Call for Analysts and Investors

Transcript

Company participants

Carlos Rodríguez Ugarte, CFO

Beatriz Izard, Head of IR

Presentation

Beatriz Izard:

Good morning and welcome to Línea Directa's 6M 2021 Earnings webcast. We are pleased to welcome you today and we also thank you for following up the business of Línea Directa. This is Beatriz Izard, Head of IR.

We have the pleasure of having here with us Carlos Rodríguez Ugarte, our CFO, who will review our financial results and activity for this first half.

Additional information can be found on our website, as well as in the excel spreadsheets that we uploaded. At the end of the presentation, we will open the Q&A session. We'll start with the questions coming from investors joining us through conference call followed by questions received by webcast. We'll be of course available afterwards to answer any pending questions.

Without any further delay, I now hand the conference call over to Carlos.

Carlos Rodríguez-Ugarte:

Thank you, Beatriz and good morning to everyone. I am very pleased to present our first half 2021 results as a listed Company.

We'll be discussing how things were for Línea Directa for the first 6 months of the year with the accounts approved yesterday by the Board and that are public at the moment.

In a nutshell, Línea Directa had strong 6-month performance delivering recurrent and stable high profitability metrics.

- policyholders grew by 3.8% and GWP by 1%, mainly reflecting pressure on premiums in the Motor line of business.
- we had outstanding technical development with a combined ratio of 85.5%, a strong testimony of our underwriting capabilities.
- net result stood at 58.2 million and return on average equity stood at almost 35%, and
- solvency ratio for the first 6 months of 2021 stood at of 203%. This figure is already taking into consideration the 26.6 million euro dividend paid on July 7th and which represented a payout of 90% on our first quarter result. It reiterates the intention of the Company to have a strong dividend payout.

Moving to the context where these results are being delivered, on the insurance front, the Spanish Motor, Home and Health lines of business had a mixed behavior:

- As with regards Motor insurance, there is a slow recovery in vehicle sales, thus increasing the age of the fleet which now stands at 13.2 years. We are also observing a migration of all risk with deductible to third party and extended third party, leading to a reduction in average premium. Mobility is increasing and fatal accidents rose by 34% as of June. GWP for the market as a whole decreased by 1%.
- Turning to page number 8, Home insurance had a different development. The purchase of homes is picking up. There's also more awareness about of the need to insure the home, as more time was spent at home during the pandemic. Market as a whole is growing at a rate of almost 5%. On the negative side, we can say that atmospheric events are here to stay
- Finally, sanitary assistance continues a steady growth, with the market also growing at 4.9%. The sanitary activity, which was halted during the crisis, is back to normal. We are also seeing a rise in health care costs.

Now I'll take you through the main figures of the first half. Premiums were up 1%, reflecting a 3.8% increase of new clients. Pressure on premiums is still very high in the Motor Line of business. Average premiums are down almost 3% for the market as a whole.

Technical result was strong, up 1.8%. The Group's combined ratio stands at a remarkable 85.5%. I would like to also highlight the 1.2p.p reduction in the expense ratio, thanks to strict cost control measures.

Financial result is resilient yet reflects the current extremely low interest rate environment, with falling reinvestment yields of our fixed income portfolio.

Profit after tax stood at 58.2 million euro, a decrease of 1.2% against the same period of last year.

Please turn to next slide, page 12, where you see the breakdown of policyholders and GWP by line of business. The portfolio as a whole increased by 3.8%, sustained by higher retention ratios. GWP grew a modest 1%, with the Home and Health line of business growing by more than 8 and 25%, respectively, whereas Motor insurance decreased by 1%, on the back of a lower price environment.

More specifically, if we turn to next page, the Motor line of business experienced a modest decrease in GWP. New business was more challenging for the reasons explained before, whilst the portfolio experienced a solid growth and strong retention rates.

On the technical front, combined ratio was excellent at 83.7% (which is 4.1 p.p below the sector with the latest available data). This is driven by ongoing cost discipline and strict underwriting in a context of increased frequency and severity.

Moving to Home insurance, premiums were up 8.5%, a growth rate that beats the market by 3.6 p.p . New business had a remarkable performance.

Combined ratio was up by only 2.5%. The combined ratio for the market stood above 100% in the first quarter of the year, with atmospheric events deteriorating enormously the results for the sector. Línea Directa posted a combined ratio of 91.2%, 10 p.p below the market with the latest available data.

Expenses remained stable which translated into a lower cost ratio as business grows.

The Health line of business continues its development, with almost 21 thousand new clients. Average premium was slightly lower driven by a change in mix.

Combined ratio is improving, albeit claims frequency is rising due to the "return to normal" and recovery of the healthcare activity.

Please let's move now to slide number 16, where we breakdown claims and expense ratios by line of business:

- Claims ratio had an excellent performance in the Motor line of business despite increased mobility. Home insurance has recurring impacts of weather events. Loss ratio stood at 65.3%
- On expenses, it can be seen the cost discipline we apply across all lines of business. Expense ratio was down 1.2 p.p to 20.2%
- All these ratios made it posible to achieve a combined ratio of 85.5%, showing strict ongoing control of risk underwriting, and expenses.

As we can see in the next slide, historically the Company has been able to achieve solid technical margins across various competitive and macroeconomic environments. Consolidated claims ratio was up by just 1 p.p of which whether events contributed with 0.5 p.p

As with regards the expense ratio, the Company has a recurrent focus on cost control over the years. Expense ratio as of June 2021 is explained by lower acquisition costs partially offset by higher staff expenses as a consequence of the listing. The item "Other technical income and expenses" reflects the amounts of settlements agreements between companies applicable in Spain.

Let's please now move to next the slide.

Financial result was resilient despite adverse interest rate environment. Fixed income revenues were down 9.2%, yet equities and investment property had a remarkable performance.

The investment portfolio is low risk, with Corporates and Sovereigns accounting for 35 and 42%, respectively. Exposure to equities and equity investment funds increased in the first six months of 2021 by almost 3%. We were also increasing the duration of the fixed income portfolio, reinvesting sovereign maturities at a longer term.

Moving on to slide number 21, what we display here is the prudent provisioning of the Company. We are on average at a 99.5% percentile. It must be noted that 2020 and 2021 reveal atypical claims management patterns due to the pandemic. Specifically, some claims took more time to settle, some treatments were delayed, and it was also more difficult to adjust personal injury claims not having access to patients and hospitals.

Finally, solvency remains very strong, and stands at 203%. It is already taking into account the first interim dividend and reflect the economic balance sheet changes occurred in the first six months of the year.

I would like to close this presentation by very briefly going through our progress on a number of strategic initiatives.

During the first six months of 2021, Línea Directa has continued to develop its digital acceleration process with new functionalities, making applications more robust and improving the customer experience. As of June 2021, 50% of customers have requested towing via the app. Meanwhile, 47% and 29% of claims were opened digitally in Motor and Home, respectively. Customers who interact digitally with the Company already add up to more than 83% of the total portfolio.

The Company also launched a new valuation and indemnification system for minor damages through Artificial Intelligence, in real time and without human intervention.

Also, the company just launched an App that automatically analyse driving behavior and rewards customers for good driving habits.

Last but not least, the Company is making further progress towards our Sustainability plan with an overall 92% achievement, Notably, the Company's market share in electric cars in Spain stands at 10%. Unfortunately, electric cars still have a very low penetration in Spain however, the Company is fully committed to it.

Thank you. And we'll now hand the call over to Beatriz to begin the Q&A session.

Q&A

Thank you very much for this presentation Carlos. We start with the Q&A.

First, we'll begin with the questions received from the conference call.

Conference call operator:

Thank you, ladies and gentlemen, the Q&A session will start now. If you would like to ask a question on the conference call, please press star followed by one on your telephone keypad. The first question comes from Mario Ropero of Bestinver. Mario, your line is open.

Mario Ropero - Bestinver:

Hi good morning. I have a couple of questions. The first one is on the combined ratio evolution for motor which is still relatively low, particularly compared to pre COVID levels. Could you give us some sort of indication about your expectation there, and then, on the combined ratio in home insurance you mentioned that it is normal, and that atmospheric events are here to stay. So, to control the combined ratio of the home insurance business, are you planning to implement additional cost initiatives to control the expense ratio in this business? Thank you.

Carlos Rodríguez-Ugarte:

Thank you, on the first question about the combined ratio of the motor insurance business I think it's a very good combined ratio. It is true that COVID-19 is still affecting the frequency of the business, especially in the first quarter of the year where frequency was lower than that of 2019, that for us is a reference as a normalized year. It'll start to pick up a little bit on the second quarter and we'll see what happens on the third quarter, especially with the vacation period in Spain.

On the other hand, severity of accidents was higher than what we expected, but if we take the two things together, still today, frequency is better than in the past, although in our budget and in our planning for the year we estimated on the second part of the year, especially in the fourth quarter, frequency will start to pick up and it will get close to that of 2019.

Having said that, I think the combined ratio of the motor insurance business is going to be as powerful as you can see it in the first half of the year. On the home insurance business, it's very difficult to do something on the atmospheric issue, we already plan every year that we will have a number of atmospheric, the trick here is to identify when it's going to happen. This year, it happened basically on the first two couple of months of the year and that has impacted the combined ratio. So, it's very difficult and it will depend on how it evolves but it's very difficult to have any measures there.

What we do on the combined ratio of the home insurance businesses is keep on working on the cost side, I mean a cost ratio dropped from the from the last number we posted on December and our intention is to keep on evolving there as we get a scale of this business and on the claims side of the combined ratio of the home insurance business. We have the numbers done at the beginning of the year of the amount that we will spend on atmospherics, and as of today, the cost of these atmospheric, especially Filomena, was in the neighborhood of 2 million gross before insurance.

Beatriz Izard:

Yes, precisely, Filomena was for us 2.1 million gross and 1.9 million net.

Mario Ropero - Bestinver:

OK, thank you.

Conference call operator:

The next question on the conference call comes from Ashik Musaddi of JP Morgan. Ashik, please go ahead.

Ashik Musaddi - JP Morgan:

Yes, thank you and good morning Carlos. Just a couple of questions I have, first of all, you were able to maintain still the growth in the number of customers basically which compares with the decline in the premiums, average premium in this Spanish motor market. So, how would you see that dynamic going forward? How comfortable are you that the growth in customer count will continue and do you have any visibility on where the pricing is heading towards? Especially given that the accident level or the claims frequency has started to normalize, is there any visibility on that, that would be very helpful to know.

The second is, in the home segment again, the growth was strong at 5% as well as the prices are going up. Any thoughts on that? Where do you see that heading towards?

And just a last question, you mentioned that the combined ratio for second half for the group is more or less looking similar to the first half? Was my interpretation right or were you trying to say something else? Thank you.

Carlos Rodríguez-Ugarte:

Well, first on the motor insurance business, I think the number of new clients in this line of business was remarkable in a difficult situation. I think, especially on the first quarter, given the fact that the demand on new cars, the amount of purchase of cars is very low as compared to a normalized year (2019), that put a lot of pressure on the growth of clients, and so I think the numbers that we posted are quite well.

In terms of average premiums, I still think there is going to be pressure on average premiums looking forward. I think the market is going to turn around, probably by the end of the year, I don't see any improvement on average premiums on this year because there's still a lot of pressure or competitive pressure, and combined ratios are still lower than in a normalized year, and I think we will see that.

So again, I think the number that we posted on new clients or increased portfolio is very good, and it's a combination of two things: (1) the good retention capabilities that we have and that we have demonstrated during the years, and (2) of course, new clients coming into the business.

With respect to the home insurance. I don't see any pressure on pricing going downwards. Indeed, I think all these atmospheric events or all these increasing frequency because of less mobility of the population, put a little bit of pressure upwards on the average premiums. I think as people start to go back to normal lives and start to use less the homes, probably the average premiums will tend to stabilize, but I don't see any pressure on going downwards.

And in terms of the combined ratio looking forward, I cannot guess how it's going to look by the end of the year. What I think is that the first half was very good, especially because of the frequency of the motor insurance business, but I'm kind of worried about the frequency on the summer because people are eager to go out on vacation, so let's see how it evolves on the summer, but I think as we reach the end of the year, frequency will start to look more or less like 2019.

But keep in mind that, in 2018, our combined ratio was in this neighborhood 85% and in 2019 was around 87%, so we will move in that ground.

Ashik Musaddi - JP Morgan:

OK, that's very clear, thank you.

Conference call operator:

The next question comes from Thomas Bateman of Berenberg. Thomas, please go ahead.

Thomas Bateman - Berenberg:

Hi, good morning Carlos, morning Beatriz, thanks very much for taking my question. Just on solvency, I think there is an "other adjustment" for about 12 million on the own funds. Could you just give us a bit of an insight in terms of what's driving that movement, and whether we should expect it to be recurring or is that a bit of a one off?

And then secondly, just on health insurance, do you have any change to the guidance there or is there any new guidance in terms of when this business might break even in the future and I guess, just on premiums on the health insurance, is this in line with expectations (+25%) or do you expect that to take up even more in the second half of the year? Thank you.

Beatriz Izard:

Hi Tom, this is Beatriz, regarding the Solvency II question and our own funds walk, basically what you have are the eligible own funds at year end 2020,- the profit for the 6 months, the change in the value of the available for sale portfolio, which basically is driven by further revaluation of our equity portfolio, and the 12 million adjustments , which mainly comes from the best estimate's liability, under solvency II.

So, we have an increase in the best estimate provision and that's basically what is included in these 12 million euro.

Carlos Rodríguez-Ugarte:

Hello Thomas, nice to talk to you. Regarding the health insurance, the first half of the year was business as usual, we are very happy with the evolution of the health insurance, I think now we have a portfolio close to 100,000 clients, with good increase in sales, good increase on the portfolio, keep on developing our value proposition in a very different way as our competitors, as we spoke in the past.

So, I think for the first half of the year, we're happy with the evolution and very much in line with what we expected. Looking forward, I still think that in order to reach break-even, we will need to double the number of clients and I think that it will take at least a couple of years. As we spoke, 2024 or by the end of 2024, so no changes on that. In terms of the context or in terms of the market, there's still a perception from the Spanish for the need of a private health insurance. People are increasingly demanding health insurance, and, in that regard, I think our value proposition is very valid, for newcomers into the business. Probably younger people, they value our proposition, which is very much linked to direct. So, I think good numbers, very much in line with what we expected, so we don't change our expectations of getting to break even by the end of 2024.

Thomas Bateman - Berenberg:

That's very clear, thanks for your answers and congratulations on resilient results. Thank you.

Conference call operator:

The next question comes from Carlos Peixoto from Caixabank. Carlos, please go ahead.

Carlos Peixoto - Caixabank:

Hello, good morning this is Carlos Peixoto from Caixabank and I have just a couple of questions. First one would be actually a small detail question on financial income, in the first half I noticed that while overall income is more or less stable versus last year, the financial costs have declined materially, is this related to lower interest rates and is there any detail you could give us on that?

And the second question would be regarding the evolution of home insurance. What type of growth do you expect to see throughout the rest of the year in premiums and, in 2022 as well, if you could share some visibility? And, what would be the combined ratio that you would feel as being the normal run rate for this business? Thank you.

Carlos Rodríguez-Ugarte:

Thank you very much Carlos, regarding the financial income. Well, we still have a 1 billion euro portfolio. Very prudent still, of which I think 80% of the portfolio is in governments and on corporate within with investment rating.

It's a difficult environment, with interest rates on the negative side, let's see what happens with inflation, the good part of the financial income for this year is that all the maturities that we expected on the portfolio on the debt side of the business have already happened. So, the second part of the year we won't have those maturities and then we won't have the problem of reinvesting those maturities at a lower interest rate.

We have tried to do a couple of things, we tried to do something more on the equity side of the business with a prudent approach but trying to increase a little bit and we did something on the real estate which will provide us with good yields. The financial result has been positive given the fact that for the entire insurance business it's going to be difficult to maintain those levels of financial income looking forward, unless interest rates start to pick up.

On the evolution of the home insurance business, I think the market is still moving upwards. Home sales, both firsthand and secondhand are performing quite well. So, I think there's still room to grow this year. We're very happy with the numbers we posted, we grow by 8%, our premiums close to 9%, much more than the market, which I think is about 5%. And I think one of the positive sides of the home insurance is that our partnership with third parties that are providing us with leads, are working very well. We have a major partnership with Naturgy, where basically we are getting very high conversion rates on the leads that we get from Naturgy, even higher than other channels that we have. So, if that works, I think it's going to be a good year for the home insurance business, and you should expect, looking forward, growth rates very similar to the ones we posted on the on the first half.

Conference call operator:

The next question comes from Patrick Lee of Santander. Patrick, please go ahead.

Patrick Lee - Santander:

Hi good morning everyone. Thanks for taking my questions. I just have a couple related to solvency, again. I notice that in this half your solvency capital required went up by some 11% which seems quite high compared to the growth rate in recent years. I think some of the market risk was explained by what Beatriz mentioned earlier on, but I also note that the non-life underwriting risk went up by around 9%. Is there anything that we should pay attention to, to why is the growth that high? And I guess related to that, it also contributed to your solvency ratio falling to 203%. While it is obviously high and very comfortable, it is lower than your recent levels at about 210%, and I guess whether we can take that as a sign or signal that you are ready to take your solvency ratio number towards your minimum or management level of 180%? Thanks.

Carlos Rodríguez-Ugarte:

Thank you, Patrick. Nice to talk to you. On the solvency side and the increase on the capital requirements. Well at the end, it's a combination of a couple of things, Beatriz also explained a little bit, but first, we have increased a little bit our position on the equity market, and requirements on that are higher than on the debt side of the portfolio. And second there has been an impact on the adjustment that EIOPA publishes every quarter. During the pandemic, that adjustment was negative, it somewhat decreased the capital requirement on the equity market were as the first half of this year, that adjustment, that is published by EIOPA and you have to fulfill, has gone in the positive side, so it has required more capital.

So that is the explanation of that increase on the capital requirement. Again, a little bit of more equity position and then the regulatory adjustment published by EIOPA on the first half of the year. And looking forward on the on the solvency ratio, I think it was your second question, we send the message to the market that our intention was, to get into levels of 180% and 190%, we are in 203% which I think is one of the best solvency ratios of the market. We are not moving intentionally to get to that 180% or 190% but we feel confident on that. The idea here is to keep on growing the business and keep on maintaining a stable solvency ratio. From there on, try to distribute dividends in the levels that we have. So, 203% is a good ratio for us, but again, our intention is to move onwards to that 190% of the market.

Beatriz Izard:

Yes, just to reinforce Carlos' message, precisely what was driving the SCR this semester was basically underwriting risk and market risk. Market risk, as Carlos is saying, because now we have more exposure to equities which are not listed, basically in private equity funds, very profitable, but there's a capital charge for that. And then underwriting risk because the USP, the specific parameter that we use, is based on historical data, and paradoxically, last year was extremely good, so it adds volatility to the parameter. So, we have a slightly above normal, I would say, specific parameter for the non-life subscription risk.

Patrick Lee - Santander:

Thank you.

Conference call operator:

The next question comes from Phil Ross of Mediobanca. Phil, please go ahead.

Phil Ross - Mediobanca:

Hi good morning, thanks for taking the question. Just coming back to motor insurance, you mentioned the migration of policies from all risks to the third party. Can you give us an idea whether that is mainly new or existing customers, and can perhaps you give us some steer on what the average price difference normally is between those two products please? And then just a quick, sort of, second question on quite high level, but on claims inflation that's been a talking point in some areas more generally across the economy, I just wonder if you have any signs at this stage, small as they might be, with claims inflation creeping into your claim's costs. Thank you.

Carlos Rodríguez-Ugarte:

Starting form from the last, I think claims inflation was nothing new on the first half of the year. The inflation on the material costs is growing up on 3% to 5% every year and I think this is what is happening. The good thing there is that in our case we are able to beat the market and as I explained many times, our positive gap in terms of repair costs compared to the market is quite high. But again, I think inflation on the repair costs is there, it was last year, it is doing this year, and that is why we are relying very much on our own car repair shops and on our agreement with 500 repair shops, in order to manage those costs, and try to be more efficient. Because, of course, inflation is there and it's picking up. And the second question was, Beatriz?

Beatriz Izard:

I think regarding the average, premium and new business and renewals?

Carlos Rodríguez-Ugarte:

I think it was more on the breakdown of those that are changing the type of insurance that they are doing. From extended, to third parties and all that.

I don't have the breakdown with me now, so Phil, we will have to look for it and send it to you because we don't have that breakdown right now, but Beatriz and Mark, will get back to you on that one and will send you.

Phil Ross - Mediobanca:

Sure, thank you.

Conference call operator:

We appear to have no further questions on the conference call, so we can move to the webcast questions.

Beatriz Izard:

The first question comes from Mario Santos from Soros Fund Management. He's saying thanks for the presentation, very helpful. Can you please develop the artificial intelligence engine initiative a bit more? How should we think about automation targets for the claim's management process a bit farther away than 2022? Can you please provide us with an idea of what type of improvement in expense ratio you expect to get by progressively implementing these types of initiatives? How much of the benefits of that will be shared with customers? Thanks.

Carlos Rodríguez-Ugarte:

This is a very good question and I think I need the help here of the IT people because I'm not an expert on this. Regarding artificial intelligence, I cannot get on the technical part of that, but I think the company is very much focused on using technology, especially on the management of clients. Of course, on the selling part, but also on the management of clients, so artificial intelligence is something that we are using, as we use other or IT tools. But in order to give you an idea on how it works, I think we will have to ask our technical people and we will get back to you on that. And regarding the improvement of the costs, which I can say a little bit more due to our other technological approach, we don't do numbers on that. what we think is, that we need to do something on the technological side, in order to improve the customer experience, the relation of the client with us and that will improve the quality perception by clients and that will improve our retentions and, of course, our selling possibility of us. But we don't do numbers on how much we are going to save. What we are seeing is our combined ratios, especially on the cost side, they are improving, and they are improving because of the technology, but they are also improving because of the cost discipline of the company. So, no numbers on that, is more strategy than doing numbers on how much I can save. And in order to translate that to clients, what we try to do is be very efficient, to have one of the best average premiums of the market. So, the answer is yes, as we get more efficient, average premiums on the on the market will be more competitive, of course.

Beatriz Izard:

I would add that for the customer is extremely easy to handle this. There's a high percentage of customers that prefers indemnification as opposed to repair, and in this way, they can get the bank transfer in just a few seconds just by three clicks, basically, on the app. So, in terms of customer easiness, it's fantastic.

OK. It seems that there are no further questions, so this concludes our meeting. Thank you very much for your time. Bye.

Carlos Rodríguez-Ugarte:

Thank you, bye. Have a nice summer.