Call for Analysts and Investors

Transcript

April 21st 2023| 9:00 AM CET

Speakers:

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Presentation

Beatriz Izard: Good morning and welcome to our conference call to discuss March 2023 results. I am Beatriz Izard, Head of Investor Relations.

As usual, our CFO Carlos Rodriguez Ugarte will first walk you through the slides and then we will be happy to take any questions you may have.

Now let me turn the call over to Carlos.

Carlos Rodríguez-Ugarte: Thank you, Beatriz, and welcome all.

We start, with the highlights for the period in slide number 5.

In a nutshell, 2023 will be a challenging year where the focus will be the technical margin:

- Premiums grew 5.3% and policyholders 2.4%. Motor is gaining momentum with premiums also growing at 5.3% in the first quarter-. We acknowledge much remains to be done to adjust prices to the `present levels of costs of claims.
- Combined ratio rose to 107.3% because of cost inflation and high frequency as compared to the 1st quarter of 2022, which had less mobility due to the Covid-19 variant Omicron. Expense ratio stood at an excellent 21%.
- We are displaying once again resilient capitalisation with a Solvency ratio of 183%.
- Finally, return on equity fell to 9.2%

Moving on, slide 7 provide our regular update on the Spanish Motor market.

- Inflation remains high. Despite a slight decrease in the last few months, underlying CPI closed in March at 7.5% and industrial prices at 7.8%.
- As with regards estimated average premiums, the market has a long way to go before converging with claims costs.

On slide 8, the buying and selling activity in real estate shows signs of a slow down with high interest rates and a weaker economic projection.

Nevertheless, the insurance Home market grew notably at 5.8% as of March.

As with regards the Spanish Health market, turnover for the industry continues to report significant growth at 7.5% yet the inflow of new customers is slowing because of economic conditions.

Let´s move on to the main figures for 2023.

The first 3 months of the year were marked by rising premiums and strong pressure on margins:

- Premiums continue to gain momentum, up 5.3%. The Motor line of business also grew 5.3% on the back of continuous tariff adjustments. Yet, much more remains to be done.
- Technical result is explained by historically high cost of claims and higher frequency in Motor and Home as compared to last year. Additionally, bear in mind we compare to last year's quarter where mobility was reduced as a consequence of Covid-19 variation Omicron. I will provide additional details on the loss ratio further down.
- Expense ratio was excellent despite marketing investments; and
- Financial result includes realised gains in equities and fixed income. Excluding such effect, financial result would have grown by 12%.

All things considered led to a combined ratio of 107% and a loss of 5.3 million euros.

We are reporting no material differences this quarter, under the new accounting regulation IFRS17.

On this matter, 3 key messages:

1. Net income was not significantly impacted as compared to the previous accounting norm.
2. Profitability could be slightly more volatile under IFRS 17 because of the effect of discounting. In a relatively high interest rate environment this can cause a higher insurance service result with offsetting effects in insurance finance income and expenses. Also, the mark-to-market of investment funds will add some volatility to the P&L
3. The current business management indicators and the current layout of the income statement will be maintained in parallel.

In slide 12 we provide the profit and loss account under IFRS17:

- The profit and loss account changes format.
- Income from insurance services is pretty much equivalent to premiums earned before reinsurance.
- Reinsurance result is presented separately.
- Net income from the insurance service would be the equivalent item to technical result.

On the right side of the slide, we present the walk IFRS 4 to 17: the overall difference is explained by the Home liability of incurred claims (LIC), the equity realised gains accounted for in OCI under IFRS 17, the mark to market of mutuals funds, and the one year unwinding of interest discount.

Overall result is pretty much the same.

We additionally published a general IFRS 17 presentation with the main impacts and criteria adopted by the Group. Please refer to it for further details.

Please turn to page 13, where you see the breakdown of policyholders and Gross Written Premiums by line of business.

All segments display solid growth:

- The portfolio increased by 2.4%, and policyholders reached 3.5 million.
- Company premiums grew 5.3 %and Motor continues its trend upwards.

Moving to page 14, the Motor segment grew 5.3%, outperforming the market by 0,6 pp. Average premiums are clearly on the rise, although we still have much ahead. We are prioritising price adjustments and April already factored further increases.

On the technical front, combined ratio stood at 107.9% reflecting:

- Average costs at record high levels, both in repair and personal injury claims. We admit much remains to be done to improve the loss ratio, yet we are moving in the right direction, adjusting tariffs on a non-stop basis.
- The first quarter was also market by higher frequency as compared to last year, which recorded low mobility due to the Covid-19 situation I have referred previously.
- The expense ratio reflects more marketing investment because of the new client focus and multi-line product offering. Such expenses which will be reduced in the next quarters.

Moving to the next slide, Home premium growth continues a good performance at a rate of 6,7%.

- loss ratio was affected by higher frequency as a consequence of increased coverages and services.
- Expense ratio reflects higher deferral in the first quarter.

Moving now to slide 16, premium growth in the health segment stood at 4.2%. We keep our strategy of being very careful with the subscription and risk selection process. Our loss ratio continues to improve.

Please let's move now to slide number 17, where we breakdown management ratios by line of business:

- Motor loss ratio increased by 18 percentage points reflecting steep cost inflation. Frequency also was higher as compared to last year both in Home and Motor as I explained earlier. Health continues to improve.
- Expense ratio stood at remarkable levels at 21%

- Overall, combined ratios reflect the impact of sharp cost inflation and higher frequency.

If we move to slide number 18, consolidated loss ratio was driven by heavy cost inflation while premiums are lagging behind. It is our firm commitment to keep firmly on price adjustment throughout the coming quarters.

- Additionally, frequency was 1.3 p,p, above that of last year. We have returned to the levels of 2019.
- Average costs in the Home segment behaved well as compared to last year whereas frequency had an impact due to increased coverages to catch up in its offering.

As with regards the expense ratio:

- We maintain strict control of expenses.
- Acquisition costs reflect the new multiproduct campaigns, investments that will be significantly reduced in the coming quarters.
- And the termination of the reinsurance commission in the Health line of business.

Now we move to the next slide. The investment result is explained by realised gains in both equity instruments and fixed income. Also, fixed income reinvestment rates, remuneration of deposits and income from investment properties are on the rise.

On slide 21 you can see the overall yield of the portfolio stands at 2,68% excluding net realised gains. We estimate to reinvest in 2023 at 2.8%.

Moving on to our solvency position, the Company's capitalisation remains strong at 183%. Eligible own funds remain stable, as the loss for the quarter was more than offset by the change in market value of the available for sale portfolio.

For its part, SCR increased by 5.5 million in the quarter mainly explained by the reduction in the symmetric adjustment and increased exposure to equities.

To conclude, 1Q numbers display a very difficult scenario of the auto insurance segment, mainly driven by inflation. Looking forward, 2023 should be considered, number wise, as a transition year, with positive improvements as the year evolves and, price increases are further implemented.

Thank you. I will now hand the call over to Beatriz to begin the Q&A session.

Q&A

Beatriz Izard: Thank you very much for the presentation, Carlos. First, we'll begin with the questions received from the conference call.

Conference call operator: Ladies and gentlemen, we will now begin the Q&A session. If you would like to ask a question, please press * 5 on your telephone keypad. If you change your mind, please press *5 again. Please ensure that your device is unmuted locally before proceeding with your question. Our first question comes from the line of Max Mishyn from JB Capital. Max Mishyn, please go ahead.

Max Mishyn: Hi, good morning. Thank you for the presentation and for taking our questions. I have three if I may. The first one is on motor premiums. I was wondering what kind of price hikes you will be implementing in April into what portfolio they are being applied and whether you see this impacting your churn rates. And then the second one is on costs. Now that inflation is easing, do you see that there are chances that repair costs can go down in the future? And the last one is on home insurance: I was wondering if you could explain why frequencies have increased so much with more detail on what we should expect for 2023. Thank you.

Carlos Rodríguez-Ugarte: Thank you very much, Max. I mean, in terms of keeping on increasing our average premiums, I think it's something that we have started last year. If you take a look at the increase in average premiums, you will see that compared to 1Q of last year, the increase in the new business was in the neighbourhood of 7% and the increase in the portfolio has been in the neighbourhood of 5%. It is true that if you take isolated 1Q23 and you compare that to the 4Q22, we are lagging, especially on the portfolio. The increase in the portfolio has been 1.5%. But keep in mind that we renew the entire portfolio during the year. In the 1Q, we renewed prices on around 20% of the portfolio. Still, we have to renew prices on 80% of the portfolio and the idea of the company is to keep on doing increases on their portfolio throughout the year. Is that going to affect the churn rate of the company? Yes, if you take a look at the numbers of the 1Q where retention rate has deteriorated by almost 200 basis points. That means that clients are still finding prices elsewhere which are not increasing. But in our opinion, that is kind of dangerous given the situation on the cost inflation. But looking forward we will keep on increasing average premiums. We have done another increase in April. And well, we will keep on doing that as long as our risk premium continues to rise.

Regarding cost inflation, repair cost was not very good in the first two months of the year. We have seen increases in repair costs in the neighbourhood of 7-8%. What we have seen in the last month of the quarter is that increases are starting to slow down. Numbers in March were fine or were better than in the previous two months and we expect that trend will calm down in the coming months.

And on the home insurance, well, what we did this quarter, some of the services that we had externalised on the management of claims (not on the repair side), we have internalised it in order to increase our quality of service and that really didn't

work that well. I mean, it really increased our frequency. So, we have refrained from that and in April we decided to go back to the previous situation where we have externalised those services and that should help improve the loss ratio on the home insurance in the coming months. That's basically what we did, we did the test and it didn't really work.

Conference call operator: The next question comes from the line of Francisco Riquel from Alantra. Francisco Riquel, your line is open.

Francisco Riquel: Good morning. Thank you for the presentation. The first question is if you can please explain the rise QoQ in the combined ratio in motor insurance. How much of the increase is explained by the Baremo? What cost inflation is still left here? So that's the first question and this is in absolute terms. And then also in relative terms, I wonder how do you explain that you are reporting a higher combined ratio than the sector average? If you think that the cost inflation or the frequency is higher for you or the tariffs, so the change in absolute and relative terms. And the second question is about your guidance. You previously were guiding for a combined ratio in the year 2023 similar to 2022 on average, do you still think that this guidance is achievable given the start to the year in the 1Q? Thank you.

Carlos Rodríguez-Ugarte: Hola, Paco. Well, if we look at the frequency, sorry, at the loss ratio and the combination of frequency and costs, what we are seeing is that frequency accounts for 30%, more or less or 35%, more or less of the increase and 60% of the increase comes from the average cost. I mean, Baremo, in absolute terms is… I don't have the numbers but of course, rising Baremo about 8.5%, on bodily injury claims, it has an impact. But I don't really think in the 1Q that has been the case or it has been much more than we are used to. I think it's more a matter of still average cost. It's true that we have much more frequency than the previous year because of COVID. But if you take a look at the evolution of the loss ratio increases which are not good. I mean, the increase in the first quarter as compared to the last quarter is milder, so my expectation is that we'll keep on improving. But it is really still today an issue of average cost, more than frequency, which as I have said frequency has increased by 1.5 p.p. on the previous numbers.

In terms of how I explain my combined ratio is above that of the market, well, we'll see the numbers of the market in the 1Q. I think it's going to be a difficult quarter for the entire market. Having said that, well we are still being very prudent in our reserving. We are still suffering from increases in repair costs, and of course, we are not very happy with the combined ratio that we posted. I mean, being on 107%, being a company more used to be on the 95, 94, it's kind of difficult, you know, to cope with that. But we'll see what happens with the market. I think it's going to be a very difficult quarter. I think its inflation in the 1Q is going to have a hit also on the sector. Having said that, numbers on combined ratio need to get improved and the way to improve numbers on the combined ratio is by increasing average premiums. We will keep on doing that. If you take a look at the market, probably we are among the top two, top three companies that are raising prices but still today

there are some insurance companies that are decreasing average premiums on the current situation. So we are on the rise, we will keep on the rise and that will have to improve our combined ratio.

And the target for the year. Well, if numbers keep on the way we are right now on combined ratios of 107%, we will not be able to reach you know combined ratios below 100%. My expectation is still today because I start to see some positive signs on the average cost. Frequency, I hope it will have a good behaviour during the year is that you will see an improvement QoQ. You know, 2Q will be better than 1Q, 3Q would be better than 2Q and 4Q will be better than the previous one. Having said that, again, if we maintain this loss ratio on the motor insurance, it's going to be difficult to reach those numbers.

Francisco Riquel: Thank you.

Conference call operator: The next question comes from Freya Kong from Bank of America. Freya Kong, your line is open.

Freya Kong: Good morning. Thanks. Thanks for the presentation. Firstly, your solvency level is now coming close to 180%, which is management-bound after which you wouldn't distribute any capital. How comfortable are you with the business if you were to drop below 180% and what level would more serious, I guess corrective actions, need to be taken on solvency?

And secondly, your motor business is still growing despite the very tough environment. And your Q1 combined ratio for motor was around 108%. Given that premiums are still below claims inflation, does that mean you're writing new business at above 100% combined ratio? How should we be thinking about this, and I guess, how do you see the evolution of your combined ratio improving throughout the year? Thanks.

Carlos Rodríguez-Ugarte: Well, in terms of our solvency, it is true that I think the last numbers we posted in December, they were in the neighbourhood of 187%. Now it's on 183%. I mean, I still feel very comfortable, and I explained that on my last call, we still think that we will be on that 180%, I mean, it's a 183% solvency rate. This is a dynamic number. It is very difficult to maintain always the same level, you have a lot of issues that are seasonable, in terms of getting the number of solvency. But it's still, I'm not worried about being above 183%. I explained that on the end-of-year call and I maintained that the company is still on 183%. Having said that, I think we are among the companies with the highest combined ratio on the solvency ratio on the motor insurance business. And I don't see that the 180% could be jeopardised on this year.

Regarding the motor insurance, well, numbers are numbers. At the end we are increasing still the new business and we are increasing the business by around 2% and the number of new clients coming into the company, 1.9% I think is the number. It's true that if you do the numbers in terms of average premium versus risk premium,

those clients are still not on profitable grounds, but also, we are a company that we manage very well the evolution of the profitability of clients and those clients will come into profit in the short term. Having said that and looking forward to the year, you will probably see that the evolution of the growth in new clients will become milder. Our intention during the year is not focused on gathering clients, it's more to focus on defending the margin, and that is what we will do. So, you should expect more efforts on rising prices than on gathering new clients. I explained in my call that we did an effort on the marketing side of the business because we needed to transfer to the market our focus on multi-clients and multi-product. But looking forward on the year, we will reduce our marketing exposure and that probably will have an impact on the gathering of new clients. So, you shouldn't expect the company to keep on growing in clients during this year.

Conference call operator: The next question comes from the line of Thomas Bateman from Berenberg. Thomas Bateman, your line is open.

Thomas Bateman: Hi, good morning and thanks for taking my questions. Firstly, thank you very much for your IFRS 17 presentation, and I really appreciate you giving both the IFRS 4 and IFRS 17 numbers, that's really useful. I was just wondering, will you give us any more comparatives, I think you've just given us last year, last Q1 in 2022, but will you be able to provide maybe the whole of 2022 comparatives soon, i.e., not just as we go through the year? That would be helpful. And can you discuss the company's reinsurance renewals and in particular does this have any impact on the performance of home insurance in Q1? And just a couple of clarification points on the investment portfolio, did you say that you expect to reinvest at a yield of 2.8% or 2.8% yield guidance for the year? And also, can you just clarify your comment on growing exposure to equities, what's your thinking around that? And just finally, back on motor, what do you think the catalyst might be for a more material change in pricing across the market? I guess it seems like your comments earlier saying that peers are still declining prices are a little bit worrying to me. So, what do you think might change their behaviour? Thank you.

Carlos Rodríguez-Ugarte: Well, in terms of our 2022 IFRS 17 comparisons, we don't have that information here. I'll get back to you on that but it's difficult because we don't have the detailed comparison of 2022. Here really we did an effort to put the number on 1Q but that comparison we don't have it. In terms of the home guidance: my expectation for the year is that the expense ratio will not be maintained at that 26%. I think that's a very good number but it has a component of a seasonable situation. I think we should be in the neighbourhood of 30%, 31%, 32% during the year, which is a good number when compared to the market. And in terms of the loss ratio of the home insurance, you will see clearly an improvement in the second quarter and looking forward on the year. As I explained before, we have some one-off issues in the 1Q that will be solved in 2Q and 3Q.

Regarding the exposure to equities, well basically what we did, Tom, is at the end of the year we decided to reduce somewhat our exposure to mutual funds and

equities because of the entrance of the new regulation, IFRS 9, together with the 17, and what we did is we somewhat rebuilt some of our exposure to equity, but I'm talking about €10 million out of €900 million of the portfolio, so it's not a relevant number. But as you know in terms of capital, the equities are the instruments that require more capital.

And then I didn't get you on motor. I think you were talking about changes in prices?

Thomas Bateman: Yeah, I just want to get your opinion…

Carlos Rodríguez-Ugarte: Again, as I explained in a previous question, if you take a look at the increase in average premiums, YoY, the portfolio which is really the one that hits on the combined ratio, has increased by almost 5%. It is true that if you take 1Q 2023 vs 4Q 2022, that increase is still very low in size, a 1.5% increase. So, what we need to do is to keep pushing there. We need to manage also the retention rate as I explained before, the retention rate has suffered in 1Q and has increased by 200 basis points. So, it's a combination of that. Looking forward, again, I think you should expect further important increases on the portfolio, you should expect less growth on new clients coming into the company and that will help us keep on improving the combined ratio throughout the year. Having said that, I think 2023 for Linea Directa and I think for the sector is more a transition year, more than a year where numbers will come out during the year. And I don't know if I'm missing some questions.

Thomas Bateman: Sorry, hello. Can you still hear me? Hello?

Conference call operator: The next question comes from Carlos Peixoto from CaixaBank. Carlos Peixoto, your line is open.

Carlos Peixoto: Yes, hi, good morning. So, my first question… First of all, sorry, I missed the first part of the call. So, if I end up repeating some questions… The first question would actually be related to the average premium per policy. So, running the maths, the simple average on the motor business would be up by roughly 3% YoY versus last year. But I was wondering on a like-for-like basis so within the different lines of coverage. But what has been average increase and when you look at the inflation and overall inflation in the repair costs and all of the levels of increases feel a bit shy, how do you see this evolving throughout the year and what type of measures do you believe can be adopted to bring this increase more in line with inflation and eventually allowing for an improvement in the combined ratio. Then the second question would actually be related to the Baremo and the overall combined ratio there in the 1Q and I was just wondering whether in the 1Q there was any specific one-off either related to the variable with some retroactive impacts or something of that nature that could help to explain here the levels or if there were no specific one-offs? Thank you very much.

Carlos Rodríguez-Ugarte: Hello Carlos. Starting with the last question, there are no one-offs on the Baremo in the 1Q. Baremo is going to have an important hit on the loss ratio during the year.

But in the 1Q, it's not been something exceptional. We knew it was going to happen. In fact, it is having the impact that we expected. In the end, an increase of 8.5% on the bodily injury claims has an impact, but it's business as usual in that in that regard. And in terms of, you know, average premiums, well, I agree with you that still today increases in average premiums are kind of shy, I explained before that if you take a look at 1Q23 as compared to 4Q22, the increase in the portfolio is still very mild. I mean, 1.5% and we need to increase that or speed up the average premium rises, that is the commitment of the company. I think I tried to explain during my presentation that the commitment of the company is to, during this year, and probably in the coming years if inflation is here to stay, we need to improve that. In the end, when you manage the company, you have to cope with rising average premiums, taking a look at competition that are still pushing average premiums downwards, which from my point of view is a clear mistake in terms of P&L, and also you have to manage the retention rates of the company. So, it's not that easy to take that decision to increase average premiums per se and just do that. But again, I agree with you. It's still very mild, the average premiums increase, and you should expect that to keep on going during the year and probably you will start to see some colour in the second part of the year in terms of gross premiums and improvement of combined ratio, as a consequence of that.

Conference call operator: The next question comes from Fernando Gil de Santivañes of Bestinver. Mr. Fernando Gil, your line is open.

Fernando Gil: Alright, thank you for taking my questions, and thank you for the presentation. Two quick ones on motor, please. The first one is on average price increases, what is the average price increase that you're doing or have done so far YTD in the new car vs the used car segments? That is one question. And the second one would be, I guess this is difficult, but assuming the frequency remains and inflation remains, to what extent do we need prices to increase to bring the combined ratio in motor to 100%? Thank you.

Carlos Rodríguez-Ugarte: Well, the second question is… It's kind of difficult to give you a number. I don't have the answer to the million-dollar question. It's a matter of risk premium on clients, analysing and rising prices of them. One of the things that we are doing to improve the combined ratio is also, with these average increases, try to clean a little bit the portfolio: increasing average premiums more on the more risky clients which means that those clients, or a number of them are leaving the company because they don't agree with the pricing, but it's difficult to give you a number how much I do have to increase average premiums to cope with the combined ratio. Keep in mind that the combined ratio is a result of two things, average premiums and the loss ratio. My expectation is, on the loss ratio, that the average cost will improve during the year. As I explained before on the call, I have seen some positive signs in March in terms of average cost which is going also 200 basis points below that increase in January and February.

Having said that, what we know, because all the insurance companies, we use the same valuation tools, that still today Linea Directa's increases average cost per repair is still below the market. But to give you a number on how much we should increase our premiums to cope with the combined ratio is kind of difficult. My commitment or the company's commitment is that we need to further increase quite a bit average premiums on any kind of client and that is something that we will do.

And in terms of the split between new cars and used cars. The first thing is that new cars numbers are not very good still in the 1Q. They have improved since last year but still, numbers are shooting for less than 1 million new cars sold in Spain. So that's going to be difficult for companies like Linea Directa and whenever there's a transaction, normally people look for prices on Linea Directa. The split between new and old cars, it's kind of difficult because normally new cars go for fully comprehensive, and old cars go for third parties. So, it's kind of difficult. We'll try to look at those numbers and if we have those numbers, we will share them with you.

Fernando Gil: OK. Thank you.

Conference call operator: The last question comes from the line of Thomas Bateman from Berenberg. Thomas Bateman, your line is open.

As a reminder, if you'd like to ask a question, please press * 5 on your telephone keypad. If you change your mind, please press * 5 again.

Carlos Rodríguez-Ugarte: …on the live, so we'll go for the questions that we have received through e-mail or though the webcast.

Beatriz Izard: OK. Thank you. Now we continue with this with the questions received through the webcast. The first question comes from Patrick Lee from Banco Santander.

Good morning, he says. Thank you for the presentation. I would like to understand the higher frequency in terms of your client's behaviour. In the past, you had expected higher prices and higher petrol prices and lower activity may lead to lower usage of cars. Has that trend played out in the last few quarters? I would like to have a feel for how much of the increased frequency is due to COVID normalisation and how much to other economic factors. Thanks.

Carlos Rodríguez-Ugarte: Thank you, Patrick. Well, we are not seeing less mobility than we expected, and it's something that is kind of weird because if you take a look at the evolution of the increases in the prices of gas, of petrol, is normally very much linked to less mobility. But we are not seeing that. The 1Q mobility has been very similar to last year or a normalised year, so that really has an impact on the frequency. Our frequency has increased I explained that is 1.5% above, you know, last year. So that really had an impact on the cost side of the business. Are we expecting that frequency to become milder? Well, we'll see. I see the numbers of Easter. Easter has not been very good in terms of accidents in Spain. So, we'll see. I think it would be better in

summer as compared to last year. But frequency is very, very back to normal. In terms of COVID, impacts. Difficult to get a number, but I will say that is more in the neighbourhood of you know €30 million more in this year as compared to last year due to the COVID situation last year.

Beatriz Izard: Thank you. I see Thomas Bateman is having some problems with the line. So, I will read your questions through the webcast, Tom. Could you please comment on the company's reinsurance renewal? Cost and attachment points.

Carlos Rodríguez-Ugarte: Well, in terms of renewal, I think we are the first insurance company in Spain that renews its reinsurance programme or reinsurance scheme. We did that in October last year, being the first one always because I think it's a good opportunity for that. Prices have increased of course for the entire sector and for Linea Directa, but I would say that if you compare Linea Directa prices with like-for-like companies, with the same priorities and so on, you will find that Linea Directa has the lowest tariffs on their insurance programme. So, of course, prices have increased, especially on the motor insurance, not that much on the home insurance, but nothing to be remarkable.

Beatriz Izard: Alright, so I think we have no further questions received from the webcast. Thank you very much, Carlos. This concludes our meeting. Thank you very much everybody for your time.