Y 2018 Earnings Call

Company Participants

- Adam Westwood, Chief Financial Officer
- Geoff Carter, Chief Executive Officer
- James Ockenden, Chief Actuary

Other Participants

- Andreas van Embden
- Iain Pearce
- Joanna Parsons
- Nick Johnson

Presentation

Geoff Carter {BIO 20756770 <GO>}

Well, firstly, a very warm welcome to people here in the room and on the phone. We're really pleased to be presenting our first full year results. We're also really pleased with these results in what I think has been a pretty challenging market still. Very conscious. We're amongst the last to present and you've heard much of the market moves already. What we're going to try and do is put out our own slant on some of the market factors. We also hope to demonstrate what makes our strategy different, our business model unique and why we think we have unique advantages in this market.

We've also reflected some of the feedback from the analysts from last year. The first of that is who is sitting upfront. On the top table, alongside Adam, I think most of you know, we've got James Ockenden and Trevor Webb, our Chief Actuary and Claims Director. Anything that looks like a difficult question is going to be heading their way later on.

On the agenda, I'll have a quick run through the highlights, Adam will then talk through the financial results. I'll then give a bit of market context around (inaudible)performance, very brief reminder of our strategy and then a summary outlook, followed by Q&A.

So without further ado, I think as context here which we'll return to later a couple of times, we believe we've fully covered all emerged claims experience during last year. That's probably a pretty differentiated picture from other people in the market. So despite those significant price increases, we are very content with the level of premium that we've experienced. We think a very strong set of results in that market even compared to what was rather an exceptionally strong 2017.

What's that given us? Leading underwriting performance; a loss ratio of 48.5%; expense ratio in line with our target at 22% and a combined ratio I think extremely strong in market terms of just over 70%, considerably inside as you know our mid-70% combined operating target.

Very strong profitability. Adjusted profit after tax of 50 million, a return on tangible equity of 54.4%. Probably one of our key measures is the capital generation. Solvency ratio reached 213%, well over our 140% to 160% target range. Despite that, we've maintained flat premium, very much in line with our expectations for last year. And probably one of the key messages, all of that has allowed us to announce a special dividend and, we think an attractive full dividend for the year of 20 pence a share.

Aside from the numbers, we continue to develop and enhance the business pretty strongly. Some of the key themes are we continually roll out new rating factors. We continually test new datasets, so we continue to build our defensive model and especially in the non-standard part of the market. We've soft launched a new direct van product. We've underwritten van for many years. What we haven't had is a direct-to-consumer offering. That is now being rolled out on the first aggregator across (inaudible) and more will follow through this year.

As you'll see, we spent a fortune with our brand consultants, and we've stuck the word van on the end of our (inaudible), very much in line with our straightforward approach to these things. We're going to continue to enhance the broker product through this year with some tweaks that we think will allow us to position ourselves in the slightly nonstandard end of the van.

On the operational side, we're continuing to roll out software robots, and these are designed to enhance customer service and efficiency and really allow us to get staff focused on value adding tasks rather than things that can be automated. We've completed our transition to the new hybrid cloud. And interestingly, we're testing very innovative AI and machine learning processes, not only in pricing but in the rest of the business. If anything, I think we're finding more benefits from things like fraud identification and fraud behaviors than we are from fewer pricing impacts, which is perhaps not where we expected to be. Last but not least, we've engaged BDO as an outsourced internal auditor.

On the employee side, and we maybe don't talk about employees enough in these presentations. They are key to our success. Very low levels of employee turnover still. We completed our first staff survey last year. Delighted to say that 88% of people would recommend us as a good place to work, which is fantastic.

So on that note, Adam?

Adam Westwood {BIO 20481660 <GO>}

Thanks Geoff. Welcome everyone. It's good to see so many familiar faces here. I'll run through the financial results for the year and give you a little more detail on our underwriting result and capital management.

So 2018 was a year defined by competitive market conditions and our response to them. Despite continuing to price to our target combined operating ratio in competitive market conditions, we've managed to maintain a flat premium year-on-year. Following an exceptional underwriting performance in 2017, our combined operating ratio has increased a little as we turn towards our normal performance. The slight dip in adjusted profit is therefore a direct result of the year on year move in combined ratio.

Given we are writing business at our target mid 70s combined ratio, it's evident we're still benefiting from good news coming out of prior years, all of which has left us in a very strong capital position. At year-end the solvency coverage ratio of 213%. As a result, we've decided to return approximately 100% of this year's earnings to shareholders, paying a total dividend of 20 pence per share for the year. This will leave us with a solvency capital ratio at the top of our preferred operating range.

A little more on the underwriting result. Our expense ratio remains at historic levels, and the year's result continues to be driven by our underwriting performance. In common with previous years, our current year loss ratio is higher than our target ultimate loss ratio because of prudent reserving in more recent claims. The higher current year loss ratio is offset by the runoff from prior years. There's been no change to our reserving methodology in 2018. We continue to pick a prudent best estimate and apply a fixed percentage risk margin to open claims proportionately across all accident years.

We've not changed the percentage risk margin in 2018. We have again seen some exceptional reserve releases coming through in 2018, largely due to continued positive claims experience. The impact of the reduction in reserves held against prior year claims and assessment of prior year claims at less than our opening reserve was just over 10% in 2018, a similar level to 2017. There's no explicit distinction between exceptional reserve releases and business as usual runoff of prudence in claims reserves. However, we continue to expect the level of prior year reserve movements to halve over time, bringing our combined operating ratio for the years towards our mid-70s target.

A quick note on investments. We continue to run an ultraconservative portfolio, which we generally hold through to maturity. Because our investments are held at fair value through the profit and loss, this introduces a little volatility to the annual profit, although valuation movements tend to unwind over the life of each bond. The net yield to maturity on our portfolio, absent any market value fluctuations, is around 0.8%.

So a little more detail on our capital position and our approach to capital management. Fundamentally, writing business at Sabre's target margins generates excess capital. Our capital requirement will grow with increased volumes of business written, but the increase in capital generated through writing business should exceed any increase in the capital requirement. During 2018, as Sabre did not grow and profit generated during the year increased our capital, so -- with no increase to capital requirement. As a result, the group is happy to recommend a dividend of around 100% of our adjusted profit after tax.

Our overall approach to capital management remains prudent, which means we'll continue to hold a minimum level of capital of 140% of our solvency capital requirement. In targeting a mid-70s combined ratio, we can be comfortable that writing business increases our capital surplus. Where necessary, we do invest capital in the business. While we've undertaken minimum capital expenditure in recent years, holding excess capital above our 140% floor allows us to do so if and when required. Our overriding view of capital is to retain within the business only what we need to support our underwriting activities with an appropriate buffer to return the business from any reasonably foreseeable shocks.

We've set a preferred operating range above our capital floor, which enables more stable returns of capital to investors by supporting dividends during cycle downturns or periods of rapid growth. As such, we aim to return excess capital to shareholders through a steady flow of dividends. This has been demonstrated in 2018 where we paid a special dividend, returning all of our earnings for the year to shareholders and retained capital at the top of our preferred operating range.

As you can see from the graph, we started the year at the top of our preferred operating range, generated significant excess capital during the year and are proposing to return that to our shareholders through a special dividend. And on that note, I'll hand back to Geoff for an update on strategy and the market.

Geoff Carter {BIO 20756770 <GO>}

Thanks Adam. Okay, that's looking back. I guess we now start to look forward a bit. So what's the market context around current and future results and I guess, what's our view on some of the key market developments?

What we have here is two graphs that start to inform our view of claims inflation. The top graph is the frequency of personal injuries, more personal injury claims in the market. And the second graph is the ABI data on overall settled claims on a non-injury and all claims bases. What this says to me is that personal injury is pretty flat. We saw declines at the start of the year, but no further declines since then. We think frequency now looks fine, but the cost of injury and bent metal continues to increase pretty rapidly. Our view from the market stats is that noninjury claims have been increasing at a compound rate of around 10.7% since 2015 with all claims inflation just over 5.5% over the same period.

That takes us to our view of claims inflation. Our view is we are in a range of 6% to 7%, which I'm conscious may be slightly higher than other people in the market. What drives us to that level? First of all, bent metal. This is the cost to fix now owned and other people's costs. We're at a high single-digit percentage year on year driven by technology in vehicles becoming increasingly expensive to fix.

PI frequency is flat, but the cost of the outflows have continued to inflate around 5%. And interestingly theft is becoming a bit of a plague, I would say. We've been (inaudible) about this recently. We're seeing theft inflation running at 25% year-on-year. So our view is corroborating market data and our own experience would leave us move definitely in the 6% to 7% range.

The other side of that coin is average premium and premium inflation in the market. There are some seasonal peaks in here. I would say the market looks pretty flat over 2018. So if you have claims inflation running at 6% to 7% and premium inflation running at 1% to 2%, there's clearly jaws opening up in the market. Maybe at best some green shoots. Feels like the market's not going down, but I'm not seeing strong evidence yet of increases coming through. As a general comment, maybe some of the larger listed players are pushing hard, some of the more medium-sized players don't yet seem to be following quite the same position.

We think the market is in quite an interesting balance at the moment. There's a range of potentially inflationary factors, so continued claims inflation, competitor margin squeeze, if our hypothesis is correct, the lawyer response to some of the legal reforms to come through and the FCA pricing review that's underway. On the other side, whiplash reforms, the Ogden discount rate and a plethora of MGAs that are launching around the market in the personal insurance space. Our strategy throughout this is to continue to price at the mid 70s combined ratio, more reflect changes as they occur and we'll be continuing to avoid speculation on where rates might go.

So guidance to these and a bit more detail. The FCA pricing review, I'm sure many people here -- everyone knows about this, really focused on inertia pricing and propensity modeling with a key concern around pockets of vulnerable customers. What are the possible impacts? Potentially an increase in new business pricing, if there's forced parity or nearer parity between new business and renewal prices and a risk of customer redress if companies are found to behave particularly poorly. Sabre doesn't utilize inertia pricing or propensity modeling. Our prices are calculated purely from risk. So for this review, we'd expect to be net neutral at worse, potentially net, well, in market terms.

The market claims inflation factors. We've just discussed claims inflation running high. Premium inflation doesn't seem to be matching that. The current dynamics continue, there must be a potential margin squeeze across the industry. It's unclear how strongly competitors have reflected that inflation in premiums. To restate, we believe we fully covered all emerging claims experienced in '18 and into '19, so we are entirely focused on maintaining underwriting discipline.

On the whiplash reforms. I think there's a fairly general strong view that these could generate saving of GBP30 a policy on the average premium in the market. That probably equates to around GBP30 a policy. Our average premium is nearly double the market, so potentially a 5% impact. We believe there's plenty of reasons to be cautious about this. There's a real risk that lawyers adapt their behaviors to neutralize some of the planned savers. There's potential for new non-whiplash claim elements. For example, (inaudible) loss to come in into the claims, a very realistic risk of emergence of new non-regulated claims management companies, often called McKenzie Friends, for example, which we can talk about later if of interest.

A lot of associated claims elements aren't included in these reforms, the most obvious one being credit hire. A real risk of claims being inflated could drag (inaudible) small claims limits. Overall, no guarantee that savings will occur would be my take on this. Our approach will be to focus on, I guess facts, not opinions. So we'll reflect these changes in our rates as and when we're confident the evidence is going to emerge and the price benefit will actually come through. The Ogden discount rate is a bit of a sideshow for us in some ways. We've got quite a low retention limit, the impact on us, no more than GBP1 million in the P&L. We're continuing to reserve and price pretty prudently on the current Ogden discount rate.

Again, reasons to be cautious around Ogden I think. The discount rate is going to be reassessed every 5 years. Now by their nature, some of these claims may take a long time to settle. You could guide them potentially two or three Ogden review cycles before you settle a claim. It only impacts England and Wales, and the Scotland discount rate is expected to be lower than the English position. I think our approach will be consistent. We'll reflect those changes as and when we're confident that they're going to emerge and we can properly cost (inaudible).

So what's our approach been over the last six months and into this year? We think we've very much walked the walk, I will say. We focus on profitability, not volume. As you know, we reduced prices at the start of last year to reflect the small BI frequency trend that we observed. Since then, it's reasonable to assume we've backed out all of those changes and have increased our prices heavily through the back end of last year and into the first part of this year. We believe that means we've fully covered claims inflation and have minimized any negative jaws between premium and claims inflation.

A reminder of our strategy. The four, probably the key bits, maintain a wide underwriting footprint, but continue to develop a defensive nonstandard position. Absolute laser focus on our mid-70s combined operating target. We don't want to deviate from that target. Continue to generate very strong cash returns and dividend. And I think the bit we are emphasizing today is we're very happy to use our capital range to support dividend in flat parts of the market. We stated this on our IPO and I think we're reiterating today that's why we have a range.

And we absolutely believe we will benefit from controlled and attractive growth across the cycle, but not in any individual year necessarily. We will grow at the right time. Our strategy had a bit of a sort of paper advertising actually. After Prince Philip had his unfortunate crash recently, the Daily Mail carried out some research on who in the market would now provide insurance to a 97-year old who just crashed his car. And had three brands in the market would, of which we were two. And having spoken to the top one, they didn't really intend to put that price out. So I think this is a good demonstration. We think there is a right price for every risk. Sadly, he didn't choose to pay a GBP24,000 premium, but we do have others who do it around that level.

So what are some scenarios if we look forward? It feels to me a bit like we're driving through the fog at the moment. We can see the outliner changes, but I will say things are still pretty unclear. Our strategy is to slow down, arrive in one piece. We need to accelerate hard once the fog clears. I guess the alternative is you keep your foot down, you might arrive very quickly or you might crash into a tree. We are pretty clear what we intend to do in this scenario.

So what do we see? If our current approach is correct, and we believe it is, potential market -- margin compression will lead to price increases. We've already taken our pricing action to correct the position and will therefore be able to grow naturally if market prices increase. Potentially, the FCA pricing review impacts in addition.

If we are to too cautious, and we don't think we are, that will be demonstrated in our data over the next 6 to 12 months. If that is the case, we'll be able to reduce prices at which point we will grow. In this scenario, we're confident we will grow. It's the timing that is uncertain. I think one point. As we are pricing ahead of the market, it's probably reasonable to assume we're going to see a slower start to the year in GWP this year, but we then expect that GWP to accelerate through the year as market prices start to catch up. And I'm going to reiterate, we absolutely believe that we will return to GWP growth at an appropriate time in the foreseeable future. I just can't foresee when that is exactly.

So the summary and outlook. We're very focused on our long term, very successful strategy. We're absolutely not going to waver from our focus on the mid-70s combined ratio target. This very profit focused model aided by our bias to the higher premium sector will allow us to continue our underwriting profitability, deliver very strong capital generation and support we believe very attractive returns to shareholders throughout the cycle. We will absolutely consider using our capital generation and range as appropriate to support dividends. Having covered claims inflation leaves us very well positioned to take advantage of growth. We also believe there's other expansion opportunities into other products with engines and wheels that are adjacent to our car and van products. So overall, I would say we are looking forward with a good deal of confidence.

And at that point very happy to take any questions at all.

Questions And Answers

A - Geoff Carter {BIO 20756770 <GO>}

(Question And Answer)

A microphone heading your way I think.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi, Nick Johnson from Numis -- sorry, Nick Johnson from Numis. So three questions, please. Firstly, on the FCA pricing review, obviously, you say that Sabre prices new business and renewal business exactly the same. I just wonder if you could give us your thoughts about how any change to regulation might impact brokers being your main route to market? What are your brokers seeing in terms of potential implications there?

Secondly, on the safety developments, yesterday, we had the news of potential speed limiters. Not necessarily that, but the regulatory direction of travel is obviously to reduce risk. Does that potentially shrink the nonstandard risk pool in the market? Does it make it easier for competitors perhaps to start writing some nonstandard business? And then last question, thirdly, on MGAs, you mentioned the plethora of startups there. Are you working with any? Do you see them as a potential threat or are they actually an opportunity? Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Okay. Sadly, it feels like they're all for me, but we'll -- so I should start off. On the FCA and the brokers, yup clearly, some brokers will be impacted. A lot of our brokers don't have any differential pricing in their models at all. They basically apply a fixed margin to our net price. Other brokers are more sophisticated and would operate more like some of the direct writers. My conversation says this is not a surprise to brokers especially and they've already taken a lot of steps to get their differentials into a place they feel to be acceptable and defendable.

On the speed limiters, well, the first thing I'm doing is going out and buying a warehouse full of unregulated VA cars (inaudible) about two years' time. My read into that new device is A, you can't get past it. You can still kick down to accelerate past the device.

Reading this morning, it can be turned off every time you get in the car. I think perhaps more importantly for us in the short to medium term, when we look back to our large claims, we don't see many actually that are driven by excessive speeds, I would say. If you can find a way of stopping people walking out from behind parked cars chasing their dog, that would be a much more beneficial thing in terms of reducing claims costs. So I'm not sure in the short to medium term, that's going to be a big driver. And there clearly is a trend overall towards more safety in vehicles. It feels like a long way off. I think the average age of the car in the UK is still seven years. I would argue it may be non-standard. People are either holding that car because they can't afford to change or maybe holding that car because they want a more nonstandard slightly older and more sporty car. So I don't think there's a medium-term impact here.

On the MGAs, we absolutely do not support any MGAs whatsoever. To me, it means you're giving away your PIN and your accounts to someone else's judgment. If we think we can underwrite it, probably we'll do it ourselves. We're not going to back anyone else's judgment and write it into our books. Okay.

Q - Iain Pearce {BIO 19522835 <GO>}

Hi, Iain Pearce from Berenberg. A couple of questions from me. Firstly, could you give us some details on the policy count and average premium in the year and if that is -- you've seen that increase over the course of the year on the policy count full [ph]. And secondly, if you could also talk to us about the van insurance propositions, what your hopes and expectations for that are and if the trends in that market are any different from the motor insurance market?

And then on capital management, could you give us a bit more detail on how you're thinking about capital management to support dividends. Whether you intend to move down towards the bottom of your solvency target range or if you're all just going to use that to protect the dividend at the current levels?

A - Geoff Carter {BIO 20756770 <GO>}

Sure. Maybe I'll start and you guys can pick up on a couple of those. On the policy count, we've seen a very small decline from year start to year end. We're probably down about 4,000 policies, and that's been up and down a bit during the year but year-on-year about 4,000 down. On the van product, James, anything about the van?

A - James Ockenden {BIO 20485926 <GO>}

Yeah, direct van perhaps have been kind of in our thoughts for quite some time. And actually a bit like car direct, private car product, really allows us to (inaudible) brokers do anything we want to. For example, not bringing their prices (inaudible). That just allows us to do that. So I think similar to the private car and direct van will allow us to insure our prices out in the market and we can maximize our opportunity there. (inaudible) lots and lots of 20 years of data on vans (inaudible) for a long time. So really this is nothing new to us. It's really just an extension of our distribution.

A - Geoff Carter {BIO 20756770 <GO>}

Perhaps the Prince Philip example we put up, it's bit tongue-in-cheek because I'm quite sure the rest of the details weren't entirely correct and all the rest of it. But actually we regret to a point that we didn't get any of our broker brands come up. That market doesn't have the right filters on payment, on ID checks and that type of thing. So it means we can guarantee, if we want to write that business, we know we're going to get our price out into the market. Teeing [ph] off that capital management, Iain? I'll start then Adam can pick up. I mean we're absolutely prepared to use the range. I think we'll be quite brave to go all the way towards 140 and then get a shock. So I think any sort of range is sensible. I don't think you'll see us bouncing on the 141% on anything. Adam, anything you want to--

A - Adam Westwood {BIO 20481660 <GO>}

Geoff's absolutely right, yeah. From a risk basis, our floor is 140%. We're currently at 160%. I think given where the market is at the moment, that's a pretty sensible place to be. Given the outlook, having excess capital there we could deploy in any way, which would be available to support (inaudible) the future is a pretty interesting place for us to be. But certainly we've never said that we want to exist at the top of that range forever, and so I can see us moving on our program.

A - Geoff Carter {BIO 20756770 <GO>}

Yeah, thanks Iain.

Q - Joanna Parsons {BIO 1558226 <GO>}

Thank you. Joanna Parsons from Canaccord. Two questions please. Firstly, on claims inflation. You've given us, your rationale as to why you think the figure is higher than quite a lot of your competitors have indicated to the market. And if premiums are still overall flat at the moment, that suggests there's a material uplift in rates that is needed to get the market to a parity place. Are you getting any indications that that might come through this year or is this a scenario whereby insurers have still got to actually recognize the facts of the reality?

A - Geoff Carter {BIO 20756770 <GO>}

Yeah.

Q - Joanna Parsons {BIO 1558226 <GO>}

And then secondly on expenses, you were talking about your ongoing investment in systems in the automation, whatever. Could that -- putting aside the fact that you may be (inaudible) the book slightly at the moment, could that generally see an improvement in the expenses for you, in the expense ratio over time?

A - Geoff Carter {BIO 20756770 <GO>}

Okay, maybe I'll start, and you can pick up the expenses on the second. I think on claims inflation, we are confident in our projection. I guess it's not for us to talk about others' projections in particular, other than we are confident that we are right at this point. If we're right and premium inflation is at 1% or 2%, then clearly there is a big gap opening up. My conversations with people, including brokers who talk to other underwriters absolutely suggests there's an acknowledgment of a need for price increases in the market. (inaudible) been talking about that and fully pressing, accelerate all the way down.

I think we see people are definitely trying to move, and I would say especially the big unlisted companies, you can see that trying to happen. You do have a couple of the smaller company or maybe like smaller -- the non-listed companies who don't seem to be so strongly pressing forward on that. And I guess if you're -- if you had a large expense base, a lot of people, it's difficult to cover right off the volume. We don't have that challenge. As you know, a lot of our expenses are outsourced. So we outsource much of our front-end customer service. The brokers actually service all of our broker-based business, which is over 70% of the book. And we outsource the first notification of loss. So our entire business model has really been designed to allow us to soften or grow our volumes without really getting an expense overrun of anything.

On the software robots, it's probably not really so much about expense savings actually. We're pretty thin. We've got 150 people. We've got no plans for any redundancies whatsoever. Nothing could be further from our thoughts. It's really about getting people focused on value add, so -- and other things we'd like to spend more time on. And we can spend less time (inaudible) into model spreadsheets. That's got to be good. On the expenses, anything else, Adam?

A - Adam Westwood {BIO 20481660 <GO>}

No, I think that's right. If you look at our expense base taking, say, commissions into account, about 75% of it is variable. So really with the size of the business, that's not going to change. That additional 25%, a lot of that is staff, and again, as Geoff says, we're not really planning on cutting that back. It's just deploying them more sensibly. Over time, the fact that we do still have that element of fixed costs and where we need to start growing, that probably would have a positive impact on the expense ratio. But I think that will be a slow and steady impact over time. Certainly in the near future, I don't project any significant (inaudible)expense ratio.

A - Geoff Carter {BIO 20756770 <GO>}

Good. Andreas, you had a question?

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

Thank you. Andreas van Embden, Peel Hunt. Just moving back to your sort of new hybrid cloud IT infrastructure, as you called it. I just want to check, where does it play? Is this just purely your front end because you outsource a lot? So I just want to try and see how does it fit into your business model. Does it allow you to plug into new broker panels and do you feel you're ahead of the curve with these investments relative to your distribution or in line? And finally, are you seeing any benefit in terms of conversion rates once you've put this in place? Thanks.

A - Geoff Carter {BIO 20756770 <GO>}

Yeah, sure. The IT infrastructure really is the sort of dull sort of back-end stuff that hosting our servers and hosting our core claims system. It's not really designed to be a front-end facing element at all. On the front end, as you say, 70% of our business is outsourced to brokers who invest very heavily on their own front end. And in some cases that's the branch network and making branches work efficiently. In other cases it's incredibly sophisticated mobile applications. One of our advantage is that we can sit behind all of those various models in the market and it doesn't cost us to take advantage of that development.

On the broker panel, we have now developed a -- or about to develop a new way of plugging into some new type broker panels. So if we see new brokers on a new type of insurer tech businesses that we feel have legs, there'll be an easier way to get our rates in there than go through a perhaps a traditional software house build that can take several months. So we are developing something slightly different there.

Conversion rates. The infrastructure is not designed to impact the front end (inaudible). There's no impact on conversion rates. What we are doing is continue to optimize our direct website. We moved that across to a new hosted solution last year, which gives us much more flexibility actually on the build and the look and feel of the goal behind shorter brands.

Anything else? No? Okay, in that case thank you very much both in the room and on the phones. Any other questions do let us know afterwards. Thank you very much.