particular item concern wise?

A - Charles Brindamour {BIO 7012323 <GO>}

So on the prior-year development, lower the long-term range, I think there is the general caution in Ontario. There's this item you are referring to and then we've strengthened a few large claims in commercial lines.

On the stacking of psychological and physical impairments to determine a cat, we are not overly concerned by it. What we have done, Doug, is we went back to all open claims and assessed where we had -- where we could end up with a different settlement based on this new decision, increase the reserves accordingly case-by-case.

The real question for me is what happens prospectively and our view is that if a new cat definition was not introduced and as you know, a new cat definition is highly likely to be introduced in 2012 by FSCO. But let's assume this doesn't happen. The cost of that decision could be between 50 basis points and 100 basis points of loss ratio in Ontario prospectively. My view is that within one year we will have a new cat definition and this additional pressure so to speak will be gone then.

But 50 to 100 basis points of Ontario auto loss ratio, this is a little less than half our business could be the impact. But as you might've heard in my remarks, my view is still that within 18 months we will have generated 12 points of loss ratio improvement despite this decision.

Q - Doug Young {BIO 5640851 <GO>}

Okay. Thank you.

A - Martin Beaulieu {BIO 15316652 <GO>}

And the definition -- the preliminary definition that had been tabled by the working group in 2011 was going in the other direction that you could not stack psychological and physiological. So I think there is a certain level of urgency in putting that in place to bring back things to normal.

A - Charles Brindamour {BIO 7012323 <GO>}

Exactly. That's a very good point, Martin. I think this decision indeed highlights to FSCO the importance of carrying on their work and putting in place the new definition of catastrophic injuries.

Q - Doug Young {BIO 5640851 <GO>}

Thank you.

Operator

Bryan Brown, Macquarie Capital.

Q - Bryan Brown {BIO 16358540 <GO>}

Good morning. In Ontario, we saw that the auto rate approvals were about 0.8% but for Intact Insurance Company, the rate approvals were down 2.3%. Are you able to comment on this from a strategy perspective?

A - Charles Brindamour {BIO 7012323 <GO>}

Definitely. Do you want to take this one, Martin?

A - Martin Beaulieu {BIO 15316652 <GO>}

Yes, certainly. Well we had started back in 2007 to take rate increases faster than the market. In fact we were one year ahead of our next competitors at that point and we had developed over the period a 14-point advantage over the market. And that has given us the margin to use some of that advantage to become a bit more competitive. So the 2% we have taken is because we had the margin to take it and still return the proper margin.

Q - Bryan Brown {BIO 16358540 <GO>}

Okay. Thanks. I guess just one broad one. The quarter-over-quarter increase in the personal auto loss ratio, maybe if you could just speak to that briefly.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. If you look at the personal auto combined ratio in the quarter, it actually dropped by 10 points. This was not an increase, it's a decrease and how do you explain that? Well it has been largely driven by the current accident year as opposed to prior-year development and when you look at the current accident year, there's two elements that have a big impact.

One, the severity or the average cost of claim was down materially, driven by the Ontario reforms. The second factor that explains the improvement in the combined ratio between quarter four in 2011 versus quarter four in 2010 is the fact that the frequency was down, driven by the mild winter conditions as we have talked about before, primarily in the province of Alberta and in the province of Quebec. It is the sum of these two factors that explains why the combined ratio in automobile insurance improved so much in the quarter.

Q - Bryan Brown {BIO 16358540 <GO>}

Okay, that's it for me.

Operator

Mario Mendonca, Canaccord Genuity.

Q - Mario Mendonca {BIO 2450557 <GO>}

Good morning, a follow-up question on the stacking. Looking at the reserve development in personal auto, it was still relatively good. There was still a redundancy. We see that coming through in the quarter. But it was a little surprising that it would not have been larger given the comments made about the contingent consideration associated with AXA.

So if in fact the development from AXA is coming in strong enough to warrant the total, the CAD89 million or whether you would look at it as a total bases or just the CAD41 million, you would have expected the redundancy to be particularly large and not small.

So I guess what I'm getting at is how important was this stacking then to your reserve development in the quarter?

A - Charles Brindamour {BIO 7012323 <GO>}

I would say that this was a meaningful increase, Mario. I think as I said before when you look at the overall development and the idea is not necessarily to report AXA and Intact separately going forward. But that being said, being the First Quarter, the stacking decision would have taken our run rate materially lower than what it has been historically, 3% to 5%.

But as I said, we have done a number of moves from a reserving point of view beyond and above the stacking, including our general caution in Ontario because as I have said, the field activity is very, very good and very, very strong and therefore caution needs to take place at the reserving level. Then we have made a few adjustments on large commercial claims as well.

I think the best reference point I can give you is that -- what I have said earlier that the cost of that decision in our view in the Ontario auto market is 50 to 100 basis points of Ontario automobile loss ratio.

Q - Mario Mendonca {BIO 2450557 <GO>}

That was the impact in the quarter?

A - Charles Brindamour {BIO 7012323 <GO>}

That's the prospective impact on the loss ratio. The amount in the quarter taken was slightly above 20 for that decision.

Q - Mario Mendonca {BIO 2450557 <GO>}

I'm sorry, CAD20 million or 20 basis points?

A - Charles Brindamour {BIO 7012323 <GO>}

CAD20 million, slightly above.

Q - Mario Mendonca {BIO 2450557 <GO>}

That answers the question. Where I'm going with this then is if the Company has made that entire adjustment in the quarter by looking at all the files and making the changes, then presumably the adjustment doesn't come through next quarter. So unless there's an entirely different reason to be cautious next quarter, do you naturally assume that the redundancy, the reserve development could at least be CAD20 million higher?

Or is the premise too restrictive when I say assuming nothing changes, is that the problem? That too many things change to be confident?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. Too many things change because you have to keep in mind that we integrated the AXA reserves in our system at the same time. So there's a number of change going one way, other changes going the other way. But one thing that is clear, Mario, is that the adjustment we have made for the stacking we are not going to do prospectively because we've done it for all open files in the past. But I think my view has not changed of the ongoing run rate of favorable development prospectively.

Q - Mario Mendonca {BIO 2450557 <GO>}

But bottom line it was CAD20 million in the quarter. So it was meaningful?

A - Charles Brindamour {BIO 7012323 <GO>}

It was a meaningful adjustment, yes. That's why we highlighted it.

Q - Mario Mendonca {BIO 2450557 <GO>}

I appreciate your help, thank you.

Operator

Andre Hardy, RBC Capital Markets.

Q - Andre Hardy

Thank you, another question on Ontario auto. In your outlook, Charles, you mentioned that you expect further increases in price given still high loss ratios with the industry. I understand that perspective. But do you feel FSCO was on board with this? They just -- or the government of Ontario introduced very material reform that reduced benefits in late 2010 and what do you feel their appetite is for approving rate increases after doing that?

A - Charles Brindamour {BIO 7012323 <GO>}

I think that -- they understand that the industry was in a really tough position a year ago. And because automobile insurance is 5% of disposable income of Ontarians going to 6%, they knew they had to stop at the inflation. They have had a big impact I think on stopping the inflation. But the industry started the reform with a big gap and I think the government understands that. This translates into a number of actions they have taken beyond and above the reforms, including the upcoming cat definition.

It's clear that as reforms become effective, government is probably looking forward to improvement in rates. But they are rational and they understand that if the industry is not allowed to operate at a decent rate of return, there will be capacity issues in the market as there have been five years ago.

I think that these guys really understand what is important for Ontario drivers and that's why I am confident about additional improvements in the Ontario market. In time, rates will improve. But I still see a need at the industry level for corrective action in pricing.

Q - Andre Hardy

Okay. Thank you. The other one is probably for Mark. You are pointing out again that investment yields are likely to decline given where rates are but you're not pointing out that growth in the investment portfolio should offset the decline in yields. So have we reached a point where in your view we are going to see some pressure on investment income in absolute dollars?

A - Mark Tullis {BIO 4180270 <GO>}

Yes, I think at our Investor Day, we gave a little guidance on this one. I think we would expect -- we don't see big growth in the assets going forward. You are correct on that and we do see further decline in yields, whether they exactly offset. But I wouldn't expect to see lots of growth in that going forward.

A - Charles Brindamour {BIO 7012323 <GO>}

I think the Investor Day's illustration on investment income for 2012 remains quite valid as far as we're concerned.

Q - Andre Hardy

Okay. Thank you.

Operator

Paul Holden, CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

Thanks, another question on Ontario auto, this one related to the minor injury guideline. Hearing that some insureds are trying to get out of -- bounce their way out of the MIG guidelines by filing for mediation and then claiming a failed mediation if it's not resolved within 60 days, can you provide any color on that, how many such cases you are seeing through your system?

A - Martin Beaulieu {BIO 15316652 <GO>}

That's not necessarily related to the minor injury guidelines themselves. But there are 20% of our open cases, which are in mediation. And what we observed there is that there is an attempt to say, well, if mediations have not happened within 60 days, they are deemed to have failed. But up until now this has not been successful. So these files are staying in the mediation backlog and they are being handled as -- on a one-by-one basis.

A - Charles Brindamour {BIO 7012323 <GO>}

We're not overly concerned by that and I would say FSCO is on it as well. I think they will try to find a solution because this clearly was not the intention that a backlog would drive a delay that would deem mediation to fail. That was not the intent and I think FSCO I suspect will try to deal with that in the coming months.

Q - Paul Holden {BIO 6328596 <GO>}

Okay, my understanding the way I read it was that claims have been filed under MIG that were not resolved under mediation of 60 days could bounce out of the MIG guidelines. But you are saying that's not the case?

A - Martin Beaulieu {BIO 15316652 <GO>}

I think technically this is how this is supposed to happen, that if within 60 days the mediation has not been successful but now it has not been heard. So I think the mediators understand that these are circumstances that are outside of the party's control to make a mediation successful.

Q - Paul Holden {BIO 6328596 <GO>}

Then final question is with respect to capital allocation for the upcoming year. MCT ratio, while you still have a nice buffer versus your target has come down. So is your preference to build excess capital or buy back -- continue to buy back stock?

A - Mark Tullis {BIO 4180270 <GO>}

I think in the near to midterm, our goal is to get back to the 20% debt to total capital ratio and then we'll go back to the same -- our long-term capital management, which is ensure we can do the dividends, consider strategic options in the short to midterm and whether there is actionable uses of the capital either to grow organically or through acquisitions. Then to the extent we've got excess capital beyond what we need for that, we do have a preference for share buybacks.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, I think the other factor, Paul, is the general capital market volatility, as you know, which is an integral part of our framework that we use to determine whether we will do buyback or not and in the current environment, this is not our intention in the short term.

Q - Paul Holden {BIO 6328596 <GO>}

Okay, that's helpful. Finally, any comments with respect to the 12% ROE cap that has been in place in Ontario auto? Are you hearing anything in terms of the possibility of that cap coming down?

A - Charles Brindamour {BIO 7012323 <GO>}

Do you want to talk about that, Martin?

A - Martin Beaulieu {BIO 15316652 <GO>}

Well FSCO has received the Auditors General report and I think they have signified that they haven't -- they would have an interest in reviewing the adequacy of the 12%. But I think that they are educating themselves at the moment and we are participating in that exercise to put in perspective what that 12% means on the long-term perspective.

A - Charles Brindamour {BIO 7012323 <GO>}

Exactly. I think it's important to bear in mind that this is a non-leveraged ROE target that FSCO is putting. The other thing that's important to bear in mind for FSCO is that if you go back in time and look at the industry, it's a highly competitive industry. The ROE in the past three, five, or 10 years in Ontario for the industry has been nowhere near 12%.

So for me, this is not talking about the right things in the Auditor General's report and I think FSCO, as Martin said, is thinking through these things at the moment. But this is really not a concern of mine at this stage.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. So that cap could be lower but if it does, it's irrelevant anyways?

A - Charles Brindamour {BIO 7012323 <GO>}

I would be very surprised if it was.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Thanks for your time.

Operator

(Operator Instructions) Shubha Khan, National Bank Financial.

Q - Shubha Khan {BIO 16255963 <GO>}

Thanks, just to follow up on Paul's question there on capital allocation specifically from a long-term perspective. Now I understand that you are probably fully focused on integrating AXA. But perhaps I can ask you to look ahead to future acquisition opportunities particularly given the backdrop of your financial flexibility and what looks at least to me looks like increasingly probable demutualization of the P&C sector.

So given that backdrop, I'm wondering what your thoughts are on acquisitions specifically in Ontario auto. Are we likely to see more or increased industry consolidation there since you mentioned that combined ratio is still ranging between 105% and 110%? And would Intact be a willing participant or are you sort of satisfied with your current exposure to Ontario auto?

A - Charles Brindamour {BIO 7012323 <GO>}

Let me talk about consolidation and then let me talk about the impact of that on Ontario auto.

So our view has not changed that there should be over the coming five years probably 20 points of market share that will trade. And given our financial condition and given our experience in integration. And our outperformance of the industry, it is an element, an important element of our strategy to continue to be a consolidator. And so indeed we are really focused on the integration of AXA. But AXA was not the last acquisition that we will do. So that's the first point.

The second point is that the conditions at the moment I think are good for a consolidation of the industry and they are likely to be good for a few years. You point to demutualization but I think for me this is way broader than that. This is just one thing that is changing at the industry level. There are changes taking place abroad. The industry performance is not great with the mid single-digit 6% to 7% ROE. And as such, you've got all the conditions in my view to see continued consolidation in the market.

Your point on Ontario auto, in general many if not most companies tend to be spread in more than one province and one line of business. But given our approach operationally in claims, underwriting, pricing, our outperformance of the Ontario market. And the fact that there is a government that is proactive at trying to keep costs under control for Ontario drivers, this is certainly a line of business where we would not shy away from getting additional exposure through consolidation.

In other words, there are very few Ontario auto-only companies but we won't prevent ourselves from doing an acquisition because there is heavy Ontario auto exposure. We feel that we've done a very good job on that front over the past three, five, 10 years and our outperformance right now is a proof of that.

Q - Shubha Khan {BIO 16255963 <GO>}

So if the right opportunities were to present themselves, you wouldn't be averse to getting back to the same sort of business mix -- Ontario as a part of your business that you had prior to the acquisition, then?

A - Charles Brindamour {BIO 7012323 <GO>}

No. I think we are not motivated by distribution of the book of business per se. We are motivated by outperforming in every segment where we operate and once you outperform in every segment where you operate, how much of the business you write in that segment in relationship with the size of your business is really quite secondary.

Q - Shubha Khan {BIO 16255963 <GO>}

Okay, just one follow-up to that, then. Specifically on Ontario auto, then again if the right opportunities present themselves, would you be -- would you come up against any competition Bureau obstacles or any other sort of regulatory hurdles if you were to seek significant or sizable acquisition opportunities here?

A - Charles Brindamour {BIO 7012323 <GO>}

I don't think so.

Q - Shubha Khan {BIO 16255963 <GO>}

That's all my questions, thank you.

Operator

There are no further questions at this time. I will turn it back to Dennis Westfall.

A - Dennis Westfall {BIO 15155973 <GO>}

Thank you, everyone, for participating. The webcast will be archived on our website for one year. The telephone replay will be available at 2 p.m. today until Wednesday, February 15. The replay number is 1-855-859-2056. The pass code is 42475261. A transcript will be made available on our website. Please note that our First Quarter results for 2012 will be released on May 2.

That concludes our conference call. Thank you. And have a good day.