Q4 2016 Earnings Call

Company Participants

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

Other Participants

- Andreas van Embden, Analyst
- Ben Cohen, Analyst
- Blair Stewart, Analyst
- James A. Shuck, Analyst
- Nick Johnson, Analyst
- Ravi Tanna, Analyst

MANAGEMENT DISCUSSION SECTION

Lance Henry Batchelor {BIO 6884486 <GO>}

Morning, everybody. Can you hear me? Is my mic on? Welcome to Saga's second set of preliminary results year-end since we became a Plc back in May of 2014. I'm Lance Batchelor, I'm the Group CEO. I know most of you in the room. A few new faces as well. Welcome to you. I'm going to be followed up here by our CFO, Jonathan; and then afterwards, by our Chief Marketing Officer, Matt Atkinson, on the far right there.

I realize it's slightly unusual to have the head of marketing present at a results session. However, the Saga brand has an enormous amount of potential and value. We're just beginning to unlock that potential. I'm really excited for you to hear about some of the work that Matt and his team are doing and the implications that that has for our business. After we've all presented, I will come back up and the three of us will have plenty of time for some Q&A.

There's our agenda. That's me. Here we go. Saga has produced another set of strong numbers. We've delivered on all of our key objectives that we set for the year. And in fact, in some areas, we've exceeded them. We've grown our profits while we continue to grow our customer numbers across the whole business. Our model continues to generate very high levels of free cash flow. We're continuing to reduce our leverage. And very importantly, we've announced today a dividend of £0.072 per share, equating to 57% of our net earnings. As you know, this is ahead of market expectations. And we've also raised our future dividend payout guidance to 50% to 70% of net income.

Let's just remind ourselves about the strategy. Now we presented this strategy for the first time in January 2015, and it's almost unchanged. 16 months on, we're making real progress and the model is really starting to perform. Firstly, our core businesses are growing. We've reduced our capital requirements, we've launched the motor insurance panel that we talked about a year ago, we've ordered the first new ship, and we've built a great team.

Secondly, we've continued to invest in the future growth of the business. Saga Investment Services, which is our investment management JV with Tilney Bestinvest, was operational just in time for the key end of the tax year. Thirdly, we're maintaining our simple operating model, one that focuses on the core businesses in order to produce very high amounts of free cash flow. This cash-generative profile has been further enhanced by our recent review into capital allocation with our underwriter, AICL.

As a result of that, we entered into a quota share agreement with NewRe to cover 75% of the risks on our motor book. This allows for the capital held within AICL to be released gradually over time, leading to an enhanced ability to increase dividends to shareholders while continuing to pay down debt.

Finally, last year, after having identified that it did not fit with our core business model, we've divested Allied Healthcare, which simplified the business and reduced operational risks. So we've been able to deliver on each of the key areas of our strategy in the last 12 months, and we have a clear plan laid out for the next 12.

Let's look quickly at insurance which, as you know, is the largest part of the Saga business. I'm pleased to report that we grew customer policy numbers across all of our key insurance lines. We launched the motor underwriting panel as planned, learning from our previous success with the home underwriting panel. This has been further supported by our underwriting performance and our approach to pricing for risk. Our own underwriter, AICL, has priced underwriting risk to better reflect our excellent underwriting performance, which has allowed our retail broker to be more competitive in our core market.

We've also completed the acquisition of Bennetts, the UK's leading motorbike insurer. We've capitalized on our advantages in home insurance, continuing to drive efficiencies through the panel, and also of our travel and medical insurance businesses, which have grown strongly. Finally, our Solvency II approach was approved, retaining our strong capital position with a coverage ratio of 170%.

Turning now to travel. In 2015, our travel business had a very strong year. We saw significant profit growth and we are on track to deliver our challenging plans for that business. We won huge numbers of awards, reflecting our focus on exceptionally high customer service and our differentiated offering. Our cruise business continues to perform very strongly, and we started preparation for our new ship, which is due for delivery in 2019. And that, of course, will materially add to PBT within our travel division.

Moving on to emerging businesses. We continued learning about the new opportunities that we've identified for Saga. Saga Investment Services platform launched, as I said, at the end of the financial year as planned, just in time for the ISA season. We started, for the first time, cautious marketing and selling of the new service. I'm very pleased to report that we do now have our first real paying customers on this platform. And in fact, we've got over 500 of them so far who've invested over £5 million. It's small, but it's a good start.

Our private homecare pilot in Hertfordshire is performing strongly. It's moved from what we call pilot category to trial status. So we're now working on the most efficient way to scale it up and to gain volume. Our customers love it, carers love working within it, and the potential of that business looks good.

Our retirement village pilot in Wiltshire has gone well. Our customers have responded very well to marketing sales approaches from Saga, and we're working with Rangeford homes to help them to deliver a superb service. I actually visited that village about three weeks ago; it's a very impressive project.

Our people underpin everything that we do at Saga. They're a very important part of the strategy that we've outlined. Now we saw considerable senior talent join the team last year with a new CFO, Jonathan; and CMO, Matt, who you're going to hear from today. But also, a new Group HR Director, Karen Caddick, who's spearheading our ambition to employ the best talent available; and a new Managing Director for Saga Investment Services, Nici Audhlam-Gardiner. Her knowledge of the wealth management and financial services space is driving that business forward. These folks have already made a significant contribution to the running of this business and to how we think about it and how we approach new opportunities to improve and to grow.

So it's been an important year. I'm very pleased that we continue to build a track record of both financial and operational delivery. However, we're already three months in to the current year, so I want to run you through the priorities that we've identified for the business in the coming year.

Firstly, we're going to grow our insurance business, leveraging our competitive advantages in those markets using both of our panels, as well as, of course, our own underwriter, which is now mostly reinsured. In travel, we're going to continue to broaden our product range, whilst developing and enhancing our digital offering, maintaining the excellent service standards on our ships and working with the Meyer Werft shipyard in Germany to ensure delivery of our new ship on time in 2019.

Secondly, we'll continue to invest for future growth. In Saga Investment Services, we're going to start to bring in customers who require detailed financial advice and we'll be investing larger sums. In homecare, we're going to expand cautiously while we qualify an expansion model for that business. And in retirement villages, we're going to look and see how we could add scale in the future.

Third, we're always going to work on maintaining our simple and efficient operating model, generating additional free cash flow from the various initiatives that we've put in place: the motor panel, quota share agreement and the more efficient pricing in AICL.

Fourth, a new addition to our strategic aims. Having spent almost two years getting the foundations of this business sorted: defining the strategy, getting growth into all of our main businesses, reducing leverage, building dividends, divesting allied, building a great team. Having done that, it's now time for us to accelerate our work on the brand, on our customer relationships, on going more and more digital, and on cross-selling.

That's the main reason that I joined this business. And as I said earlier, Matt's going to tell you more about the things that we can do better in that part of the business, the exciting initiatives that he's got in place to further build the brand and to grow value.

I'm now going to hand over to Jonathan, who's going to take you through the numbers in more detail. He will then pass on to Matt, and Matt will talk you through that strategy to become a customer-driven business. Thanks.

Jonathan Stanley Hill {BIO 16892113 <GO>}

Thanks, Lance. And good morning, everyone. It is very pleasing to be able to report such a strong set of results in my first full set of preliminary results. We have reported good growth across the business with trading profit 5.2% higher. A strong increase in available cash flow has allowed us to further deleverage from 2.6 times to 2.3 times at the end of the year.

And based on these numbers and our future expectations for the business, we have proposed a final dividend of £0.05 per share. This will give a full year dividend of £0.072 at a payout ratio of 57% of net earnings from continuing operations, excluding the one-off benefit of the purchased Acromas tax losses. And additionally, as Lance has mentioned, we have raised our dividend guidance to 50% to 70% payout ratio.

Looking now at the group P&L. Revenue from continuing operations increased by 7% to £963 million. Insurance revenues were up by £20 million, while travel revenues were £42 million higher, benefiting from the full year benefit of Destinology. Trading EBITDA and trading profit grew by 5% and 5.2% respectively, and PBT was £176 million. This is after higher amortization of acquired intangibles and losses on the fair evaluation of derivatives, partially offset by lower non-trading cost impacting the year-on-year numbers by around £6 million in aggregate.

Profit before tax from continuing operations increased by 55% to £176 million, with the prior incurring material one-off IPO and exceptional debt costs. As a reminder, the prior-year loss after tax was due to the write down of Allied Healthcare. Basic earnings per share were strongly ahead at £0.133 with the prior-year again impacted by the IPO and debt costs.

Before I go on, I want to cover off two other points. Firstly, we have until now primarily reported on and guided to trading EBITDA. As the business is maturing as a Plc, we are going to move away from this measure and move towards a more meaningful earnings metric, which better reflects shareholder value in the long term. The presentation of this year's numbers will focus on trading profit as a more appropriate metric for measuring our performance. Trading profit is trading EBITDA less depreciation and amortization, excluding those amortization of acquired intangibles. And going forward, we will also focus on PBT as a key metric.

Secondly, we have adjusted the reporting segments to more accurately reflect the business as it is today. We therefore now report our insurance products together, including motor, home and other; tour operating and cruising combined make up insurance – travel. Thank you. And emerging businesses and central costs, together cover personal finance, which is previously in other financial services. Continuing healthcare services, previously in its own segment, the media businesses and our pilots and central costs.

Our core insurance and travel businesses performed strongly during the year, helping to drive the group's trading profit. Combined, these businesses increased trading profit by 9.1%. I will now look at each of these businesses in turn.

In motor, trading profit increased by approximately 18%, despite a highly competitive motor market. Underlying core policy numbers continued their upward trend and increased 3.1% in the year, excluding the impact of Bennetts. And with those Bennetts policies, growth was around 15%.

Revenue growth reflects a reduction in our core underwriting business, offset by the first revenue contribution of Bennetts of around £10 million. Our core underwritten business delivered an increase in trading profit of around £8 million, which I'll cover off in a second, with the remainder coming from a strong performance in our broad (14:51) Direct Choice business, and our claims handling and credit hire businesses.

There was limited profit contribution during the year from Bennetts, given that the peak motorcycle renewals occurred during the spring before we have purchased the business. And secondly, there's limited profit contribution in these numbers from the motor panel. We have retained our focus on achieving the right balance between growing customer numbers and growing profits.

In our motor underwriting business, profitabilities improved as lower net earned premiums were more than offset by improved claims experience, increases in other income streams and lower operating expenses. Net earned premiums were 2.7% lower, mainly due to falling or flat premiums during the back-end of 2014/2015 as these earn through. And secondly, a reduction in the business written for the AA.

The group has not seen the increase in claims frequency being reported elsewhere in the market. We continue to believe that this is largely a result of the characteristics of our current customer base, with the majority of customers being retired, therefore lessening the impact of lower fuel costs and current economic and employment growth. Also, claims severity during 2015 has been broadly stable. Again, positive compared to inflation and personal injury claims costs reported elsewhere.

The combined operating ratio at 74.4% has improved by 3.5 percentage points, partially as a result of the £2 million increase in reserve releases in motor, reflecting an improvement of claims experienced on large and small PI claims. The pure operating ratio improved by 1.9 percentage points with lower revenues more than offset by the benefit of our expected claims cost and lower operating costs.

The motor panel has performed well since its launch in the summer of 2015, with the new external underwriters accounting for around a quarter of the net premiums underwritten on renewals in January 2016. And we're very positive about how that is progressing. AICL's participation continues to be key to the panel's success both in motor and in home, allowing us to ensure competitive tension and efficient pricing towards our (17:23) broker business.

The panel is currently made up of five insurers including AICL, as with the home panel, it takes time and increased numbers of participating underwriters to ramp up the full efficiency. And we are aiming to get another couple of underwriters on the panel this year.

Favorable claims development experienced during the year to 31 January 2016 has resulted in a reduction of reserves acquired in respect of prior-year claims. This has been driven largely by large and small personal injury claims and by other classes resulting in consistent overall reserve releases year-on-year of £68 million. The strengthening reserves in 2014-2015 is an allocation of the reserve surplus and represents surplus on top of our cautious best estimate. There has been no deterioration in the 2014-2015 year.

Moving on to Solvency II. We gained regulatory approval, obviously, for the use of our Undertaking Specific Parameters route at Solvency II during the year. And under Solvency II, the group had an SCR of £129 million at the 31st of January 2016 and available capital was £220 million leading to a coverage ratio of 170%. This strong capital position is at the top end of the range we expect for our coverage ratio. This will reduce at the half year given that AICL pays its main dividend during the first half of the financial year. We have assessed the sensitivity of our solvency capital ratio at various potential changes, and we believe that our solvency position is robust.

In March of this year, we announced that we had entered into a quota share agreement with NewRe to cover 75% of the risk of the motor policies of our in-house underwriter AICL from the 1st of February 2016. The highly competitive terms of this arrangement are a testament to the quality of our book and historic underwriting performance. The agreement will help to reduce our exposure to underwriting risks and will lead to a gradual reduction in capital deployed in the underwriter. Combined with our more conservative investment policy outlined in our interims last year and more competitive pricing by AICL, this will result in an increase in available cash flow, allowing us to pay down debt as we have previously thought and increase dividends to shareholders faster than previously anticipated.

In home, despite a very competitive market, we continue to capitalize on the efficiency of the home panel, further reducing the net rate available to our retail broker. This enabled us to grow revenue by nearly 9%, which also benefited from higher core policy numbers and increased profits from the profit share agreement with New India. Trading profit increased by 3.2%, with growth in revenue partially offset by increased operating expenses.

Revenue in other insurance lines grew by 6.4% to £92 million, with increased travel insurance volumes and improved margins on private medical. Trading profit was down by £4 million, primarily due to two factors: an increase in the marketing investment earlier in the year in respect to legal services; and then the impact of the administration of Parabis Law, who were our third party, providing legal products to the group.

Our travel business has had another strong year of trading, delivering a 27% increase in trading profit. Revenue growth of 11% was mainly due to our first full-year impact of Destinology, but also benefited from growth in Saga Holidays and Titan. The profit growth was driven by three factors: both Saga Holidays and Titan businesses delivering higher revenues and profits with increased higher value, higher margin, long haul, and third-party cruise products; Saga cruise delivering improved yields; and finally, higher profitability in Destinology. So, a really positive year for the travel business.

Moving on to what we now I call our emerging businesses which includes our wealth management business, Saga Investment Services, personal finance businesses, Saga homecare, our publishing business, and the retirement village pilots. The segment's revenue and gross profits both increased in the year.

The increase in trading loss was due primarily to the normalization of listed company cost amounting to around £6 million of the increment with the remainder being additional investments in new businesses such as Saga Investment Services.

Cash flow performance for the year continued to be strong with the group achieving an available operating cash flow of £178 million, approximately 75% of trading EBITDA. The £15 million increase on the previous period was driven by higher dividend payouts from our restricted businesses, travel and AICL, both of which registered strong increases in profits; and therefore, we're able to pay higher dividends.

At the interims last September, we announced plans to reduced net debt-to-EBITDA ratio to between 1.5 times and 2 times with the dividend payout ratio of 40% to 60% of net income. We expected to be towards the bottom end of this range by the time we receive delivery of the first new ship in mid-2019 and before any debt associated with the ship has drawn on (23:42). We then expect to move towards the bottom of the range, again, in anticipation of the second ship being delivered two years later subject to us exercising the option. And after this point, the group would remain within this target range moving forward.

With the quota share agreement we announced earlier this year, combined with a more prudent investment policy and the expectation of vehicle possibly becoming smaller as the panel develops, we expect additional capital will be released from the underwriter gradually over time. The 1.5 times to 2 times leverage range remains our intension, but with this higher dividend guidance range of 50% to 70% of net income.

During the current financial year, insurance profitability is expected to benefit from higher policy numbers, the positive impact of the panel, the ongoing benefits of the efficiency improvements that we make within the services businesses, our broking business. This will be partially offset by approximately 1% profit impact of the recently announced quota share arrangement and by reduced level of reserve releases which are expected to contribute materially during the year, but on a reduced level from last year.

We believe that the steps that we have taken in our underwriter to reduce our exposure to potential losses and price risk more competitively, combined with our ambition to grow our footprint via the motor insurance panel, will result in a higher quality of earnings. And we are confident that we can drive continued profit growth in our motor business, benefiting from the written earned benefit of the motor panel and the ongoing efficiency improvements, more than offsetting the reducing reserved releases.

Strong growth in the tour operating businesses will be offset by the impact of a two-month wet dock maintenance period for the Saga Sapphire, which started recently. As a consequence, travel profitability is expected to be relatively flat year-on-year. Subject to market conditions remaining materially consistent, the group is targeting to deliver for full year 2017, both PBT growth of 5% to 7% and ongoing customer growth while, at the same time, continuing to deleverage towards our target range. As previously described, the additional capital released gradually over the next few years from AICL will provide that enhanced cash flow, which will enable us to pay the enhanced dividend payout ratio.

I'll now hand over to Matt.

Matthew Atkinson {BIO 21848472 <GO>}

I thought Pierce Brosnan look pretty good (26:46) 60. I'm absolutely delighted to be here. I think against the backdrop of the numbers that you've just seen, I've joined a very strong business with a very strong future and a strong foundation for future growth. What I wanted to do in the next few minutes is to give you a sense of the forward (27:07) destination and plans that we have to evolve the brand and some of the marketing activities, to give you a sense of my enthusiasm and optimism, but also my practical approach to creating action and future growth for the business.

I mean, essentially, there are four things I want to give you a sense of direction of travel and some of the actions that we're already taking. The first is about rejuvenating the brand and how we plan to evolve the brand proposition over the coming months and years. The second is about how we're going to do that through strong foundations of looking at customer insight, understanding customers deeply, and using their insights to transform the customer experience.

The third is a crucial investment in involving our multi-channel capability to adapt our models to the new world of multi-channel customer behavior. And the fourth, which is strongly related to the first three, is about how these activities will improve what we're going to describe as core product holding per customer.

So, let's just talk for a moment about rejuvenating the brand. 98% prompted awareness. It's a pretty big number. And actually, a lot of brands would kill for that level of awareness and also would have spent millions and millions of pounds to get it.

And my plan, obviously, isn't to start spending extra money. My plan is to take that number and do some work to convert it into what I would call mental availability. The opportunity for the brand is to do some really critical work around how we turn that level of awareness into what we call in the world, different salience. Be known for doing things that the customer really values. Ah, Saga is the company that does those amazing cruises. Oh, Saga is the company that does the amazing travel and motor insurance. And our opportunity with that level of scale is clearly to transition that into improved numbers and improved conversion over time.

That, of course, starts with a better understanding of the customer. One of the things that was extraordinary to me when I first joined is that we don't really have a way of measuring the brand in real detail. And so, some of the work that we've immediately done is to implement some new measurement system into the business which will come to fruition in June of this year.

What that measurement system will start to allow us to do is to really decode that awareness level to start to drive different sets of activities and actions that can improve our performance, but we've already taken other steps. So, for example, in the first few months of my tenure along with my partners in the business, we've started to really dig in to customer insight and understand the underlying reasons why customers behave the way they do. One of the things that Saga was really good at in the past was kind of a numbers-based measurement of customers, but what we're starting to do increasingly is get under the skin of customers, to talk to them and really understand their motivations, their choices, the reasons why they do what they did. Using that kind of insight is a massive opportunity for us to further differentiate our offer and to do things that are distinctive and different.

The other thing that we're also doing already is to implement a new way of measuring our customer experience. Historically, what we've done, as we've mentioned the customer experience in a really effective way, but what we're going to start to do is to deaverage those measures and start to do measurements along the customer experience in real time. These kind of systems will enable us to improve customer journeys, to unlock new value, to remove redundant processes and to improve an already stable and effective operating model.

But what is also happening as a result of these activities is we're already starting to use them to our advantage. Now, I expect you won't be able to see the full detail of this, but as a result of that insight work, one of the things we were able to do in our Christmas through to New Year travel trading campaign, we start to represent the benefits of Saga in a very different and distinctive way. The core message here is really, what that did for us as a business is to transform some of our core metrics. It improved our consideration scores. It improved our difference scores. And more importantly, drove a better return on investment for the overall campaign which, as you will have seen, has produced a strong set of numbers in our core business, and we will continue to do more of these things as time develops.

The other area that this insight is really driving is how we can transform existing assets that we already had. You saw that wonderful picture of Pierce Brosnan on the front of the Saga Magazine. One of the things that we've started to do is to think about what our digital content strategy is aligned to some of our core assets.

And this is a real opportunity for the business because most of our competitive set don't have the frequency of contact and opportunity that we do. We have a magazine with a very high subscription readership, but through a little work of thinking about the content and thinking about how we can use that content across our multi-channel footprint, we've been able to shift our numbers to have 1.8 million monthly visits to that content.

Now, that number is actually a significant opportunity for the business. That gives us 1.8 million opportunities to capture that data and append it to the GMD (33:06) to shop in a more personal way with a targeted offer and to do things that improve our operating model and to shepherd people from that content across into our trading businesses.

And already in the first part of few months of doing this work, we've seen a 33% increase in the number of leads from this kind of content going into our overall business. What we're also going to do as a result of the insight is re-launch The Magazine at the end of the year, and it obviously presents a very significant data opportunity for us.

Now, this is the one that I get really, really excited about. Now, I joined a business with a massive data asset. And actually, to be honest with you, our marketing operating model is really efficient, but clearly customer behavior has changed. And what we need to do is adapt our marketing and model to be more multi-channel. The opportunity here is really to connect up Internet and multi-channel with our physical data asset.

So, we're in the middle of implementing a new marketing cloud-based system which is called the Adobe marketing cloud. We're in the process of implementation and the capability will be live at the end of this year. What this really does without going into too much detail is it takes our data assets and it connects it to the Internet, so that we have a single view of the customer as they travel through our business.

What that means is we can do really simple things. So, you go to that website, you're one of those 1.8 million customers. You download a pension guide. We append that to the database. We can immediately see that activity. You happen to be in the process cycle of renewing your motor policy. When you shop in the contact center, all of that data will have been fed in to the contact center to enable somebody in the contact center to have an appropriate, targeted and relevant conversation.

Another opportunity is we have MySaga. And thanks to the business, we have 1.2 million registered customers in MySaga. And these are the people who go on a daily basis to administer their relationship with Saga. Imagine that we can take all of that history, that browsing history, the things that customers have done, so that when they show up in MySaga, we're able to personalize a relevant offer or activity into that contact. That leads to a high level of conversion. It leads to a marketing operating model. It gets much more efficient over time. So, this is a real step change for the capability, and we'll start to improve the way we're able to personalize, target and change the customer experience over time.

Finally, what that means is a reconcentration of our effort. Historically, you will have heard us talked about the number of 2.6 products per customer. We're going to shift our focus there to talk about real products. What that included historically was a single product plus an add-on. So, for example, you've had motor and legal, that counted as two. In this new world, we can concentrate our effort on real products, and the real number is 1.7. And so, my concentration and the team that we've already set up is going to be using these new capabilities to increase that number over time. Because they're more loyal, it creates better economic value, and we have significant headroom in our business to create future economic value from this focus.

We've already, as a result of setting up the new team, had a couple of trials in place, and you can see the numbers for yourself. So, we've done a simple travel-to-travel trial. We have taken that team and focused them on travel customers to travel insurance, 1,800% increase in the numbers. So, you can see there's a really significant opportunity for us. The second trial has been in our Investment Services business where we've concentrated our effort on customers who hold multiple products, perhaps they hold two or three. And actually, what happens is you see a massive and significant improvement in conversion, almost 18% uplift. So, the future focus of these activities and program is all about rejuvenating the brand, changing the customer experience and improving the core product holding per customer, and investing in the capabilities that were already being rolled out to do that.

So, in the future, the things that I'm going to be talking about are measuring obviously those increases in customer value but Net Promoter Score and the core product holding per customer and how that changes over time.

I'm going to hand back to Lance now.

Lance Henry Batchelor {BIO 6884486 <GO>}

Thanks very much, Matt. As you can see, some very exciting work going on in this area. I'm absolutely delighted to be working with Matt again for the third time in our careers. I'm looking forward to keeping you updated on our progress. Now, I'm going to sum up now with a brief look at current trading before concluding with a reminder on how we're going to continue to implement our strategy of growth and shareholder returns in the coming months.

Last year saw a sustainable rise in motor insurance premiums from the end of Q1. And we have seen this trend continuing into Q1 of the current year. At the same time, our claims experience has continued to be stable, as Jonathan said earlier, with no apparent negative fluctuations in frequency or in personal injuries. As such, AICL is continuing to price competitively and to win business. And the insurance panel, the motor insurance panel is behaving as anticipated, allowing our retail brokers to be more competitive outside of AICL's traditional core market.

The home insurance market continues to be a very competitive place to operate, but our proactive management of the home insurance panel means that we're very well-placed to compete. Within what we call other insurance, PMI continues to perform well, the medical insurance. On travel insurance, we have seen some impact of the falling demand for traditional winter sun destinations and for single trip travel insurance policies. But demand for the annual and for multi-trip policies continues to be very strong. Overall, you should expect continued robust performance across all of our key insurance lines.

On travel, we typically have excellent visibility into the travel business. We've already sold a significant proportion of our trips for this year, both in tour operating and also in our cruise operations. Also, as previously highlighted, we will be undertaking some necessary maintenance on Saga Sapphire during the current year, which will have a budgeted impact on the cruise businesses' performance.

And finally, let me just remind you of the earnings structure of the business and of our plans to continue to deliver on our strategy in the coming year. As you can see from this simple graph, over three quarters of our trading profit originates from areas where we have no capital at risk. This is because once we operate our own cruise ships and we underwrite some of our insurance policies, the majority of our business operates as a brokered model.

By further growing our core businesses, we're going to continue to capitalize on the initiatives that we've already put in place in order to grow in a non-capital intensive manner. Capital in our underwriter will continue to reduce as the quota share agreement takes effect and as AICL prices more effectively to accelerate cash and profit generation.

The overall contribution from our underwriting activities in AICL will also continue to reduce as the insurance business grows via the motor panel, meaning the majority of our future earnings will come from broking activities. When combined with prudent investment for growth, maintenance of our simple operating model and our continued focus on customer centricity, this is going to result in future free cash flows supporting increased returns to shareholders via a progressive dividend policy.

All of this means that moving forward, we are fully focused on creating a business with low capital intensity and high earnings resilience with increased free cash flows leading to higher dividends. We have great confidence in the sustainability of this dividend policy.

So, that completes our formal presentation, I'm going to open up to questions from the floor. Please, can I ask you to wait for the mic, to state your name before asking your question. I'll triage the questions and pass them on to the team if appropriate.

Who should we start with? So...

Q&A

Q - Ravi Tanna {BIO 16926941 <GO>}

Thank you. Good morning. It's Ravi Tanna here from Goldman Sachs. I have three questions, please. So, the first one relates to your earnings guidance and your switch from EBITDA to PBT of 5% to 7%. I understand there's a 1% drag from the quota share deal. I was just wondering, is that purely the fixed fees that you're paying to NewRe or should we expect a further drag relating to profit sharing or profit commission arrangements that you have there?

The second question was, how long should we think about until your motor earnings profile normalizes? Clearly, you've got reserve releases coming off a transition to the capital-light model and 25% of premiums already going through the broker panel. So, should we expect 2017 to be the trough as it were?

The third question is on Saga Investment Services and the wealth management JV. I guess, firstly, should we expect any further costs from either of those entities? And secondly, with the Legal Services product, do you – will you continue to be selling that product or what's happening now that Parabis has gone into administration? Thank you.

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

Thanks, Ravi. I suggest Jonathan takes the first two of those questions and then I'll pick up on Investment Services and Legal.

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

You should assume that the 1% is pretty much the cost, that is the fixed fee and there is an immaterial element which is a profit share. That's quite a straightforward one to start with. I'm just trying to pick up on the second question, Ravi, you're talking about the normalization of profitability. We've got various things going to be going on in our motor business. You've got the impact of the panel and that has a couple of effects. That is the effect of a written earned benefit as we get more broke and less underwritten business. So, as that percentage grows over time, you will get a benefit until that stabilizes.

Going the other way, you will have reserve releases reducing, and that will happen gradually over time into the future. And then, the third element, that wasn't raised but is something we deliver year in year out, is improvements, efficiencies across our broked business in terms of how that's run by Roger and the team. And we clearly see that the benefits of the written earned benefit plus those efficiency benefits that Roger delivers year in, year out should more than offset the impact of the reducing reserve releases. And as well as that, we have a bigger motor book than we did before.

So, I think – does that answer the question, Ravi? Okay.

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

On Saga Investment Services, we've always been clear that the level of investment required to get that off the ground is quite low, low-single-digit investment. It will – it's not expected – has not been expected to breakeven for at least a couple of years where we get it off the ground. Remember, it's a 50/50 joint venture, so costs and then benefits are shared with our partner, but it's not material to our results. And on legal, that was our pilot.

The partner that we were working with went into administration. And consequently, we've paused that project while we review alternative suppliers. We still believe that there is an unmet consumer need in the space. What we learned during that pilot process was that Saga customers were very interested in the proposition. So, the team is, if you like, taking a pause, drawing breath, finding the right alternative supply structure. And then, I think you should expect to hear news from us again.

A - Matthew Atkinson {BIO 21848472 <GO>}

And the other thing we did do is ensure that we got another supplier to ensure that we got no customer detriment through this process.

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

Blair, I think you had your hand up before. Yeah.

Q - Blair Stewart {BIO 4191309 <GO>}

Thanks very much. It's Blair Stewart from BofA Merrill. A couple of questions on the panel. Firstly, I think you've indicated that one quarter of the volume is going through the panel as things stand. Could you give us a broad outlook there? Does that go to the half or what do you think in rough terms? I know it's difficult to say. And as that happens, should there be any impact on the P&L? Do you make less money from the panel than you would from underwriting? I know the profits emerge more quickly in the panel. That's one set of questions.

The other question on the panel really is just to your expectation for growth in the policy count. I think it was up 3% in the last year. With the introduction of the panel, are you able to tap more customers that you wouldn't normally have reached? So, should we expect that 3% to continue to grow?

And finally, on the dividend, we get dividend ranges from lots of companies, and some are just indicative and they have no intention of moving up the range. And some companies do have a real intention of moving up the range. Where does Saga sit in that range? Thanks.

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

Okay. I think we'll split the answers. So, I'll just answer the question about the panel percentage. The key point to make about our panel is it is genuinely a level-playing field. AICL sits on that panel and so do a number of other supplies, and there will be more that come on to the panel in the coming year. And essentially, all the underwriters sitting on that panel fight for share. And it's up to them and their strategy and their risk assessment as to how much volume they choose to win on that panel.

Our broking business will pick the best priced supplier and go with it. Therefore, we cannot predict and we don't try to predict the right number for third-party underwriting. We've been operating a panel for five years now with home, and we've seen an ebb and flow to AICL's share on that panel. We passionately believe in being on the panel ourselves with our underwriter. Because, if you like, that keeps the panel honest and it means that we continue to learn about all the dynamics of the marketplace. But we don't have a target number for what percentage AICL takes or third parties. What we want is to get the best possible price and the best possible service for our customer.

Do we publish AICL share on the home panel? I'm not sure we do.

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

It's somewhere just over a quarter.

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

There you go. We do now. And Jon will talk about the P&L with...

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

Yeah, sure. I mean, setting aside the written earned benefit and the underlying economics of a broked versus an underwritten, clearly, the underwriter is pricing to a 3% return on net premium to the extent that we can get a cheaper piece of underwriting from somebody else. We will make more money in our broked business and marginally less money in our underwriter. But at the same time, we will require less capital to be retained within the underwriter. So, from a profit prospective, we do not expect a significant detriment or any detriment, in fact, from moving to this.

I mean, the key point here is the customers who are likely to go to the panel are people who are probably at the riskier end of our driving set, where we aren't – which doesn't necessarily sit right within our sweet spot, and others are likely to come with a better price than we would price that. So, we think this will not be negative to underlying economics.

The next question was in terms of policy count. We have been very clear all along that we will continue to use the levers around profit and volume in order to deliver an earnings stream across our range of products. We have a choice should somebody come to us through a direct channel to the business, a cheaper distribution channel. We have the choice of still spending the marketing money we had intended to spend on a higher priced channel, or we can decide to deliver the same amount of growth and deliver more profit. We always have that metric, that ability to play those two levers of growth and profit, and we'll continue to use those to ensure that we can try to drive a sustainable level of profit growth while delivering customer policy growth as well.

And then your final question was, are we actually going to do what we say we're going to do. Sort of. I think the most indicative point that I can give you is we've gone from 49.5% to 57% in one go, and you should expect us to continue to be progressive in the range over time and move that forward. We've taken a big step forward in the first year. You should expect us to move forward again as we move into the future.

Q - James A. Shuck {BIO 3680082 <GO>}

Thanks. It's James Shuck from UBS. I had three questions, I think. Firstly, just on the reserving situation, could you just clarify the comments on page 8 of the report? You talk about competitive approach to pricing, meaning that in the future, more profit will be realized in the current year while historic reserve releases will reduce over time. I'm not sure why competitor pricing, as such, had really influenced that emergence of profit.

I think what you're saying is you're going to be reserving less conservatively on new business and therefore, the releases will come down over time because you book the earnings upfront a little bit more. But perhaps you could just clarify that for me, please.

Secondly, on the allocation of surplus onto the 2015 year. So you've obviously seen what looked like negative development on 2015, which you're saying is just a reallocation of the surplus. I'm not entirely sure what's happening there. Could you just explain to me why you kind of added to that that surplus, particularly if my interpretation of the first comment is right because it seems to be that, therefore, you will expect further releases to come through. I suppose connected with that, it seems like you've restated the reserve release from last year by £10 million, meaning that the pure year as such was not as profitable as we initially thought. It's not clear to me why that was the case.

And then my final question is around the non-trading items. So you have a number kind of below the line items, which, I think, had a £7 million release from contingent consideration from Destinology. You had nearly £4 million write down from Bel Jou Hotel, and a near £3 million release from legal disputes. All of these things have kind of caught me by surprise somewhat. I wasn't aware that you actually owned hotels. There's nothing in the investment portfolio that really suggests that you have financial assets as such, so could you just give us some insight into the investment portfolio and nonfinancial assets that might be a part of trading activities that are held there? And just to clarify the situation whether there's any other legal disputes. It's a question I'd asked in the past, and I was pretty sure I got an answer that there was no ongoing disputes at the time, so I was surprised to see that and that number come through.

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

Should I take those then?

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

I think you can take this.

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

Thank you very much. That's very kind of you, Lance. I think you've answered the first question, actually, James. The point is that years back we had two effects going on. We were pricing incredibly conservatively within the underwriter at the point where our policy count was dropping year-in, year-out in motor. And what we have clearly said for the last 12 months is that we will price not less conservatively, but closer to best estimate but still within our limit of caution.

And you're absolutely right. What that means is we don't keep piling up reserves, which we released in the future. What we ensure is that we give Roger and the broke (54:07) businesses the right price of risk to go out into the market and be able to contract and compete. So you're absolutely correct, it's about pricing closer to best estimate.

On the second point, the allocation of surplus. This is basically just saying the way that we price within our underwriter is at best estimate plus a return on that of circa 3% of net premium. Effectively, within our total reserves, we have a surplus that was non-allocated to that year and all we've done is move some of the historic surpluses out against prior years to against that year. So there's been no deterioration in the performance, so we're not expecting the underlying performance in that year to deteriorate. What we've done is put some of the surplus against that year.

Restated prior year releases, we actually mentioned this at the half year. It was noted then. We talked about it then. We don't think it's a big issue. In the prior year numbers, there were £10 million of claims costs which were shown in the current year rather than the prior-year releases where they should've been. So what we've done is correct them and make sure they are purely comparable on a year-on-year basis. That okay?

Q - James A. Shuck {BIO 3680082 <GO>}

Okay.

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

And then on the non-trading items, there's a specific question which I'll deal with. We owned one hotel that was bought a long time ago. That is one of the few hotels in Antigua that is actually on top of the hill rather than by the beach. We have taken the opportunity to look to sell that hotel and have written that hotel down. It's the only asset we held. The only other assets that we hold within our underwriter, which are property-based, are the buildings that we use in the UK that we own. There are no other assets such as the Bel Jou.

Do you have any other specific questions on the non-trading items?

Q - James A. Shuck {BIO 3680082 <GO>}

Just on any other outstanding legal disputes we should be aware.

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

No. I mean, there was an old dispute around a ship refurbishment, which is what we settled with the yard. So we had fully provided for it. We then ended up getting some money back in that dispute. So it was a positive for us.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay. Thanks.

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

Thanks, James. Lots of hands up. Ben.

Q - Ben Cohen {BIO 1541726 <GO>}

Thank you. It's Ben Cohen at Canaccord. I had two questions. Firstly, I think in the past you've provided some information about the people that you've put on to the database in the period. And I just wonder if you could say how that is moved in the year and in the six months, whether you still have kind of good momentum in that? And maybe a related area, in terms of the cross-sell target that you're looking for, I noticed you didn't kind of put any number to that. If you're not prepared to put a number to that, would you be able to talk in terms of the kind of incremental benefit presumably included in the EPS or the PBT growth guidance that you're looking for? How much of that do you see coming through from cross sell, if not in this year then maybe in the next year? Thank you.

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

Well, on the first one, I'll have to get the exact some number for you, unless Matt knows it off the back of his head. But it's going to be straight line build basically, carry on (57:32) added.

A - Matthew Atkinson {BIO 21848472 <GO>}

Yeah, the database is in good health and is growing. We have momentum in growth as a result of the business growing and attracting new customers. So the new named process as we would describe it is in growth as a result of the growing businesses and the growing performance.

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

Obviously, over the year, we started at 10.8 million, and we finished at 11.2 million. So, we talked previously about adding gross 500,000 to 700,000 and around 200,000 people leaving the database each year so you get a net growth of around 400,000, which is exactly what's happened during the period.

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

Whenever we see growth in either motor or travel insurance or both, those tend to be the two big sources of new names into the database for us and they're both growing at the moment. So we are seeing names coming in. I think what'll be exciting to talk about in the months and years to come is the conversion of those names into a more complex relationship with multi-sale.

So picking up on that point, we're very explicitly not putting hard numbers against the opportunities for cross sell at the moment. Obviously, we've done the maths on what the opportunity looks like, but our core budget assumes minimal change in cross sell. So if we can drive cross sell with more products out over time, we see that as a real opportunity for the business, hence, if you like, the level of excitement that we have about it. But we're unlikely to go into the market with specific targets on cross-sell. What we will instead do is report looking back, if you like, on how well we're doing every six months or so. Next question?

Q - Nick Johnson {BIO 1774629 <GO>}

Morning. Nick Johnson from Numis. A couple of questions. Firstly, just coming back to the 25% number in terms of premium income that's not going to the panel in January. It's quite a big number. I was wondering if there's been a corresponding drop in premium income to AICL, or is this growth coming from outside the footprint of AICL? Can you just elaborate on the makeup of that 25%, please?

And then secondly, just a technical issue, I guess, is just the cost reallocation between segments that you've done based on new revenue split. Is that going to be an ongoing adjustment period to period? Thanks.

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

The answer to the second question is my hope is not. But, I think what we've got is a stable base now. I think we've got the allocation real set and we will attempt to stick to those so we don't get so many movements between categories going forward.

On the 25% panel share, that is primarily customers that we were historically underwriting that have then moved across to the panel where a better rate has been offered. They tend to be slightly at the higher risk end of the drivers that AICL was previously underwriting. So the panel is doing exactly what we thought it would do.

In AICL's heartland of low mileage older vehicles, we are still definitely the most competitive within our core dataset that we understand absolutely implicitly. And at the edges of our boundaries of risk, there are others who take a different view of the price of that risk which is exactly what we'd expect. So yes, there is a converse decrease in premium going to AICL, yes.

Q - Nick Johnson {BIO 1774629 <GO>}

Thanks.

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

But there is also some growth coming through, as you can see, from the underlying motor business, anyway.

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

A couple more questions, then, we should wrap.

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

Andreas van Embden, Peel Hunt. On the cash conversion rate of 75%, just as your business model develops and you move more into the broker business, is there anything holding the business back increasing that cash conversion, and where could it go to aside from CapEx, obviously, in the ship?

And the second question is on Saga Investments. What levels of assets under management would you be targeting over the next three years? Or maybe, could you give a level of assets under management where you would be breaking even on that business? Thank you very much.

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

You can take the first. I'll take the second.

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

Yeah, sure. We're at, obviously, 75% in the year. We would expect to be in the 70% to 80% range over time. There are areas of investment that we will undertake. I mean, we have some deposits going on the first ship, which come out of their respective businesses but still effectively hold back the cash flow of the business. There are other areas we need to put small amounts of money in. Fundamentally, I don't believe we'll move outside that range.

What we're saying about the cash flow is that with the quota share in place, the likely smaller AICL, the investment policy, our cash flow will be better than we had planned it to be, thus enabling us to pay that higher range.

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

In terms of projecting assets under management, it's very interesting. If you talk to veterans of (01:03:00), St. James's Place at one extreme or (01:03:03) at the other extreme. It's impossible to predict what your assets under management growth curve will be. So, we have avoided the temptation to try and put hard numbers into a plan or a budget. What we are doing is we're using our database and we are growing, and we're going to see where it goes to.

The good news for us at Saga is that we'd have to put no capital in to get this business started, unlike a lot of those other brands that have had to start by injecting tens of millions of capital sometimes. There's a bit of operating cost to build a small team. And then very efficient marketing, because we're talking to our own database. We're talking to customers that we already know. And so, if you like, we're balancing the level of investment in marketing and learning about the most efficient marketing as we climb the assets under management curve.

The only honest answer we can give to you is we don't know what AUM will look like in three or five years' time. We do know where breakeven is. I don't want to publish that number because it's commercially sensitive, but it's surprisingly low because we haven't had to put huge amounts of capital in. Sorry, that's not a helpful answer when you're trying to model what Saga Investment Services can be. I totally recognize that. The only consolation I can give you is we can't do any better than that internally in our own budgeting.

What we do know is there's an unmet consumer needs. Our customers like what we're offering. And in a way, it's a typical new Saga launch. You have to see where it goes over time. Please follow up. Yeah.

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

So, okay. So in that case, you mentioned, I think during your marketing presentation, that you would be shifting to customers that would deposit higher amounts.

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

Yes.

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

What is that just average per customer deposit, which you're targeting? Thanks.

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

Well, the first wave of customers that have come in came in on the back of the annual ISA charge. And so it won't surprise you, because I think it's pretty close to industry averages that their average investment was around about £10,000 a head. But an important thing to remember about customers in that world is that they invest many times on the same platforms. So when you look at assets under management, it's not the simple math of one customer multiplied by an investment. The same customer should come back to you again and then again and then again to get a kind of cumulative impact.

Now what we're now starting to get is the customers for whom the investment is a much bigger decision. Because this isn't £10,000 on the ISA, this might be £50,000 or £100,000 of significant savings. Those conversations typically, according to the industry experts, can take six months or even more to get from first contact to money actually arriving on the investment platform.

What I can tell you is we have a number of customers that we can see coming down the pipe. Some of whom have committed already. And between now and the next ISA season, our focus will largely be on those kind of more complex transactions. That obviously changes the average per customer dramatically when you get a few customers come in putting £50,000, £80,000 in instead.

Again, I've got good visibility into how many customers we've talked to have come back for second conversation, have indicated willingness and we can make projections as to what kind of assets under management that will be. But until we've been around the whole loop ones, full year of operating, it's going to be very difficult for us to make any projections.

A - Matthew Atkinson {BIO 21848472 <GO>}

One note if I may. This is sequencing opportunity as well, so the marketing plan work will have been done by the end of the year. That gives us a much more joined up view of the customer. We have very high levels of traffic. So that'll allow us to use our current model in a much more personalized way. So we'll experiment with that when we get to next year, and that will give us a better way of understanding customer behavior and opportunity.

So to Lance's point, we've tested the operating model. We've got early in signs, but actually we're putting some capability into this business that will allow us to do – explore the opportunity even further in the next period.

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

One more questions, or are we there? Looks like you're exhausted. Thank you very, very much, everybody. Really appreciate you coming along, and we've enjoyed presenting. Any follow-ups, please come back to us. Thanks.