

## Q3 2018 Sales and Revenue Call

### Company Participants

- Jonathan Stanley Hill, Group Chief Financial Officer & Executive Director
- Lance Henry Batchelor, Group Chief Executive Officer & Executive Director

### Other Participants

- Andreas Evert Cornelis van Embden, Analyst
- Anna Hui, Analyst
- Ben Cohen, Analyst
- Edward Morris, Analyst
- Nick Johnson, Analyst
- Ravi Tanna, Analyst
- Robert Rampton, Analyst

## MANAGEMENT DISCUSSION SECTION

### Lance Henry Batchelor {BIO 6884486 <GO>}

Good morning, everybody. It's Lance Batchelor here, the CEO. My apologies, I gather there was some kind of a technical glitch with the phone lines. Hopefully, you can all hear me clearly. I'm joined this morning by Jonathan Hill, our CFO. Jonathan and I are each going to talk for a few minutes and then we will open up to questions.

I'm going to cover three subjects on this call: firstly, a quick update on current year trading and the reasons behind it; second and most important, some actions that we're taking to accelerate growth; and third, how this plays out for the forecast in 2018 and beyond.

First briefly then current year trading. Saga has traded well throughout most of 2017, but in quarter four, we hit some strong headwind. In October, we saw a significant step-up in the competitive environment in motor and home broking, which cost us both policies and margin; and Monarch Airlines went bust, costing us about £2 million in additional flight costs and lost profit from cancellation. Hurricane Irma and other weather events in the Caribbean added more cancellation costs. As a result of these factors, Saga will come in towards the lower end of our previous guidance at 1% to 2% growth in underlying PBT.

It's worth noting that our in-house underwriter, AICL, has again performed strongly and will deliver higher reserve releases than expected. Our travel business has also performed well leaving aside the Monarch impact. We've completed a review of our operating structure, which will realize approximately £10 million of annualized saving next year. The

more challenging trading in travel and insurance means that our baseline growth is likely to be slower than we'd anticipated.

Second, we're taking action to accelerate growth. In the 3 1/2 years since IPO, we've bedded in our motor panel, we have a better understanding of High Affinity Customers, we've launched our new membership program, Possibilities. It already has 200,000 members or almost 200,000 members and 85% of the customers that we speak to are choosing to activate their membership.

We're in the final testing of our new insurance IT platform, and we've launched our new claims platform. With greater customer insight and a stronger business platform, now is the right time for us to make a targeted investment to grow the business. We, therefore, intend to invest an extra £10 million to drive customer growth next year, and we expect to maintain this level of investment into the future.

This investment and some financial headwinds that Jonathan will explain mean that next year's profit will reduce by about 5% against this year. That is below our previous guidance for next year. However, it's the right thing to do in order to build value for the longer term. It means that we can use our home and motor panels to compete effectively. It will help our holiday and cruise businesses to win volume. Newly acquired customers normally take a year or two to become profitable, but by 2020, our profit will start to accelerate off a larger base.

Before I hand you over to Jonathan to give you more color on this, there is one last important point. We expect to make no changes to either our current year dividend or our dividend policy. Now Jonathan.

### **Jonathan Stanley Hill** {BIO 16892113 <GO>}

Thanks, Lance. So first looking at 2017-2018, as Lance has said, we expect to deliver growth in underlying profit from last year of between 1% and 2%. In terms of the trading in Retail Broking, we have seen a significant uplift in competitor activity in both home and motor in Q4 since our last market update with some players aggressively targeting volume growth, which has led to lower persistency for a period. We expect this increased level of competitive activity to continue and, therefore, our profit growth in our retail broker is expected to be marginally lower during the initial two years of investment than previously anticipated.

The cost associated with Monarch were caused by a range of factors. Where we had passengers in resort, we had to pay for the flights to bring those customers home. Where we had future passengers who were booked on Monarch flights as part of one of our packages, we had to acquire new flights at higher cost and then, clearly, we also had some cancellation.

For the full year, we expect our written broking performance to be positive year-on-year with a strong performance in motor even after the tougher Q4 trading, partially offset by home and travel broking. On an earned basis, the profitability of our Retail Broking

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business will reduce year-on-year due to the lower return to earned benefit, which I'll touch on in a minute. Even after those effects of Monarch, we will deliver another strong uplift in our Travel profit. And finally, our claims experience within the underwriter continues to be very positive for small and large PI, which has enabled us to maintain reserve releases at roughly the same level year-on-year.

Now turning to next year, we expect to significantly improve our quality of earnings with an increase in profits coming from Retail Broking and Travel. Around half of this increase is expected to come from the organic growth in this business and the other half from a lower cost base. We have taken the actions to deliver these cost reductions, the majority of which is driven by lower head count. And as a result, there will be a one-off charge in the current financial year of approximately £4 million.

Offsetting these improvements, we expect to experience reductions in reserve releases and one-off earnings of around £20 million. This headwind will be roughly half and half split between lower reserve releases and a reduction in written to earned benefit. The written to earned benefits have been a constant profit benefit of between £10 million and £20 million since the time of IPO. And these result from the standard accounting treatment which affects the timing of recognition of profit between underwritten and broke policies.

We have moved more towards a less capital intensive model and taken less underwriting risk in AICL. Therefore, AICL has written less business sold by our retail broker, both on ancillary product and with the introduction of the motor panel 2 1/2 years ago. Also, the introduction of the arrangement fee, which is standard in the insurance industry, had an effect on this written to earned benefit.

In summary, this is happening because we have increased the number of policies we broke and reduced the level of underwriting risk in the business. In terms of debt and leverage, there are no implications for any covenants and we expect our leverage ratio to remain below 3 times, including the debt associated with both shifts.

So, just to recap on where that leads us, the current year underlying PBT where we expect to be between 1% and 2% growth year-on-year and there will be a one-off restructuring charge of £4 million to deliver that £10 million cost reduction. Next year, profit will reduce by around 5% year-on-year reflecting that up-front investment in customer acquisition and those financial headwinds. And for 2020 and beyond, it's too early to give specific guidance, but we will see a better quality of earnings and profit growth. Retail Broking and Travel will be benefiting from the investment in customer acquisition. Cruise will benefit from the new cruise ship and all this from a lower cost base and a stronger business platform.

I'll now hand back to Lance.

**Lance Henry Batchelor** {BIO 6884486 <GO>}

Thanks, Jonathan. Finally a word on strategy, the core of what Saga is all about remains the same. We will still focus on being customer-centric using Saga Possibilities. We'll still target growth in our core insurance and travel divisions. We will remain asset-efficient. We are investing for the future. It's the same strategy on a stronger business platform with more investment in growth. In the longer term, we're confident that we'll see better quality of earnings and profit growth across the business supporting our progressive dividend policy.

We will now take some questions.

## Q&A

### Operator

Thank you very much, Lance. Our first question comes from the line of Anna Hui from RBC. Anna, please go ahead.

#### Q - Anna Hui {BIO 19762795 <GO>}

Good morning all and two questions from me please. First, can you give a bit more color into the trading environment in home and travel broking in terms of where this competition is coming from and volume as well? And second on the cost savings, so can you give us some more information about which segments you see this cost saving benefits to impact in next year? Actually, and the third one, so on motor broking as well, can you give a bit color on the volume? Thank you.

#### A - Jonathan Stanley Hill {BIO 16892113 <GO>}

Yeah. Sure. In terms of home and travel broking, if I take travel insurance first, we obviously updated you at the half year, particularly around the pressures we had had in Q1 around the FX position that we had with our underwriter and that left us competitively disadvantaged in the first half of this year. That, as we said at the interims is unwind, and our volumes are back to a relatively sensible level.

One of the issues that transpired in H2 is because of the hurricane season in particular, we had a lower quantity of long-haul bookings not only in the Travel business but also a lower demand for long-haul travel insurance which tends to command a higher premium. So, we saw a little bit lower volume than we expected in Q4, really driven by some of those hurricane impact on travel insurance.

In home, this is a continuation I think of really what we've seen for about the last five years. It's been relatively constant. We've had reducing prices to three years then pretty much flat prices for a couple of years against the backdrop saw a flat gross written premiums against a backdrop of marginal inflation coming through, so that's really just the continuation of same trading that we've seen in home insurance over the last few years already.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Turning to your question around costs, I mean most of the cost structure at Saga is made up of people, and after 3 1/2 years of investment in systems, more modern marketing platforms, process improvements, we are in a position to be able to remove a number of people from the organization in order to right-size us and essentially make us efficient for the future. That has happened across the business. It's almost complete now. Most of those cost savings have been driven into the business. And just to reassure, the majority of the roles that have been removed are at the middle and upper management levels. We've worked very hard to try and protect the customer experience.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

And then I think your final question, Anna, was in terms of the motor broking volumes. Clearly, the step-up in Q4 activity has affected the persistency levels. We'll give you a clear guidance that - we'll give you a clear update at the year-end of the impact on volumes but, certainly, we saw persistency stepping down a couple of percentage points in that Q4 period, which impacted volume.

**Q - Anna Hui** {BIO 19762795 <GO>}

Okay. Thank you.

**Operator**

Our next question comes from the line of Andreas van Embden from Peel Hunt. Andreas, please go ahead.

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

Hello, good morning. Two questions for me please. First of all, on the motor panel. Could you just comment on where you are in building that up? And how many sort of underwriters are now on the panel? And are you satisfied the panel is now sort of efficient as it were? Are there enough members on the panel for you to be able to compete effectively in, as you say, a market that has become a bit tougher in the fourth quarter? And also give a bit of an outlook of where you see the panel or how you see it evolving next year.

And the second question is on the additional acquisition costs of £10 million. I'm surprised you're investing more into trying to sort of converge your customer base into doing more business with Saga. Could you maybe spit out those £10 million? What are you going to exactly invest in and how do you think that is going to sort of generate a boost in your policy accounting? Thank you.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Thanks, Andreas. So I'll deal with the first question. So, where are we on the panel? We still have the four external underwriters. What we referred to at the half year was some quite significant Ogden impact, which had impacted the net rates that we were effectively

getting from those external underwriters and we talked through the implications of that on written to earned at that point.

What we've seen is a much more positive performance as Ogden I think has settled down in the market and people have really got their heads around that. So we've seen an improvement in the performance of the panel certainly in H2 and we'll give you some more flavor on that and more specifics at the year-end but it really has bounced back to where it was before and is heading absolutely in the right direction. So, we feel pretty comfortable with that.

If you'd strip out the sort of blip from that Ogden impact and the impact on net rate, we have seen a steady progression in the panel share over the 2 1/2 years since we've had it. So we would like to think, everything else being equal - and there's obviously a lot of stuff going on in the motor market at the minute around whether we're seeing that rate moving again, what the government's going to do on that. Everything being equal, we'd like to see the panel taking a greater share as we go into next year.

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

So where does the disappointment come from in terms of the growth within the motor panel? What's the disappointing factor here?

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Well, I think one of the disappointing factors for us was in the first half of the year that the external underwriters decided to price Ogden significantly more aggressively in terms of what they put into net rate than our business, AICL, which we think understands its level of PPOs very clearly, and has been - as we said at last year-end, has a limited impact from PPOs because we have a very low number of them. So that's one of my disappointments that we had that situation where the external underwriters became very cautious, I think, in terms of using broker channels. And then we've seen that coming back in H2.

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

But do you think you need more members on the panel to be able to make it work or is the panel maybe too narrow in terms of membership?

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

I don't think the panel is too narrow and I think Lance will talk in a second about where we're going to put the investment because at the end of the day, to grow a book you need to invest, and the first year of that costs money. And we're going to put some money behind both our home and on our motor panels to get some growth.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Okay. So let me step in and just talk a bit about the marketing investment or the £10 million investment. First of all, I'm just going to say, I can't share all of the detail because I don't want to flag to all of our competitors exactly what we're proposing to do, but I'll tell you what I can. The first thing is that roughly half of the £10 million investment will go into

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driving our insurance business and roughly half will go into travel. Again, I'm not going to give exact detail, but you're roughly in that order of magnitude. In both cases, the intention is to attract new customers and also to drive more cross-sell internally within the database and finally to ensure that we retain HACs, High Affinity Customers, into the long term.

A lot of the money is going to go towards price. We want to make sure that we are competitive in the market in terms of both insurance and travel pricing. This links back partly to the first half of the question around panel efficiency. We think that the panels work very well but they can only gain volume if our front-end pricing is competitive. And so a good proportion of the £10 million will go into ensuring that our market pricing is competitive. Some of the money will also go into channel access. So, for example, if you use a price comparison website, you pay for the privilege. For example, if you want to send out either digital or analog marketing to your travel and cruise customers and potential customers, that costs money.

We have good elasticity data at Saga going back many years, both in travel and insurance. We have a very good feel for what you get back when you invest money. Our challenge for the last few years has been that we've been managing the business for margin and we're now rebalancing that consciously to also drive volume and we have a very good sense of what we will get back for the extra money that we're investing.

One other point I want to make is that when you invest in new customers, whether they are insurance customers or travel customers, you don't get instant payout. Typically, on an insurance customer, it takes from one to two years for that customer to become profitable, which creates a dip in profitability during that period as you move from flat volume to growth in volume.

And the same is true of travel. When you attract a new travel customer and they book with you, they don't actually travel with you typically for 6 to 12 months and it's not until then that you realize the full revenue from that customer. So the investment in both cases goes out up to a year or so before you get the returns. What we want to do is we want to take the business that it's been running roughly flat in volume terms and we want to get it growing. And in order to do that, essentially, you have to invest for a year or two in order to break that and move upwards and that's what we're doing.

The last point I'll make quickly is that we know so much more about what a good customer looks like based on the learnings of the last year or two. We know what a High Affinity Customer looks like. We know what a potential High Affinity Customer looks like. So, in terms of our ability to target the marketing money, we are much smarter than we were and that's one of the reasons that we've decided to start the investment cycle now and take some growth on the business. We've also spent four years really rebuilding all of our tech platforms; ordering new ships; launching Saga membership, the Possibilities scheme; and so on. So, we really feel that now is the right time for us to get behind that investment.

Next question please.

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

All right. Thank you.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Thanks, Andreas.

## Operator

Our next question comes from Ravi Tanna of Goldman Sachs. Ravi, please go ahead.

**Q - Ravi Tanna** {BIO 16926941 <GO>}

Hi. Good morning, everyone. And I have three questions please. The first one is on your choice between underwriting and broking. I guess you've always maintained that you're somewhat agnostic between the channels and you're happy to push business through either depending on where the customer wants to go and what's the most kind of appropriate. But, clearly, there's extremely different profitability profiles earned versus written patterns, et cetera. So I was wondering how you're thinking about that given what's happened.

Second question is also kind of back on the broking panel, I'm sorry to belabor the issue, but I wasn't quite clear on the actual trend in terms of customer volumes of policies sold via the panel over the course of the year. So perhaps you could break down for us first half versus more recent quarters. What's happened over the course of the year? What the trend has been on the motor broking panel?

And then the third question please, on the dividend and the decision to maintain that, could you just clarify in respect of your kind of operating cash, it seems to me that that would take you close to 100% of operating cash to maintain the kind of dividends, the expectations that are in the market. Is that how you see it or is there an intention to pay dividend out of your solvency? Can you just clarify your thoughts on that, please? Thank you.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Maybe I can deal with those questions. I think the answer to the first question is, do we let written to earned dictate how we try and run the business. We don't. What we want to do is, get the best economic outcome and get the best profit into our retail broker. We should never be influenced by the accounting treatment of how we deal with the profit flows. That does give us issues in terms of how easy it is to forecast when we see movements in things like the panel share. So, we will continue to have a level playing field. We do continue to be agnostic between our in-house underwriter and the external underwriters, but we very much want to make sure, we've got a level playing field and do the best in terms of net rate. So hopefully, that deals with the first question.

On the second, we obviously saw if we go back and think of our statements in the last two half years, we said at the year-end that we were up to approaching a third of net revenue



on renewals coming from the panel. So that was the back end of last financial year. Then clearly with Ogden, we saw that significantly step down and we had some of the issues around the implications of that on written earned at the half year.

But then we'd certainly see the panel stepping up in H2 again, as I said, as everything's calmed down within the Ogden and people have really got a good grip on it and see what's happening going forward. And we're certainly back towards the level we were in H2 last year and we'll give you further color on that at the prelims next year.

In terms of the divis, we have de-levered. We're getting into - we'll update at the year-end where we are in leverage ratio. As we get towards the bottom end of that range, we're quite comfortable paying out a high level of our free cash flow and our operating cash. Then we'll take one of the ships on, and we'll generate a significant uplift in cash flow. That'll help us de-lever because, at that point, we'll have quite a lot of cash flow paying down debt on the ship in particular.

And then we'll take on the second ship and, at that point, we'll generate significant cash. So in the short run, to the extent that we're getting towards the bottom end of that 1.5 to 2 times band pre the delivery of the first ship, we feel quite comfortable paying out a slightly higher percentage of our operating free cash flow.

**Q - Ravi Tanna** {BIO 16926941 <GO>}

Thank you.

**Operator**

Our next question comes from the line of Robert Rampton from UBS. Robert, please go ahead.

**Q - Robert Rampton** {BIO 20079733 <GO>}

Hi. So going to that PBT headwind from the written to earned, it seems like until Q4, you are pretty confident you could offset the £10 million a year headwind. Is the implication the home profitability in Q4 is significantly lower? And if so, would you expect that to change if persistency rates don't change? That's it. Thanks.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

The answer to that question is, yes, we did expect to be able to - we had an expectation of trading and delivering enough growth within our Broking business to offset the headwind this year and then into next year. Now, clearly, some of the more challenging trading both on home and motor in terms of persistency in Q4 has naturally made that more difficult. And yeah, that competitive activity, we are assuming, continues into next year at that level, and we've taken that into consideration as we've given the guidance into next year.

And I guess as you try and bridge from your previous forecast where previous estimates through this estimate, one of the key elements that has changed in that is the level of competitive activity within the market, and the assumption that the rate of growth that we had anticipated in our Retail Broking is going to be slightly lower than we had previously anticipated.

**Q - Robert Rampton** {BIO 20079733 <GO>}

So one follow-up on that, if that's okay. Could you please - so you've mentioned that motor was doing well in 2H. However, you've just commented that motor has been disappointing in 4Q. Do you mean that - or could you clarify whether you mean motor policy count has been good in 2H and its profitability that has been affected by the persistency or - yeah, just some clarification (27:22).

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Yeah, sure. Sure, Robert. So, up to the end of Q3, the profitability on a written basis of our motor book is very positive and, hopefully, that comes out of the statement. It just then got pulled back a bit from where we were heading towards at that point by the downturn in persistency both on the motor side and also coming across to the home side as well. So we were doing well in terms of our profit. For the year, we're still going to be up year-on-year in our written motor performance, just not as quite as much as we had thought at the time that we were last commenting to the market.

**Q - Robert Rampton** {BIO 20079733 <GO>}

Thank you.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Thanks, Robert.

**Operator**

Our next question comes from the line Ben Cohen of Investec. Ben, please go ahead.

**Q - Ben Cohen** {BIO 1541726 <GO>}

Good morning. Thanks very much. I had two questions, please. The first was of the investment that you're going to make in the customer acquisition and maybe I just missed it in the detail but could you sort of talk through the timeline and as to how much of that do you think we will then see in the profits in the following year and then in the out-years? And I suppose part of that, what is the risk that that will get competed away?

And the second question in terms of the underwriting reserve release, I think you've given an outlook for the decline in the coming year. Can you say anything about the outlook in the further out-years given that that is quite a big swing factor when it comes to the development of group profitability for, I suppose, years kind of two and three? Thank you.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Yeah, sure. Do you want me to deal with these? In terms of your question on being competed away, I think we take the simpler one is obviously our Travel Business. Once we've spent the money next year and got a booking, that customer is coming with us the year after. So it's just the fact that we spend money to acquire a customer and the booking timeline as such, they generally book up to 12 months in advance, and therefore, the revenue and profit recognition come on departure of the customer. So, that's relatively straightforward.

Then in terms of the insurance business, as Lance said, we're very clear on our pricing and elasticity curves within our insurance businesses. So, we know that when we acquire a policy that we will lose money on that policy in the first year. And then in that second year, you get a positive contribution that gets you back towards or into a positive position. And then you start making money in the third year generally on these policies, and that takes into consideration the persistency rate that you see on those policies over that period. So, we've got a pretty tried and tested understanding of that elasticity across the insurance business.

The second on the reserve releases, we've obviously guided into next year that £10 million to £15 million level. It obviously is heavily dependent on our experience during the year, but it's not an unreasonable expectation that it should continue on down at that sort of rate. But obviously, the year after, there's no written earned headwind. We will just have the reserve release headwind.

**Q - Ben Cohen** {BIO 1541726 <GO>}

Right, okay. Thank you very much. Thanks.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Thanks, Ben.

**Operator**

Our next question comes from the line of Matthew Hudson of Traders. Matthew, (31:25) please go ahead.

**Q - Lance Henry Batchelor** {BIO 6884486 <GO>}

Hi, three questions. First of all, you guided earlier on what you thought was happening to profit this and next year and the year after. Can you just tell me what you think your underlying profit number is, on which we should base that guidance? Secondly, I'm a bit confused about the pressure you're seeing in the insurance side. If this is a branded business with lots of brand recognition, then why are you struggling so much in a difficult market? And thirdly, I'm a bit confused when I look out to 2018, I can't quite reconcile the change in profit number. It looks like about £40 million to me and I think you've explained about £30 million of it. So, could you just help me on that? Thank you.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Can I take the first question and then - so the underlying profit number for last year was £187.4 million. That's the underlying profit number we're guiding off.

**Q - Lance Henry Batchelor** {BIO 6884486 <GO>}

Fine.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Do you want to deal with the second one?

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Yeah, I mean quickly on the pressure that we've been under in quarter four in the insurance market almost immediately as we went into that quarter, we saw a significant dial-up of the competitive pressure across the market from multiple competitors. It looked to us like several competitors decided to go after volume and that's both new customers in the market but also requires us to respond in order to retain the current customer base because these days more and more customers will review their pricing on an annual basis. We have to remain competitive in order to protect persistency of our current customer base. And that meant some margin erosion and that's the right thing for us to do to protect those customers.

Yes, we do have a strong brand and we know that about roughly two-thirds at the time that we attract a new customer on a price comparison website. We were not the cheapest on the list. They are willing to invest in order to go with Saga. But, ultimately, we have to remain competitive in order to attract new customers and retain previous customers and the strength of our brand has real value to it. But that doesn't make you immune from competitive forces.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

So, Matthew, (33:45) I'm just trying to understand if you're reconciling the market guidance back to next year's number or whether you're trying to reconcile this year through the next year model?

**Q - Lance Henry Batchelor** {BIO 6884486 <GO>}

No, I'm looking at 2018, looking at 2018...

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Yeah, 2018...

**Q - Lance Henry Batchelor** {BIO 6884486 <GO>}

...relative to what the consensus was before.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

So relative to consensus before, we clearly have a - so we had a consensus, I believe, just over the mid to £200 million to £210 million level and we're talking about being £180 million. Now clearly, £10 million of that is the investment that is new. So that gets you to £190 million and then effectively what you have is the carryforward of the shortfall on this year's trading and on the Retail Broking side. And then we've said we expect that growth to be - given the competitive environment, to be slightly lower year-on-year. So what we've talked about today is organic growth of 10% into next year in those businesses without it starting off a lower base.

**Q - Lance Henry Batchelor** {BIO 6884486 <GO>}

Okay.

## Operator

Our next question comes from the line of Nick Johnson of Numis Securities. Nick, please go ahead.

**Q - Nick Johnson** {BIO 1774629 <GO>}

Good morning, all. Just one question, first of all, on travel insurance. Just wondered how much of the (35:17) purely from the long-haul bookings? Are you comfortable with the underlying business of volumes robust, (35:24) excluding the impact of long-haul booking, or has there been a shift in buying habits of customers and new competitive pressure in the travel insurance market generally? That's the first question. And secondly, just on cost savings, this one is if you could say whether there are any - is there scope for any further cost savings in the future or are you now all done on that front? Thank you.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Yeah, sure. In travel insurance, we see, when we look at some of the short-haul demand, the short haul volumes relative to same time last year, it's as robust and as solid as it was at that point. Obviously, the big point for us comes in Q1 when we get a lot of travel insurance bookings in because that's, obviously, the time when the travel industry itself has the greatest level of bookings. And that's obviously when our travel insurance volumes really come in. Clearly, we've seen an impact in the back end of the year from those hurricanes on the long-haul stuff. But now we're not seeing anything that suggests a fundamental shift away from where we were before.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Nick, on your cost question, look, we've taken out a meaningful slice of cost. We're going to, on an ongoing basis, review our cost structure to ensure that we remain very lean and we're not anticipating significant extra reductions in cost, but we are anticipating retaining very tight control over our cost structure.

In the three years or so since IPO, we did need to go through an investment phase where we brought in new people with new skills, where we updated our marketing platforms, where we invested in some of the IT and so on, and that did require a buildup of new skills on top of old skills, if you like. And we're now starting to see the returns come

through as some of those platforms come to life and enable us to be more efficient and, on the back of that, we've taken the recent steps to reduce cost base by £10 million. But you shouldn't expect to see further cuts of that sort of magnitude.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

And we will be on top of the cost base. Don't worry.

**Q - Nick Johnson** {BIO 1774629 <GO>}

Okay. Thanks very much. Thank you.

## Operator

Our next question comes from the line of Anna Hui with a follow-up question. Anna, please go ahead.

**Q - Anna Hui** {BIO 19762795 <GO>}

Hi. Two follow-up questions from me. First on the home/motor broking, some of the motor insurers have been talking about increasing prices due to escape of water claims. Is that something you've also been seeing in the competitive pricing environment? And secondly, just on the £10 million marketing acquisition, you said that you would expect this to continue into the future and it sounds like part of that is probably you lowering the margin you're getting on this business. Am I reading this right?

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

We haven't specifically commented on home and I don't think around the escape of water, but it's an industry-wide phenomenon that everybody is seeing within that part of the market. That obviously has an impact on the net rates. Clearly, we take no risk ourselves on home. So therefore, that itself has no impact directly on any underwriting results, clearly, because we aren't exposed to that risk. But clearly, it has an impact on the net rates that come through from our panel. So, yeah, you have claims inflation coming through at a time of relatively stable gross written premium, so it creates margin pressure certainly.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

And then on the second question around the marketing acquisition, I mean clearly if you take 2 million, 2.5 million policies and you start to grow off that base and you're spending £10 million more then if you divide one by the other, there is a cost to doing that. And in that sense, you could say the margin on each policy will be slightly lower during the investment phase. Remember that in year two, as Jonathan described earlier, you'd expect to see the customers that you invested in back in year one hit breakeven, and then as you move into year three, they become profitable, and therefore, the extra roughly £10 million a year that we're expecting to invest starts to pay for itself within years two and three. It starts to cover itself with extra volume.

**Q - Anna Hui** {BIO 19762795 <GO>}

Okay, perfect. Thank you.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Thanks, Anna.

## Operator

Our next question comes from the line of Robert Rampton of UBS. Robert, please go ahead.

**Q - Robert Rampton** {BIO 20079733 <GO>}

Hi, two follow-up questions for me. You've previously commented that (40:10) market is good, but what made you (40:15) the magnitude of the change in persistency or was it - you didn't expect (40:20)? And then the second question in terms of EBITDA to cash conversion, given that you won't be offsetting the written impact. Does that imply a higher level going forward? Thanks.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Sorry, could you just repeat that second part, Robert? I didn't quite catch it all.

**Q - Robert Rampton** {BIO 20079733 <GO>}

Sure. So given you haven't been able to offset the fall-off in earnings from going written to earned, the £20 million, what are the implications for your EBITDA to cash conversion? Thanks.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Actually, if I can deal with that one first, the EBITDA to cash conversion will improve because the written to earned has no cash impact whatsoever. So, actually, we should see our margin a lot less than that percentage because it's just an accounting adjustment that's got no economic or cash difference at all to the business.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

And then if I go back to your first question, Robert, in general, we do believe the churn in the marketplace is a good thing for Saga. But the magnitude and rapidity of change that hit in quarter four basically required us to correct to ensure that we retain current customers and we remain competitive in our search for new customers. So what we have done is we have adjusted in order to achieve that and that's what's affected the current year projection.

If you look forward at the £10 million investment that we're talking about, I mean that's going to make us to sharpen our pencil in terms of external pricing and in an environment where there is churn, that's going to make Saga a more attractive proposition to customers who are in the market.

**Q - Robert Rampton** {BIO 20079733 <GO>}

Thank you.

## Operator

We have a follow-up question from the line of Ravi Tanna of Goldman Sachs. Ravi, please go ahead.

**Q - Ravi Tanna** {BIO 16926941 <GO>}

Hi. Good morning. Just one final follow-up on the broker panel I suppose, in arriving at your previous guidance on profits that you've provided to the market, presumably you would've had an underlying assumption as to how quickly the panel will have grown in terms of volumes and the rough margin that you would've earned.

And I wonder whether you could share with us any of the underlying assumptions as to how you had anticipated that the panel would progress and how you see it from here because clearly that's been revised downward sharply in fourth quarter because, clearly, it's a difficult thing for the market to anticipate. But presumably in arriving at your three year (43:21) profit guidance, you must have made some underlying assumptions. So to the extent that you can, if you could please share those with us.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

Yeah, I would attach it slightly less, Ravi, to the margins that specifically come out of the panel. This is about the margins we make in our Retail Broking business and the level of persistency that we have in that business. We aim to widen that margin through the competition between our internal underwriter and the external ones. But we thought that we are going to be able to deliver a bigger uplift in our Retail Broking business. And it wasn't an underperformance either from our own underwriter or the external underwriter, it was the market conditions and the competitive landscape that held us back from being able to get those margins slightly higher within our Retail Broking business. Does that make sense, Ravi?

**Q - Ravi Tanna** {BIO 16926941 <GO>}

It does, I suppose. I guess the underlying question still remains as to what you'd previously assumed in terms of market conditions. It's obviously a very volatile market. I guess what I'm trying to get at is what gives you reassurance that this cannot be repeated. This is a very volatile market both motor and - well, particularly motor insurance, and competitive conditions will fluctuate over time. And I suppose that's really what I'm getting at. I do appreciate that it's not necessarily underperformance by your in-house underwriter and that it's a function of competitive conditions, but one would imagine that that will continue over time.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

I mean in essence, if you look at our forecast for next year the guidance that we're giving, you can say that we are assuming that the competitive conditions will remain very



challenging. Our assumption is that what we have seen in quarter four to a large extent represents a new normal and that that's what we will see in 2018. And as a result, we have lowered our estimate as to how much profit growth we're going to be able to create next year.

**Q - Ravi Tanna** {BIO 16926941 <GO>}

Okay. Thank you.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

We have baked it into our assumptions.

**Q - Ravi Tanna** {BIO 16926941 <GO>}

Okay. That's very clear. Thanks. I may have missed that earlier. Thank you.

## Operator

Our next question comes from the line of Edward Morris of JPMorgan. Edward, please go ahead.

**Q - Edward Morris** {BIO 16274236 <GO>}

Hi. Thanks. Just a couple of final questions for me. Just on the written to earned benefit, we have the benefit of that in last year and what we're expecting in the current year. Do you have the figures for the other years since IPO, how much of a benefit has this been? And then the second question is on customer numbers, I mean sort of talked a lot about the competitive dynamics here, but can you just give us an idea of what you expect your customer numbers to do next year and then the year after, after the benefit of the marketing spend? Thanks.

**A - Jonathan Stanley Hill** {BIO 16892113 <GO>}

For the first two years, it was at or above £10 million in both of those years. So it was £10 million then, I think, we'll provide those numbers to you later in detail but it was £10 million then I think above £10 million and then £20 million and then back to £10 million.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

And then on the second question, we're not going to come out with projections on customer numbers. I just - I don't want to give that level of detail out into the market, but you should expect to see growth in both insurance broking side of the business and in our travel side of the business, which will be really the first time that we've invested in growth since IPO with the focus up until now as you know has been more on PBT than it has been on a number of customers.

**Q - Edward Morris** {BIO 16274236 <GO>}

Okay. That's great. Thanks.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Thanks, Ed.

## Operator

We have no further questions on the phone line. So, I'll hand back to you, gentlemen.

**A - Lance Henry Batchelor** {BIO 6884486 <GO>}

Okay. Thanks, everybody, for dialing in. My apologies that there was a 15-minute delay at the beginning, while some technical issues were apparently sorted out. Hopefully, we've been able to answer your questions satisfactorily. We're all available on the phones for the rest of the day. Call through to any of the team and we will endeavor to answer your questions. And if there are any investors on the call, let us know. We would be very happy to speak or come and see you. Thank you very much, everyone.

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