S&P Capital IQ

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Intact Financial Corporation TSX:IFC

FQ1 2018 Earnings Call Transcripts

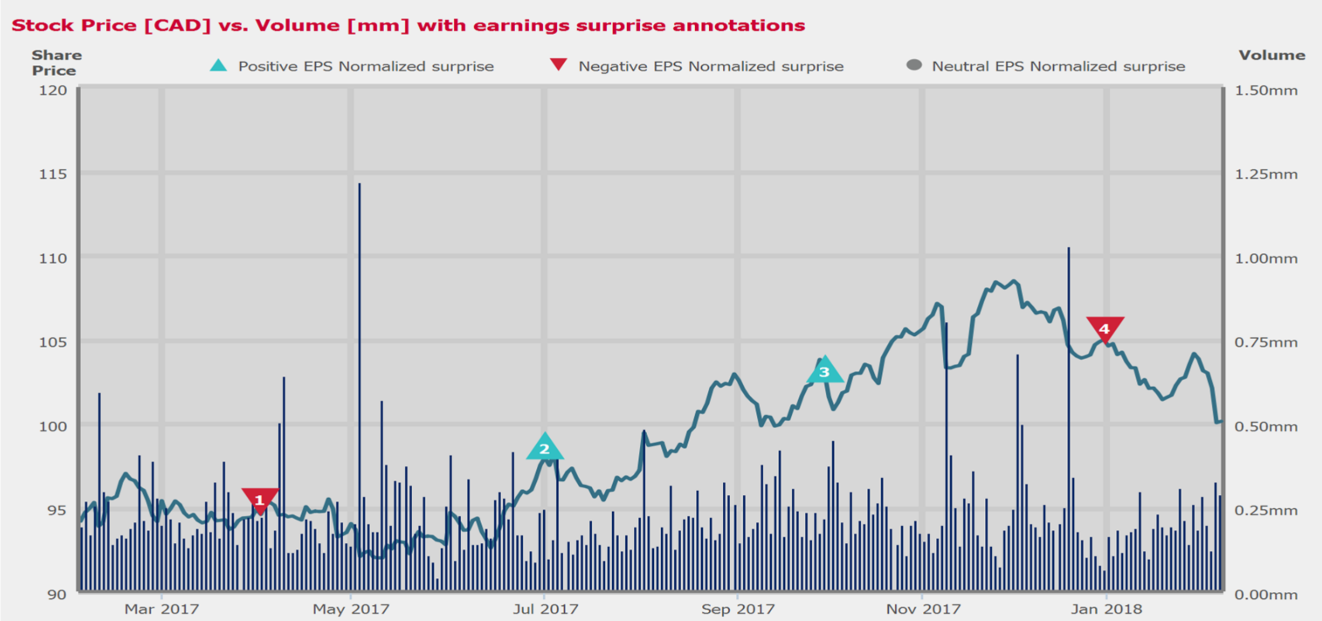
Wednesday, May 09, 2018 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2018-			-FQ2 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.87	0.81	(6.90 %)	1.54	5.81	7.49
Revenue	-	-	(2.54 %)	-	-	-
Revenue (mm)	2415.38	2354.00	-	2496.00	9787.33	10096.51

Currency: CAD

Consensus as of May-09-2018 12:23 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2017	1.03	0.90	(12.62 %)
FQ2 2017	1.32	1.44	9.09 %
FQ3 2017	1.59	1.61	1.26 %
FQ4 2017	1.73	1.63	(5.78 %)

Call Participants

EXECUTIVES

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Charles Brindamour
CEO & Director

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Kenneth Anderson
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Presentation

Operator

Good morning, my name is Emily, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp. First Quarter Results Conference Call [Operator Instructions] Ken Anderson, Vice President Investor Relations and Treasurer, you may begin your conference.

Kenneth Anderson
VP of Investor Relations & Treasurer

Thank you, Emily. Good morning everyone and thank you for joining the call today. A link to our live webcast and published information for this call is posted on our website at intactfc.com under the investors tab. As a reminder, the slide presentation contains the disclaimer on forward-looking statements, which also applies to our discussion on this conference call. Joining me here in Toronto today are Charles Brindamour, CEO; Louis Marcotte, CFO; Darren Godfrey, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Patrick Barbeau, SVP of Claims. We will begin with prepared remarks followed by the Q&A. With that, I will turn the call to our CEO, Charles Brindamour.

Charles Brindamour
CEO & Director

Thanks, Ken. Good morning, everyone. Thank you, for joining us today. Yesterday evening, we announced first quarter net operating income of $0.81 per share, after reflecting a $0.70 impact from the exceptionally severe winter weather experienced across Canada. Our U.S. specialty business added approximately $0.07 to NOIPS posting solid underwriting results, and driving a 16% increase in our net investment income. Top line growth, was close to 20% driven primarily by OneBeacon. Our Canadian business grew north of 1% with strong growth in commercial lines. Rate actions in auto ahead of the market tempered personal lines growth.

The overall combined ratio was 99.2%. Our U.S. operation showed solid results with a combined ratio of 95.3%. In Canada, the combined ratio of 99.8% included approximately 5 points from the severe winter weather. However, the fundamentals of our personal property in Canadian commercial business remain very strong. Personal auto performance remains a focus and our corrective measures are gaining traction. Book value per share grew 10% over the past year, operating ROE was 12.4% despite close to 2 points of drag from the severe Q1 weather, and we ended the quarter with a total capital margin nearing $1.1 billion. To be clear, 12.4% operating ROE is not an acceptable performance level for IFC, and we're focused on our action plan to return the ROE to the mid-teens.

When it comes to industry results in 2017, despite temporary underperformance in auto, overall we outperformed the benchmark by over 6 points of combined ratio. This drove an increase in our ROE out performance to almost [700] basis points last year.

Looking ahead, with the early actions we've taken to improve auto, we expect to remain well ahead of our long-term objective of 500 basis points in the near and midterm.

Let's look in more detail at our results by line of business starting with Canada. So personal auto growth remains muted as our rate actions taken ahead of the market resulted in top line pressure as anticipated. The combined ratio of 106.4% was well above expectation due to the unusually severe winter. While weather was a factor this quarter, it's not an underlying concern. Adjusting for seasonality, the combined ratio run rate has improved mildly to above 98% at the end of the quarter. Physical damage inflation remains the main driver of recent underperformance and is our primary focus. Initiatives implemented to date have improved rate adequacy, portfolio quality and claim frequency and severity trends related to bodily injury and psychological injury. However, cost pressures related to physical damage persist. That's why we've continued to meaningfully raise rates across the country.

Segmentation initiatives continue to improve portfolio quality, and claims management actions focused on cost and the time taken for repairs are being rolled out. We're executing on our plan, and remain committed to bringing personal auto's combined ratio back to a mid-90s run rate by year-end. Consistent with our track record in the segment over the past 5 and 10 years.

The outlook for auto is improving in our view. Industry rate increases accelerated in the first quarter across the country. We see continued expansion of the Facility Association and industry risk-sharing pool as well as our nonstandard auto business. This validates our views that the market is firming fast. The industry grew 4.5% in 2018. So this environment supports our profitability improvement plan, and we see mid-single-digit growth for the industry continuing in '18.

In personal property, premium grew by 2%, rate increases and favorable market conditions were tempered by unit decline due to our rate action in auto, which impacts bundle policies. The combined ratio in property of the quarter of 88.3% was very strong, despite the severe winter. Our actions over the time have been successful and proven to be sustainable. Personal property is performing and positioned very well for the future. The outlook is also favorable, the industry grew close to 6% in '17 as elevated weather and CAT losses supported continued firm market conditions. We expect mid-single-digit growth this year as the industry continues to adjust to changing weather pattern.

Looking to commercial in Canada. Our top line was up 5% as we saw strong growth in specialty lines and improving momentum in commercial P&C.

The combined ratio of 99.5% was elevated due to the winter weather, which led to unusually high water and fire damages, however, I'm pleased with the underlying fundamentals of this business. The overall industry outlook for commercial is also improving with mid-single-digit growth expected in 2018. Our pricing and segmentation actions continue to pay up, and this business is positioned for growth and a sustainable low 90s or better combined ratio moving forward.

Turning now to result for our U.S. Commercial segment, premiums of $321 million bolstered topline growth significantly. On an organic basis growth in the profitable segments of the business was strong at mid-single-digit level. We saw declines in segments undergoing profitability improvement as planned and expected. The combined ratio of 95.3% is an improvement of 2.1 points over last quarter including modest favorable prior-year dev. Strong progress is being made on synergies, and we will provide more details. And we're monitoring this business closely and advancing towards a low-90s combined ratio to deliver mid-single-digit run rate accretion to net operating income per share by the end of '19. The specialty team is beginning to capture the upside opportunity from expanding the distribution of OneBeacon's profitable lines. Brokers are responding enthusiastically to our ability to serve new customers across the border, North and South, and we're starting to see the potential from our broad distribution network in Canada too. We've had over 1,800 submissions on new technology and entertainment products, which were launched just a few months back. Looking at the industry outlook, market conditions remain quite competitive in the U.S. since the transaction closed, but continue to evolve better than slightly anticipated with upward pricing trends in certain lines.

Overall, we expect low single-digit industry growth for U.S. specialty in '18.

Turning to strategy, we're investing to lead, as consumer, data and technology trends transform our industry. So our digital teams continue to enhance our online and mobile platforms and that's resonating with customers. In fact, 83% of online quotes in belairdirect are now via quick quote, and over a 1/3 of our direct customers are registered on Client Centre. 42,000 of Intact Insurance customers registered for Client Centre in the first quarter, and active claims have been viewed online over 10,000x. So these are concrete proof points of our progress in leadership and customer driven transformation.

In conclusion, the weather led to disappointing results in the quarter, our employees from coast-to-coast responded to get our customers back on track, and I want to thank them sincerely as they really make a difference. Market dynamics are now beginning to shift in our favor. Commercial lines in Canada are performing very well or taking advantages as growth momentum emerges. Our strategy has continued to pay off in personal property. In personal auto, we're ahead of the market on rates and taking all steps necessary to bring the combined ratio back to the mid-90s, and we will keep cranking up actions until we get there. Profitability in our U.S. franchise is up to a solid start to the year, and we're moving fast to capture growth opportunities. IFC's financial position is strong and gaining momentum. With the strategies we have in place together with our actions and discipline, we expect to deliver on our financial objectives to outperform the industry ROE by at least 500 basis points and grow our net operating income per share by 10% per year over time. And with that, I'll turn over the call to Louis.

Louis Marcotte
Senior VP & CFO

Thanks, Charles. Good morning, everyone. For the first quarter, net operating income was $120 million almost unchanged year-over-year despite absorbing some $40 million of additional weather-related losses compared to Q1 2017. OneBeacon contributed $15 million in underwriting income with a solid 95% combined ratio, and net investment income was up 16% in the quarter. Our balance sheet remains strong with over $1 billion in total capital margin and debt-to-total capital at 23%. Let me add some additional color on key elements of our first quarter results. Firstly the weather, as Charles mentioned, we estimate that the severe winter impacted our combined ratio in Canada by almost 5 points or $130 million pretax. This represents the amount of losses we incurred over and above our historical patterns. This amount includes both CAT and non-CAT weather events. These events took the form of winter storms, drastic temperature shifts as well as extreme and persistent cold temperatures. For example, Montréal incurred 12 days, when there was rain, while snow was still on the ground. This is 70% higher than the historical average. During those days, we saw a rise in claims related to water seepage in homes or buildings as well as auto collisions. Another example, there were 50% more consecutive days with temperatures below minus 20 degrees Celsius in Calgary and Edmonton in 2018, compared to the average. This drove elevated claims for pipe bursts, heating related fire losses and auto collisions. Again, these winter conditions led to pretax losses of approximately $130 million above historical patterns or 40 million more in weather-related losses than the challenging conditions experienced in Q1 2017. Having said that, weather is a driver but it is not an excuse for our Q1 results. Our business is to provide coverage to our customers and help them get back on track when they need us. If such conditions persist, we will take pricing and product actions, and we would expect firm conditions to continue in the property lines. In the meantime, we are maintaining our CAT guidance at $275 million per year.

Turning to our Canadian lines of business, the combined ratio in personal auto was 106.4% but included an estimated 5 points of unusual weather. If we exclude excessive weather and remove about 3 points of seasonality, the combined ratio drops to 98%, which we would consider to be our current run rate. This is still high, but within range to achieve our mid-90s run rate by the end of the year. At the end of Q1, our written rates were up 4.5% and our earned rates up 5.6%. We expect earned rates to grow at this pace with the remainder of 2018. Auto prior-year development was unfavorable 0.7 points. This is not a concern. As we continue with our improvement plan, we expect close to 0 PYD in personal auto until we are more confident that our plan has fully matured.

Our property and commercial lines in Canada remain very strong, we're extremely happy with 5% commercial growth, this is the strongest performance we've seen in over 3 years. We expect continued momentum in commercial for the remainder of the year. The Canadian expense ratio remains low at 28.9% and stable year-over-year. Our teams have diligently managed expenses to invest in technology and productivity, while maintaining an industry-leading expense ratio.

In 2017, of our 6 points of combined ratio out performance, 4 points came from loss adjustment and general expenses. In addition, we are pleased to see that both channels have outperformed the industry in terms of expense ratio.

Distribution income was strong at $24 million, in line with our expectations for the first quarter, which historically represents approximately 15% of annual distribution income. We remain on track to hit our 10% growth objective for 2018.

Now turning to U.S. specialty. The addition of OneBeacon bolstered IFC's premium base by 19% in the quarter. Given the seasonality of written premiums in both Canada and the U.S., we expect the addition of U.S. specialty will drive mid-teen growth for IFC in Q2 and close to 20% in Q3. The underlying current-year loss ratio of 59.1% was healthy and well aligned with our expectations at this point in time. I'm very pleased with the profitability actions being taken in the U.S. Prior-year claims development was favorable by 1.3% a turnaround from last quarter. It is important to note that our low-90s objective for U.S. specialty does not rely on favorable PYD. On expense synergies, we realized approximately $4 million in Q1 most of which benefited the combined ratio. The actions taken to date on synergies have brought the annual run rate to U.S. $20 million close to our $25 million target expected in 2019.

We expect OneBeacon's expense ratio for the rest of the year to be similar to Q1's. Net investment income increased 16% in Q1 to $122 million mainly due to the addition of the OneBeacon portfolio. After completing the integration of that portfolio and our normal rebalancing activities and considering the impact of rising rates, we are raising our guidance for investment income growth in 2018. We now expect net investment income to grow 12% in 2018 being an increase of approximately $50 million pretax over what we reported in 2017. This quarter's tax rate is well below expectations at 14.2%. This is related to the income mix in the quarter, which had a higher proportion of dividend income and U.S. specialty earnings than usual. Now looking at the strength of our balance sheet we ended the quarter in a very strong, financial position with a total capital margin of $1.1 billion. In Canada our MCT was 201% and in the U.S. the RBC regulatory capital stood at 411%. Both well above minimum required levels. Our debt-to-total capital ratio was 23%, and we're still on track to reach our 20% target in 2019. In conclusion, despite a challenging winter, the fundamentals of our property and commercial businesses in Canada are strong, and OneBeacon is developing very well. In personal auto we are being diligent and persistent in our actions to improve profitability. We intend to maintain our strong capital position to capitalize on any growth opportunities that we see in manufacturing or distribution in Canada. With our talented employees, robust operating platforms, and sustainable competitive advantages, I'm fully confident that we will outperform the industry ROE by at least 500 basis points, and continue to deliver value to our shareholders. With that, back to Ken.

Kenneth Anderson
VP of Investor Relations & Treasurer

Thank you, Louis. In order to give everyone a chance to participate in the Q&A. We would ask that you kindly limit yourselves to 2 questions per person, if there is time at the end you can re-queue for follow-up.
So Emily, we're now ready to take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Tom MacKinnon with BMO Capital Markets.

Tom MacKinnon
BMO Capital Markets Equity Research

Couple of quick questions here. One if you can elaborate on what's happening in terms of personal property. We're getting a little bit of a slowdown in terms of the growth in direct premiums written. You mentioned some of the, I think, the stuff used to grow in the 4-ish percent range and now it's down to the 2% growth. You mentioned some impact as a result of bundled policies. How should we be looking at this, the profitability looks a little bit better, but the top line looks a little weaker? And how should we be thinking about this, is it on a temporary basis in terms of the top line being a little bit lower? And when do you expect that to kind of pick up again?

Charles Brindamour
CEO & Director

Let's start with that question, Tom. So Darren, why don't you share your perspective on growth in home insurance?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

I think you're right there, Tom. I think that when you look at the quarter itself, we continue to generate about 3% increase in rates in the quarter, but where the pressure obviously came, as you alluded to, was on the unit side. So we were down a couple of points on the units. And it very much is in alignment with our auto action plan given the high penetration of bundle policies, and as we've moved well ahead of the marketplace, as you know, on the auto side, there's some overflow onto the residential as well. So I would expect moving forward, as we're seeing momentum from the industry on the auto side that should relieve some of that pressure that we're seeing right now from a growth standpoint on the auto and on the res but we're not quite there yet, so we still feel a little bit of pressure in the short term.

Charles Brindamour
CEO & Director

Indeed, and we're quite keen on that business. It's been performing well with the combined ratio of little above at 91% over 5 years including Fort Mc and the Calgary flood, so this product is very well positioned, we'd like to grow more, but automobile matters. The other element of drag, I think, Darren, in the top line in the first quarter is the fact that we've grown faster with tenants and condos than with home. Those 2 segments are very profitable, we're also keen to grow in that space.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And then a follow up with respect to personal auto. You've highlighted a 98% run rate, if you exclude the heightened weather-related losses and some seasonality. How do you anticipate -- can you just refresh us as to -- remind us how you think you can get this to being a mid-90s run rate by the end of the year? That seems to be at least another 3 points pick up over the next couple of quarters. So what's in the hopper to that's going to help that?

Charles Brindamour
CEO & Director

Thanks. Tom. I'll let Darren take that one as well.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

So as we outlined at Investor Day there really is 3 components to the plan. First one being, rate obviously, we continue to receive approvals on further rate increases in 2018. And obviously, we're earning the impact of increases from the 2017 as well. So there's 5 points of earned rate, obviously not just in the quarter, but we expect over all of 2018. So there's definite momentum coming from a rate standpoint. The other piece of the plan is obviously from an underwriting, from a resegmentation, reselection standpoint. Again we are tilting our action plan towards PD pressure, both from a segmentation and from a reselection standpoint. Ensuring the quality is there from a new business and from renewal standpoint. There's a couple of points there, and then obviously, Patrick and team are working very hard from a PD standpoint, from a claims action plan as well too. So there's another point there. So the numbers that I quoted there is obviously for all of the 2018 impact. Obviously, what remains is the loss cost trend to offset some of those improvements. So we're confident, and we remain committed to driving towards the mid-90s run rate towards the end of this year, as I said, we believe we're at 98% right now. We're confident in our ability over the coming 3 quarters that each of those actions, as I've outlined, will continue to drive us towards that mid-90s by year-end.

Charles Brindamour
CEO & Director

Might be worthwhile for Patrick to give a bit of perspective on your action plan on claims. Just give bit of color, what's going on and whether we're making progress.

Patrick Barbeau
Senior Vice President of Claims

So as I mentioned, in last few quarters the claims action plans are focused on 3 main elements, so we've deployed better tools to the front line to make sure we guide our clients more rapidly to the right process, so whether it's total loss or car that can be repaired, that's one part of our actions. We have implemented as well tighter controls in the estimate process itself in terms of what types of parts we -- and methodology to use to repair cars. And we've adjusted a few processes that are helpful to minimize costs around rentals, storage fees and so forth, and the good thing was action plans on physical damage, is upon the claim side, as once you implement it, you get the full benefit of it about 90 days after implementation. You don't need to wait for renewals obviously to come in. So in Q1, we are starting to see some traction -- concrete traction from some of those actions. For example, we have reduced the cycle time on total losses by a full 2 days, which allowed us to save about 10% on rental costs and storage fees. And we're seeing on the average estimates of the repairs for pending claims go down between 2% and 3% compared to the last 2 quarters. So good signs for what we'll be earning from those actions in the coming quarters.

Charles Brindamour
CEO & Director

It is a line of business that has volatility, it's all hands on deck, we're poking on our action plan on a weekly basis with Darren, Patrick, and few of our colleagues across the land, and we'll crank it up, if we feel we need to, as we go along until we get to the mid-90s. There's no doubt we'll get there.

Operator

Your next question comes from the line of Geoff Kwan with RBC Capital Markets.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Just wanted to follow-up on the personal auto side. I mean, it seems to me the tone around personal auto and the conviction around getting to mid-90s seems a bit stronger today than say 6, 9 months ago. Is that a fair assessment and I don't know if it's -- if you can say on a, say a scale of 1 to 10 where that level of conviction is today versus again say about 6 to 9 months ago?

Charles Brindamour
CEO & Director

So I think the difference between 6 to 9 months ago, on one hand we've seen the pick up on physical damage trends in the last year. On the other hand the bulk of the action plan is in the pipeline now, and I think what Patrick is talking about, 6 months ago, we were starting to think about. Now we're starting to see results and therefore our degree of confidence is up a notch because the actions that we have in the pipeline are there. Putting a number between 0 and 10, we keep our ability to forecast for pricing as opposed to expressing feelings with numbers, but certainly the actions are in place, we have levers we can work with. The market is firming up meaningfully right now, and I think gaining traction. The interesting thing Geoff, the industry results came out last month and it was interesting to notice that on one hand we outperformed from a combined ratio point of view by a full 6 points, which is a huge out performance, on the other end we're not in the auto, and this has turned upside down over 2 years. So we know it's not anti-selection or anything like that, it is a difference of view. And the thing we've concluded is that we are far more cautious about liability than the rest of the industry at this stage, and when I look at other coverages we do have out performance. In liability, we've taken a pretty cautious stance, which I think puts us in a decent position as I look ahead in our ability to outperform the industry going forward. Rates are running, claims actions are in the pipeline and the market is improving. Therefore, we feel better than we did 6 to 9 months ago. But I won't hide the fact that there is a high degree of anxiety in the organization and that will be the case until we're back to our historical track record in that segment.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Okay. Thank you, and then just the other question I had was, I don't know, I know we're only about a month and a half in, any color or thoughts on CAT, weather-related stuff? Obviously we had the freezing rain out in Ontario and Québec. There's been some windstorms out here in Southwest BC and then maybe -- are you able to talk about exposures, I don't know if that's too granular because there's some concern out here in the BC, Ontario with the snow pack being at the levels or at the rates that they are.

Charles Brindamour
CEO & Director

Yes. There's been indeed what you've described, have been number of storms. I'll let Patrick, who is in the business of getting people back on track give you his perspective on that.

Patrick Barbeau
Senior Vice President of Claims

Yes. Jeff, you're right. We have faced a few events since the beginning of Q2 that's normal, though to see more catastrophe events in Q2 than Q1. In reality we had 3 events, we had a windstorm in early April, we had a late winter storm that touched Ontario again in the latter part of April. And just last week another significant windstorm that touched again Ontario and a portion of Québec. Our claim's team across the country have worked very hard to again get our people back on track fast, and our response has been very good. On the other end, even if the high level of water in many rivers across Canada, it's hit the media. On that front, it's been very quiet. We haven't received a lot of damage or new claims. So 5 weeks into Q2, we have faced a significant volume of CATs, or coming up from CATs, but it is really too early to tell if CATs overall will have an abnormal impact on our results of Q2.

Operator

Your next question comes from the line of Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

First question just follow-up on the personal auto side is that -- seems like you have 3 points improved over the next 3 quarters, I just wonder given your action plan, how much cushion do you keep for yourself for unexpected events like for example weather or not, and what you see is the biggest risk of achieving those targets?

Charles Brindamour
CEO & Director

I think the bulk of the cushion in my mind as we described the action plan is in the improvement of the profile of the portfolio. Because from a risk-selection point of view there lots we're doing, the rate increases we're taking are segmented rate increases, they are not average base rate increases, they are highly segmented. And the mix between new business and in-force has shifted dramatically in the past year, and I think when I look at the plan that Darren has laid out, the underwriting or quality profile of the portfolio is probably the one where Darren is more cautious in his assessment of the impact, I would say, would be the main area. Darren anything you want to add?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

No, I think that, I think, maybe the other area just from a claim standpoint that I think, as Patrick outlined, we're starting to see some early signs on the PD side. So I think there's potential there, but nothing we're prepared to bank on at this point in time, but it may potentially -- I mean, I think at the end of the day, the -- as I mentioned, it's all about for us, I think, is the lost cost trend that we'll experience in 2018. So to the extent that we can be tempering that's where we may create some cushion.

Kai Pan
Morgan Stanley, Research Division

And my follow-up question is on the PYD in the personal auto adverse like 70 basis points. Could you talk a little bit more about that -- is that related to -- because you mentioned your action plan, one of the sort of headwinds is increasing pressure on BI and AB. Is that same issue you had last year? And also your guiding 95%, assume is not including any reserve development, which imply a 71% of underlying loss ratio, which you haven't seen that like since 2012. I just wonder how do you bridge that gap without favorable reserve releases?

Charles Brindamour
CEO & Director

Go ahead, Darren.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes. So I think when we look at the PYD in the quarter, they are climbing. As we noted in the MD&A, it's primarily coming for some certain large losses. We would view the -- obviously disappointed that it's unfavorable in the quarter, but to create some context, we're talking $6 million of unfavorable PYD. We would see that as noise in the quarter, I mean, clearly would rather be the other way than unfavorable, but this is normal noise on some larger older claims that we can get from quarter-to-quarter. Doesn't really, it doesn't reflect any recent unfavorable court decisions or anything of that nature, so it's not consistent with what we're seeing in some past quarters that we've talked about. Obviously, we don't give guidance by line of business but from an IFC standpoint going forward, now with adding OneBeacon, we still remain in the 2% to 4% range from the PYD. But with, obviously, some noise from quarter-to-quarter now, we do probably expect to be in the near term, little bit on the lower side of that because of rising interest rates, but that creates some offset in the current accident year. With respect to personal auto itself, as you've highlighted, our improvement plan does not assume any form of favorable PYD, and I think it's fair to say that as we continue with our improvement plan, we'll expect to see close to 0 PYD in personal auto until we're more confident that our plan has well and truly fully matured.

Charles Brindamour
CEO & Director

Yes, and I think, Kai, your assessment is right low-70s is sort of the zone where we need to take this, we were in the low-70s right until '15 actually where a big portion of the performance you're seeing and the underlying loss ratio in '16 and '17 is reserving position we've taken on the current accident year based on the trends we've observed. And so we've got lots in the pipeline to take us there, as I said, we won't crank up the actions until we get there. There's no structural issues here, it's a question of calibrating the option -- the actions and I think what we have in the pipeline is pretty robust.

Operator

Your next question comes from the line of John Aiken with Barclays.

John Aiken
Barclays Bank PLC, Research Division

Just wanted to take a look at the CAT losses in the quarter, I mean we're down essentially 1/3 from a year ago, but we obviously had more significant weather impact. Is this, was this a conscious decision of Intact to change the mix of business or is this just something a classification issue that popped up in this quarter?

Charles Brindamour
CEO & Director

No. I think that the winter conditions were extreme in many parts of the country and it has lead very strange patterns with -- in January, in February in particular massive jumps in frequencies across all lines of business. And at the end of Feb frequencies were up 15% just to put things in perspective an average across-the-board. So dramatic winter conditions, and we felt that was important to make sure that we isolated that to understand the performance of the business. I'll let Louis, share his perspective on this.

Louis Marcotte
Senior VP & CFO

Thanks, Charles. So clearly, the threshold for CAT is $7.5 million that has not changed, what we saw, as Charles said. The spike in frequency and that triggered on our side a review of what was going on, and we actually went out and mapped every spike of frequency on a daily basis to weather patterns in the regions when those occurred. To come up and identify really what were the drivers, and this is where we're coming up with a bit more granularity in terms of the weather events that have driven spikes in frequency, but are -- have not individually been large enough to be classified as a CAT, but there's no change in classification, it's purely the way the weather developed over the country and we can easily -- we can tie it with claims activity and that's what we've done in classified a bit each of those weather patterns to provide good information on the drivers of the results.

Charles Brindamour
CEO & Director

And also to inform our own decisions about the business factors, an important exercise to do.

John Aiken
Barclays Bank PLC, Research Division

That's great. And then as a follow-on, how much of the growth outlook for Canadian commercial. Does that come from new business or business lines attributable to OneBeacon? Are you able to give us some order of magnitude?

Charles Brindamour
CEO & Director

Our guidance on commercial lines, top line at the industry level is for the industry and therefore would not include upside in relationship with what we're doing on tech entertainments and our cross-border desk. That being said, the market is changing, we're seeing in our own number meaningful swings, while continuing to increase rates. And I'll let Alain, who is the top guy on that to give you his perspective.

Alain Lessard
Senior Vice President of Commercial Lines

So John, if you look at the growth on the P&C side about 60% of the growth in the first quarter is coming from our regular business, and about 40% is coming from specialty business. Where we saw growth north of 10%, and the growth in specialty line is coming from all sorts of situation, but mostly from E&O, farm, niche business. Basically, lot of the stuff, we've invested a lot last year, we're seeing some pickup of the growth on the specialty lines from the new lines of business we introduced past OneBeacon, but we think that this will pick up more in the second, third and fourth quarter this year. On the regular business, the 60% growth is coming from both new business and retention. Basically, we believe, we are in the market that is slightly firmer because we see more quote request, our closing ratio has improved by about 3 points, our retention ratio has improved by about 4 points, So all of that is driving growth on the new business side, so -- and on the redemption side. And that's despite passing on still rate increase to the tone of 2% on renewal and keeping our new business rate at the same level they were last year.

On the auto side, I would say the growth is coming from 3 segment, 40% is coming from our sharing economy where the popularity is still improving, 30% is coming from the specialty line mostly trucking on the verge of hefty rate increase, we're passing mid-teens, and 30% is coming from regular auto where we saw the same situation as commercial P&C, an increase in new business by about 40% and an improvement in retention by about 3 points. So that's how we saw the growth in the first quarter.

Charles Brindamour
CEO & Director

A clear change, I will say over 3-month horizon, very clear, and I think, I'd love to take credit for some of the actions that we've taken, but there's a tailwind building up here.

Operator

Your next question comes from the line of Meyer Shields with KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Two quick questions. One, Louis you mentioned that if the current, I guess, adverse winter weather conditions persist then you'll take rate. Does that mean we have to wait for another year or 2 of bad winter weather, or are there signs about weather forecasting for the winter that you can see during the rest of the year?

Charles Brindamour
CEO & Director

There's no signs that this is recurrent, first point. Second point, rates are going up in auto across the board, and therefore, we're sort of cranking rates at a pretty hefty pace at this stage. If we feel that there's a structural changes in weather pattern we'll adapt, but we were far from having reached a conclusion at this stage.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then second, you talked about slowing Canadian personal property growth, reflecting bundled customers that makes perfect sense. Is there a difference in their profitability profile versus the rest of the property book?

Louis Marcotte
Senior VP & CFO

On the property book. No, they're pretty much -- there's marginal difference at best between the 2 of them.

Charles Brindamour

CEO & Director

There big difference, is retention. And so this is a business that's running, as I said, 5-year average, 91% combined, 80% sort of combined ratio in the past 3, 4 years and a bundled product retention is meaningfully better than what we would call in monoline and so from an economics point of view this is a very attractive combination. But downside is, when work is needed on the automobile, you're putting pressure on the other side, but still I think that the retention edge, economically speaking, is quite valuable to us.

Operator

Your next question comes from the line of Mario Mendonca with TD Securities.

Mario Mendonca
TD Securities Equity Research

Charles, what -- in the 95% or as they call it the mid-90s combined ratio for personal auto that you're targeting. What lost cost inflation rate are you building into that guidance?

Charles Brindamour
CEO & Director

We're building in that guidance 4-ish percent lost cost inflation.

Mario Mendonca
TD Securities Equity Research

And where would you say it was, say in 2017 and early 2018 so far?

Charles Brindamour
CEO & Director

So early 2018, so far, if you look at the severity in aggregate for Q1, severity was flat basically. There's a bit of noise. If you remove the noise, you see that there's roughly 3 to 4 points of trends. And Darren, at Investor Day, I think, said 3.7% is the number, I recall, you quoted. We're not really seeing that in Q1 when you look at it in aggregate. When you remove the favorable noise and severity, you see that indeed the inflation in the system is between 3 to 4 points so far this year and sort of in that pipeline last year.

Mario Mendonca
TD Securities Equity Research

So you'd need to see something well north of 4 -- or something north of 4% inflation -- lost cost inflation to invalidate your guidance? And I guess what I'm getting at is what sort of things could cause that to play out?

Charles Brindamour
CEO & Director

I think that -- so first of all your read is right. I'll let Darren, talk to that and then I'll complement, if needed.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes. I think the other thing just to be, so yes, as I say, we're in the 3 to 4, we quoted 3.7% obviously on the Investor Day. I think you've got to remember that there's an offset there as well, which is on drift, so as the portfolio with new business and so forth, we actually get a lift of 2 points with what we call vehicle drift so that's like an offset versus a trend. So we're really talking a net 2 is sort of how the math would work. Where's the risk in the plan? As you've identified, it is in, is it is in that assumption. It comes back to severity trend. As I say, right now if I go back to '17, we saw flat frequency. If I look at '18 so far frequency is up, but when we back out the weather impact frequency is slightly down. So we don't really see significant risk there at all from a frequency standpoint. So very much is a severity conversation.

Charles Brindamour
CEO & Director

Yes. And I think, Mario, when I think about severity what could take it past 4 points. Well, you could have a court decision, now I'm sort of blue skying with you, you could have a court decision this year that would change our view meaningfully on claims going forward and because the current accident year, a big portion of it includes an actuarial assessment of severity, would change our view of severity because of an external event like a court decision that might push severity up a bit. That's an example of something that could go wrong. The speed at which the carpool is changing has an impact and the amount of new cars we're writing has an impact on the aggregate inflation. Now that has an offset with the drift that Darren is talking about. But as we said, during the last quarter, part of what is causing severity at the moment more than what we anticipated originally is the fact that the inflation for newer models is much greater than what we had planned for. That's reflected in the 3.7%. The other thing that could change inflation as a onetime before now and the end of the year might be a reassessment of the past. Meaning, that as you price, you basically take the past and you bring it forward. And the current accident year performance in particular in long tail lines like liability would include a portion of actuarial assessment, and if the actuaries would look at the past and say we were wrong a bit there that might push their assessment of the current accident year's performance and reserves that need to be booked and that would flow through severity. Now this is bit actuarial and granular, but these are 3 concrete examples of how things could be above 3.7%. On the latter point, when I look at the industry's results, as I've mentioned earlier, and I look at our liability performance on more recent years compared to our peers the stance appeared -- the Intact stance appeared to be far more cautious -- so -- than the rest of the industry, which means I think, this is at least a data point that says that the odds of being off on liability, which is the coverage that can influence severity because of the past, I think are probably smaller than what they would've been a year or 2 ago.

Mario Mendonca
TD Securities Equity Research

That's helpful. One final thing, how do we measure -- you say that success would be a mid-90s run rate? But let's put that and say, if we can, something that we will be able to observe in Q4 '18. What combined ratio in Q4 '18 would be consistent with achieving a 95% run rate.

Charles Brindamour
CEO & Director

Yes. For me, 95% is the only thing that you need to look at in the last few months of '18, so you can say Q4, you need to take into account your own assessment of the seasonality of automobile insurance in Q4 and that can be a point or 2 in the last quarter.

Mario Mendonca
TD Securities Equity Research

So something like 97% or so in Q4 would be consistent with the 95% run rate?

Charles Brindamour
CEO & Director

I think that's a fair statement.

Operator

Your next question comes from the line of Doug Young with Desjardins Capital Market.

Doug Young
Desjardins Securities Inc., Research Division

Just Louis, I just noticed you reported in the nonoperating results an underwriting loss of $15 million related to the OneBeacon exited lines, and so I just want a clarification. I mean, I assume this is a program, an architect business, I presumed, but I just want to confirm this is not included in the 95.3%

combined ratio. And I understand why it wouldn't be because you want to show kind of your ongoing business what your results are, but I just wanted to confirm that first off?

Louis Marcotte
Senior VP & CFO

Confirmed. You're absolutely right. So that -- the results of those 2 lines that we abandoned and it is $15 million in nonoperating.

Doug Young
Desjardins Securities Inc., Research Division

And then, what's the combined ratio on those exited lines, and where I'm trying to go with this is how long can it take for these to run off? Are these like by the end of this year that $15 million should be gone, that program in architecture business should be off or is there a lingering liability tail that comes with these businesses that could continue to go on for a few years?

Charles Brindamour
CEO & Director

Not material, Doug. I think you'll have the single-digit sort of million drag, but keep in mind that those 2 lines have reached the point at, which the adverse development cover will pick up a portion of the pressure that will come there. And they're being run off the book as we speak. So that business by the same time next year will be completely gone.

Doug Young
Desjardins Securities Inc., Research Division

And what's the, I mean, just to finish up? What's the combined ratio on that exited business or how big are you on premium and I can do the math on that?

Charles Brindamour
CEO & Director

Yes. That will would be well in excess of a 100% that's why we've exited those lines. And Alain, earned premium left.

Alain Lessard
Senior Vice President of Commercial Lines

There's about, I would say, $20 million, $25 million of earned premium left for the rest of the year and like the first 2 months of 2019.

Doug Young
Desjardins Securities Inc., Research Division

And was there any adverse development in the quarter on that?

Louis Marcotte
Senior VP & CFO

So there would be some. So you talked about the tail risk here. So the business is running off. There is a book of liabilities, which has been provided for, the adverse development cover will cover some of those pickups. So the residual part is what could hit the book, or the results nonoperating results in the future, but that's where Charles is saying it's not, we don't expect any materiality, material elements going forward on that book.

Charles Brindamour
CEO & Director

And we took a cautious stance as we wound down this -- those 2 lines.

Doug Young
Desjardins Securities Inc., Research Division

Yes, I just want to get a sense that I'm getting the full picture, but maybe I'll follow up on a few other things, but that's it for me.

Operator

Your next question comes from the line of Meny Grauman with Cormark Securities.

Meny Grauman
Cormark Securities Inc., Research Division

Just a question on M&A, specifically what you're seeing in terms of valuations for brokers are multiples going up. Is there more competition for these kinds of businesses?

Charles Brindamour
CEO & Director

So there's a lot of noise and anecdotes, and the reality is that between the deals we partner with entrepreneur and brokers and the deals we do ourselves with BrokerLink. we're seeing very similar multiples and valuations, and we haven't seen any meaningful inflation in the past 18 months actually. People talk about that, we've reviewed that last week when we looked at the average of all the deals we've done either BrokerLink or third-party brokers in the provinces in which we operate. There's no clear inflation worth talking about. There's a lot of opportunities out there. Pressure in automobile insurance certainly contributes to that as well because as the market is firming up it is tougher to be a broker as well. So it generates activity. Certainly our experience over the past decade or 2, and we stand ready to capitalize on that.

Meny Grauman
Cormark Securities Inc., Research Division

Thank you. And then if I could just ask a follow-up question on the topic of bundling and that's -- what share of the personal property customer base is bundled? And how has that trend changed over time?

Charles Brindamour
CEO & Director

Darren.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

It's roughly half, and we really haven't seen much of a trend. Over time, I think that in the most recent history anyway, it's relatively flat.

Louis Marcotte
Senior VP & CFO

It's been varying between 50% and 55%, over time.

Operator

Your next question comes from the line of Paul Holden with CIBC.

Paul David Holden
CIBC Capital Markets, Research Division

Just wanted to go back to the conversation of cost inflation and personal auto, with the comments being that severity and frequency are roughly flat. So if I look at the year-over-year change in the underlying on personal auto again, it's roughly 2 points, 3 points higher year-over-year with 1.7 points coming from weather and pools. Which suggests you saw about 60 basis points of negative trend with 5-point -- 4 points of positive earned premiums. So just wondering maybe I'm missing something there, but suggest to me that either claim severity or frequency was up, quite a bit, year-over-year?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

The one thing I would add there, Paul. So you're right, the 1.7, it does relate to weather. There is a pools impact there as well too, year-over-year. Even though pools were still favorable in the quarter, but if we are to strip out the weather, strip out the change in pools, we'd actually see a slight reduction in the current accident year.

Paul David Holden
CIBC Capital Markets, Research Division

Okay. Okay. But then even to that point with the earned premiums up 5.4%, clearly there's an offset from again whether it's cost inflation or severity, no?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes. No, I think the one thing to consider, so when we talked about the 5 points of earned rates and so forth that is rate increases that we were to reflect in new business and renewals. Because of our segmentation strategies, as Charles alluded to, our rate changes are heavily segmented. There's quite a shift in mix happening in the portfolio right now. So whether that be in terms of we highlighted reduction in new business. Often we will see a tilting in our retention ratio based on the size of the renewal increase. So ultimately what we realize from a rate increase is less than what we've actually received approval on. Now that all ultimately does lead to quality improvements in the portfolio and...

Charles Brindamour
CEO & Director

Lost cost improvements.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

And then ultimately lost cost improvements as well. But there's a number of different factors at play here.

Paul David Holden
CIBC Capital Markets, Research Division

I see, okay. So it's not as simple as just doing that math, okay. Second question then, so we can go to rate file and see that intact, it's 5 points as you'd previously communicated. The market, however, only took roughly 2 points at least in Ontario in Q1 and that includes the 5 points from Intact, so the rest of the market is something lower, why -- like why do you think it is that your competitors who as you pointed out are having even more problem in personal auto are moving this slow to take rate? Is there any kind of pushback from the regulator? Are they just slow in asking for rate, like what's the issue here?

Charles Brindamour
CEO & Director

So if you look at 24 months. Now you're talking about Ontario, if you look at 24 months our rates are up 12%, the industry is up 6%. So that's the data point that validates what you're saying. And if you look at the last 12 months, we're up close to 5, the industry approaching 4, cumulative on 12 months. So the industry started to move. And when you realize that you need to move because there's a trend, the filing process takes 6 months, and that's why a sense of urgency as soon you see a green shoot of inflation is important, which is what we've done two years ago or in the summer of '16. So I think there is the time needed to recognize the trend, there is a time needed to file, and then when people start to file at the same time, the regulatory process tends to be a little heavier. And I think Paul, you would explain a portion of the difference you're talking about with those three levers. The fourth point, in which, in my view there is uncertainty is the fact that we have taken a view on liability in particular in Ontario and in a few jurisdictions. That is more cautious than the rest of the industry and we're acting on our conviction. Here there's a difference of view and time will tell who is right or who is wrong.

Our stance has been -- we're acting on our conviction, we're playing it safe and the liability is a longer time -- longer tail line of business and we'll see in time. But I do think Paul, that when you study province by province, line by line, the coverage by coverage, the industry's behavior, they're really starting to move. It's just you cannot turn on a dime to change rates and that's why we started to move 2 years ago.

Paul David Holden
CIBC Capital Markets, Research Division

Okay, so the message there is we should see larger rate increases at the industry level in the next couple of quarters.

Charles Brindamour
CEO & Director

I wouldn't expect so and I would expect that to be the case across the land.

Operator

Your next question comes from the line of Jaeme Gloyn with National Bank.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Just one quick follow up on the question around underwriting results from exited lines, so it was $10 million in Q4 and $15 million in Q1? Just to clarify that's $15 million, will expect to see something like that through the end of 2018 and then in 2019 it's going to be minimal at that point. Is that the right time frame to think about it or has it blown the threshold now, so that losses should be minimal starting in Q2 '18?

Charles Brindamour
CEO & Director

That's a better way to look at it, I think there was a cleanup as we close those segments and now I think a chunk of it is in the adverse development cover. The earned premium, as Alain has talked about, is dropping the business is run off and you shouldn't see that sort of nonoperating impact in those quantum in the next quarters, no.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. Great. And then also talking about costs, nonoperating cost. So I'm looking at the integration and restructuring costs. Running about let's say 30 million here over the last 3 quarters what's the time frame for that subsiding or it is and what level should we expect it to run over the next few quarters to the year?

Louis Marcotte
Senior VP & CFO

So I'm expecting a drop over the forthcoming quarters, quite significant. This was, I would say, a Q1 heavier load and I would expect that to shrink meaningfully over the past -- the next 3 quarters. So maybe in the 30, 40 overall by the end of the year in total, but it's heavy loaded in the first quarter.

Charles Brindamour
CEO & Director

In line with our guidance.

Louis Marcotte
Senior VP & CFO

Expectations, yes.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

And then last question for me just around the investment income obviously an uptick here in the market-based yield that was earned on the portfolio, but I also noticed an extension in the duration of the portfolio from 3.5 years to 3.8 years. You should explain some of the factors that are driving, I guess, what is higher net investment income than what was previously guided at the Investor Day?

Louis Marcotte
Senior VP & CFO

Absolutely. So I would say 3 drivers here. We've -- as we do normally in the first quarter, we rebalanced the portfolio, we fine-tuned our Canadian mix, according to our efficient frontier. We stick to the same risk envelope, but the team fine tunes it on an annual basis, and I would say that's 1/3 of the upside. Than the OneBeacon integration, so moving their mix to what we're used to including the duration. So you'll remember, the fixed income portfolio of OneBeacon at a shorter duration, we moved that a bit, and that drives really the increase. so everything we're...

Charles Brindamour
CEO & Director

Increase in duration.

Louis Marcotte
Senior VP & CFO

Increase in duration. Yes, so that's a second factor. And then in the quarter taking a bit advantage of the increasing yields there was some trading on bond portfolio to capture the upside from the yields. So of the increase in the guidance we provided this morning, it's 1/3, 1/3, 1/3, taking advantage of yields, taking the -- optimizing the OneBeacon portfolio to our standards and fine tuning the Canadian mix are the drivers.

Operator

And we have no further questions at this time.

Kenneth Anderson
VP of Investor Relations & Treasurer

Well, thank you everyone for joining us today. Following this call a telephone replay will be available for 1 week, and the webcast will be archived on our website for one year. A transcript will also be available on our website in the financial reports and filings archive. Also we'll be hosting our Annual Meeting of Shareholders at 11:30 a.m. this morning at the arts Gallery of Ontario here in Toronto. You may also join this meeting via live webcast from our website. Lastly, our second quarter 2018 results are scheduled to be released after market close on Tuesday, July 31. Thank you, again, and this concludes our call for today.

Operator
And this does conclude today's conference. You may now disconnect. Have a great day.