Call for Analysts and Investors

Transcription

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Speakers:

CFO Carlos Rodríguez-Ugarte

IRO Beatriz Izard

Presentation

Beatriz Izard: Good morning and welcome to Linea Directa's conference call to discuss March 2022 results. I am Beatriz Izard, Head of Investor Relations. As usual, we 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 our CFO, Carlos Rodriguez-Ugarte.

Carlos Rodríguez-Ugarte: Thank you, Beatriz, and welcome from my side as well.

We start with the highlights for the period in slide number 5:

- Policyholders grew by 4% and premiums by 3.5%, displaying very solid growth across all segments, especially in Home insurance which grew at double digit and is progressively gaining weight.
- Combined ratio remains strong at 89.0% in a context of increasing frequencies and inflation.
- Net result stood at €24.2 million and return on equity at 29.2%; and
- The Solvency ratio as of March 2022 was 195.1%. This figure is already taking into consideration the €21.8 million first interim dividend to be paid on June 8th, a figure that represents a payout of 90%.

Moving on, slide 7 provides an update on the Spanish Motor market, which is still displaying a complex environment:

- New car sales continue to be impacted by the serious supply crisis that the car industry is enduring, which in turns affects the turnover of the insurance business.
- Sector GWP are up 1% in the first quarter and average premiums show very timid signs of stabilization following the sharp decreases experienced since 2019. They increase by 1.1% year on year.

Turning to slide number 8, Home continues with a positive development. House sales continue to climb, up almost 33% yoy, and Home insurance sees further growth with revenues up 3.9%.

Atmospherics events were quite relevant for the industry in 2021 and combined ratios climbed to almost 97% last year. This first quarter no major events took place.

For its part, sanitary assistance continues to grow in premiums and policyholders. The market is growing at 7.2%. Health costs and hospital tariffs are also on the rise however, the market seems to be passing the increase.

Now I'll take you through the main figures for the year.

In the context I just described, the Company continues to grow together with robust profitability metrics:

- Premiums were up 3.5%, reflecting an increase of 4% in policyholders and premium growth across all lines of business.
- Technical margin decreased explained by higher frequency and price pressure in the Motor segment.
- Financial result, reflect lower reinvesting yields on the maturities of our fixed income portfolio.

So, all things considered led to a remarkable combined ratio of 89% and a profit after tax of €24.2 million, down 18%. Please note that that the mobility of last year's first quarter was still limited due to Covid as opposed to this quarter

Please turn to next slide, page 12, where you see the breakdown of policyholders and Gross Written Premiums by line of business. The portfolio increased by 4.0%, supported by excellent retention ratios. Policyholders reached 3.39 million, with solid growth across all segments.

Company premiums grew 3.5%. Despite the still competitive environment, Motor manages to growth 1.7%. Home grew at 11%, which is triggering a steady increase in its overall weight.

More specifically, if we turn to next page, the Motor segment grew 0.7 percentage points above the market. Again, the portfolio recorded a solid growth in a still very competitive environment.

On the technical front, combined ratio stood at a noteworthy 88.3%:

- Expense ratio was excellent and stable, excluding one-off restructuring costs; and
- The performance of claims was driven by an increase in frequency and insured risks. Severity was not relevant in the quarter, as apposed to the previous one.

Moving to next slide, Home had an excellent performance during the first three months of the year:

- premiums grew at double digit, up 11%, a growth rate that beats the market by almost 3 times.
- combined ratio stood at 92.4%, 5.9 percentage points below that of 2021 with remarkable performance in both, the expense and loss ratio. In the latter, atmospheric events were mild in the quarter.

Moving now into next slide, Health continues its path. Premiums grew more than 14%. We continue with a prudent subscription policy and a careful risk selection.

The expense ratio has been adjusted to take into account lower first quarter expense deferral (unadjusted ratios fall to -3.2 and 2.1% in Q1 2022 and 2021, respectively).

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

- Loss ratio had notable marks across all lines of business. Motor loss ratio stood at 70.2%, explained by frequencies on the rise, strong inflation and a still very competitive environment. Average premiums in this segment remain under pressure.
- Home reflects mild atmospheric events this quarter.
- Expense ratio was 19.8 showing the strict ongoing control of expenses. As I mentioned earlier, Health reflects the expenses deferred in the first quarter, which will normalise over the rest of the year.
- All things considered resulted in a solid combined ratio of 89%.

If we move to the next slide, consolidated claims ratio, up 3.3 percentage points, was driven by the Motor line of business as I just explained.

On the next slide we elaborate on the expense ratio. Acquisition expenses reflect more efficiency in the acquisition of policies. Expense ratio stood at an excellent 19.8%. The item other technical expenses include one-off, exceptional restructuring costs.

Let's please now move to slide 19. Rates are on the rise, yet reinvestment yields on the maturities don't exceed the yield on the fixed income portfolio, hence the 2.8% decrease. Income from equities and investment property was up 8.3 and 0.6%, respectively.

Please turn to slide 20. The asset allocation has remained pretty much stable. We reported good returns from equities, properties, and corporate bonds. The overall return of the total portfolio (rolling 12) stands at 3.36% (2.60% excluding net realised gains).

Moving on to our solvency position, the Company's solvency margin stands at 195%. The Board approved yesterday an interim dividend for an amount of €21.8 million to be paid on June 8th, which is already considered in this ratio.

Eligible own funds reflect 21 million of less unrealised gains on the *available for sale* portfolio because of rising interest rates and high volatility of equities following the Russian invasion of Ukraine. Oher adjustments include a positive variation in the Best Estimate for Premiums. This provision has a seasonal effect in the 1Q and will increase in the 2Q.

For its part, SCR decreases by 14 million in the quarter. This is explained by:

- Lower exposure to equities and the symmetric adjustment dropping to 1.4% (it was 6.88% as at December 2021); and
- A decrease in underwriting risk mainly driven by the final adjustment of the specific parameter which now stands at 3.86 (4.95 in December). NO further changes are expected.

I would like to close this presentation by very briefly going through the organisational changes recently undertaken by the Company. Let's move to section 4.

We are welcoming Patricia Ayuela as the new CEO of the Company since February 17. Patricia has been part of Línea Directa since 2003 and of its Management Team since 2008. She is already providing great impulse and direction to the Company. One of the main organisational changes she is now implementing is a customer centric strategy (as opposed to a policyholder focus). Two distinct divisions are created to serve this purpose:

(i) The Commercial department, responsible for client acquisition in the Motor and Home line of business taken together; and

(ii) Clients, responsible for the management of clients is a broader sense.

We are certain this will provide further growth opportunities and increasing customer satisfaction.

Patricia will be having a relationship with the market, and I am sure you will meet her in the medium future.

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: If you would like to ask a question at this point, please press star followed by number one on your telephone keypad. When preparing to ask a question, please ensure your phone is unmuted locally. And our first question comes from Max Mishyn from JB Capital. Please Max, your line is now open.

Max Mishyn: Hi, good morning. Thank you for the presentation and taking the questions. I have a couple on motor if I may. The first one is on the repair costs, what dynamics are you observing, comparing to 4Q21? How much have repair costs accelerated growth in 1Q22 and how do you compare yourself to the competitors in the sector?

And the second question is on the one-off that you had in the expense ratio of motor insurance. Could you give a little bit more colour? What are those costs and how much savings do you expect to achieve?

And the last one is on the frequency of claims. I was wondering, what is your take on how high gasoline prices can impact mobility? Have you noticed any dependence there? Thank you.

Carlos Rodríguez-Ugarte: Well, thank you very much. On the repair costs, we have some concerns about inflation in this part, especially on the material part. It is true that on 1Q22, the impact has been mild, but I think that for Línea Directa and the sector, it will have an impact. If inflation doesn't turn around in a V-form, it will have an impact on material costs for the entire sector.

Having said that, keep in mind that repair costs for Línea Directa, as compared to the competition, we are much more efficient. On average, our repair cost is 300 euros below that of the market, so that is an advantage, and even more advantageous when inflation rises, but of course, I think it's going to have an impact on the entire year, although it is true that on the first quarter yet, we haven't seen that much of an impact.

On the second question, which is the restructuring costs, this is normal when you do organisational changes. As I explained over my presentation, we created different departments, client-oriented, which I think is going to be very good in the commercial side of the business and you must do some investments there. To give you a number is very difficult, but my perception is that if we haven't had those expenses in the first quarter, our expense ratio would be very much in line with the one posted on December 2021.

And then the gas prices, if it remains at the levels that we are seeing, probably it will have an impact on the frequency, a positive impact. When gas prices go up, normally mobility by cars is lower and people use more public transportation, so this will have a positive impact on frequency. It's very difficult to quantify that, but of course that will happen if gas prices keep on the same track.

Max Mishyn: Thank you very much.

Conference call operator: Thank you, our next question comes from Francisco Riquel from Alantra. Please Francisco, your line is now open.

Francisco Riquel: Hello, good morning. Thank you for taking my questions. I would like to focus also on costs, in general. If you can please elaborate more, claims costs are up 7% excluding what you call "atmospherics". Policy count is increasing by 4% and there is an increase in the frequency so meaning that there is very limited cost inflation embedded in this first quarter, I understand. So if you can please elaborate a bit more on how much is the frequency, the severity, what type of cost inflation are you seeing, any mitigating measures and what shall we expect for the full year. You mentioned before that you are expecting a catch up in the inflation costs in the P&L in the coming quarters.

And then also… I may stop here if you want.

Carlos Rodríguez-Ugarte: No, go ahead, Paco, go ahead.

Francisco Riquel: Okay, so also OPEX is down 2%. So if you can breakdown the evolution between marketing expenses and other cost lines. It seems to me that you are spending less in marketing and acquisition costs, and I wonder if you feel that growth in policies will be sustainable if you spend less.

Also, the one-off costs that you mentioned before in motor, I wonder whether it is a one-off or whether these are new investments which will remain there in the cost base for the coming quarters as well.

And just a last question, if you can please explain the difference between the growth in the gross and the net premiums and how to expect this gap to evolve during the year. Thank you.

Carlos Rodríguez-Ugarte: OK. Thank you, Paco, and very nice talking to you. It is true that as I explained before, the impact of inflation on the loss ratio is still mild. It increases every year, regardless of the inflation situation, but it is true that 1Q22 was not that bad. If you take a look at the loss ratio, basically, the increase in the loss ratio was more linked to an increase in frequency, more than the increasing severity. Indeed, severity in the first quarter has been quite good as compared to the last quarter of 2021, where really the company had an impact on severity, so we are happy on getting normalised in in the severity side of the loss ratio. The increase is because of the increase of frequency of exposure of cars, and still inflation had a very small impact.

You have to take into account also that the contracts that we have with our repair suppliers many times are not linked to inflation because they are long term contracts, especially for example for the paint supplier, which is a very important cost on the repair side.

Having said that, even though Línea Directa buys directly from suppliers as compared to competitors who usually pay the repair shops, if inflation remains at the levels that we are seeing, of course we don't expect inflation to be on these levels by the end of the year, it will have a negative impact on the loss ratio and it will increase the cost. It's difficult to quantify that. Of course, some mitigating tools that we are using include renegotiating with our suppliers. Again, many of our suppliers don't have a one-year contract, they have more than a one-year contract so that mitigates a little bit the impact. But again, it's going to be negative for the loss ratio if we keep on maintaining this inflation.

Then the second question you were asking was…

Beatriz Izard: Regarding expenses.

Carlos Rodríguez-Ugarte: I don't have that feeling, Paco, that we are cutting on marketing expenses. I think we are on the same levels on marketing investment, more or less. Of course, for the year our budget is very much in line with what we spent the other years. I think what we are doing is cutting costs in other areas. For example, our digital approach is allowing us to reduce the number of calls in our customer service; not on the selling part of the business, because on the selling and retention part we like the phone, and we still use it. But it is true that the number of calls on external call centres that provide customer service to our clients is dropping, and that means we are saving on expenses. And then, our approach in the company is analyse, basically on a monthly basis, the evolution of expenses and try to be very efficient. But again, we have an approach of being very involved in our marketing effort, it is the way we create brand awareness and attract clients, so you shouldn't expect a decrease on this type of expenses during the year.

And the third one is the growth difference between gross and net, well basically is the timing on the entrance of the policy. I mean, we don't sign all the company's policies on January 1st, we do that along the year and of course you have to decrease the gross premium by the provision of premium not consumed, basically it is that. It is something that all insurance companies do, you can only put on the P&L the premium that is already gained.

Beatriz Izard: Yes, good morning, Paco, I think we are coming from a more flattish figure, particularly in motor, in the 4Q of last year. And now, as the GWPs are growing usually net premiums earned are lagging behind in terms of growth.

Francisco Riquel: Yes, sorry, if I may, I understand the difference between gross and net premiums. It is the gap in the growth in both lines, why is it different this year?

Carlos Rodríguez-Ugarte: Because last year premiums were going down and you have the impact of the previous year. I mean, you have to take a look on a yearly basis, when previous years gross premium was decreasing, it makes a difference between the earned premium and the gross premium.

Francisco Riquel: Thank you.

Conference call operator: Thank you, our next question comes from Thomas Bateman from Berenberg. Please Thomas, your line is now open.

Thomas Bateman: Good morning, everybody and congratulations on the results, much more solid this quarter. Could you just give us a little bit more colour on the solvency position and in particular the changes in reserving, I mean, there's a higher view of reserving buffer there. Also, can you give a little bit of colour on motor pricing? If it has picked up a little bit, has there been any changes in competitor behaviour that you could point out? And finally, on the new strategic course, Patricia, where should we expect to see these changes coming through on the numbers? Is it higher growth, is it lower expenses? Maybe you could just give a bit more colour on those four strategic goals, that would be really helpful. Thank you.

Carlos Rodríguez-Ugarte: Hello Tom, very nice talking to you. On the first question regarding reserving.

Well last year, by the end of the year, the solvency ratio was kind of affected by the change of the statistical methodology for calculating provisions that we have by the end of the year, approved by the regulator. I think this year, this quarter I mean, we have seen a much less impact because things are… they get to become stabilised, you know? So, I think that is something that was a one-off on the last quarter of the year and we didn't have that impact on this year, you know?

And then the solvency ratio. Well again, it had a negative impact this year because of the situation with the investment portfolio and the situation of the market. But basically, the reserving impact was on the last quarter of 2021.

Additionally, I mean we have two impacts, positive impacts, this quarter, which was the symmetric adjustment that the EIOPA requires for the portfolio was closer to 2% up this quarter, whereas last quarter was in the neighbourhood of 7%. That is because what EIOPA tries to do is to protect volatility and when the market is in an upward trend, normally this symmetric adjustment is higher. So that had a positive impact on this quarter.

And finally, the specific parameter that we use in other guarantees in the motor line of business also benefits a little bit this quarter, the solvency ratio. And that's going to be stable looking forward on next quarter.

So again, we always have said that we will be glad to have a solvency ratio above 180%. We are at 195%, probably next quarter will be more in the neighbourhood of 190%, 192% then 195%, but I think it's going to be stabilised.

Then on motor pricing, I mean we don't have, we still don't have the last numbers of the sector as of March. I mean, we were thinking that maybe yesterday they were going to be published, but they didn't. My perception, looking at my retention rate, looking at the evolution of the gross premium, is that still the sector is very competitive in terms of pricing, but I think that pressure on pricing is becoming more mild than in the past. And again, many times we have talked I expect, you know, a changing cycle looking forward this year. So, I'm happy about the evolution of the gross premium. I see some of our competitors sending messages that they are going to rise pricing. In our case, as you know, we do this on an individual basis. We don't have a general strategy of rising prices, but my perception is that somewhat average premiums are becoming more stabilised than in the past.

And then on the last question regarding our new CEO. Well, I think one of the good things of having Patricia as CEO is she knows very well the company. I mean she's been with the company, many, many years, she's been in the management team for so many years and she's been in the back and in the front, managing the back and the front so she knows the entire business all around. I think Patricia is very eager, you know, to keep or increase the growth of the company and that's something that she has communicated to the entire management team, so you should expect that the company is going to grow and it's going to grow even faster than it has been growing in the past.

And of course, the second main objective here is to keep on doing the company more and more digital, and that means that expense ratio should keep on improving. Again. I mean, Patricia thinks that this is a business very based on efficiency and that efficiency has to come through digitalisation.

So, the main objectives of our new CEO is growth, you know, increase the growth of the company as well as keeping the company as one of the most efficient companies in the sector.

Thomas Bateman: That's really great, in particular on the growth and the expenses. I just want to come back to the reserving one more time. I know you said there was a negative one-off in Q4, but it seems like there's a kind of a 12 million positive this quarter. There's been some, I guess there's been some quite material moves over the last few quarters, so I'm just trying to understand where that positive 12 million has come from.

Carlos Rodríguez-Ugarte: I guess you refer to the best estimate on premiums. That is a seasonable impact, because of the evolution of the rolling of our premiums. If you take a look at the first, I mean I can send you the first quarter of last year because probably you don't have that because we were not listed. But it's always a positive impact that happens on the first quarter of the year. It's an impact that will not be on the second quarter and become more stable, but it's an impact of the seasonal evolution of the premiums of the company.

So those 12 years that is a positive gap on the first quarter, we won't have that on the second quarter. It doesn't mean that we will have a negative impact, but we won't have the positive impact. It's something that always happens on the first quarter because the P&L of the company and the commercial activity of the company is much higher on the second half of the year than on the first half of the year.

Thomas Bateman: OK, understood. So, it should normalise throughout the year. OK, thanks so much for your help. Really good results.

Conference call operator: Thank you. Our next question comes from the line of Phill Ross from Mediobanca. Please Phill, your line is now open.

Phill Ross: Hi there, good morning.

So, first question on motor. I think you mentioned severity is not relevant this quarter as opposed to other quarters. If you could just expand on the reasons why that is, please? Or is it just a COVID normalisation type thing?

Second question, again on motor. In the past you've highlighted the trend of customers choosing third party cover over comprehensive covers. Just wondering if that trend is still noticeable or is it levelling off a little bit now?

And then the third question, I guess more generally, you saw customers interacting with you more or buying insurance more digitally and online during COVID, partly because they were forced to do so. Can you tell us whether these trends are continuing in Q1? Or is it too early to say at this stage? Thank you.

Carlos Rodríguez-Ugarte: Well, the loss ratio is very similar to a normalised year. I mean I think mobility after Christmas came back to normal. I mean so frequency is picking up and that's going to be normalised for the entire year, I think. And nowadays people are going back to the offices, people are using the car. Of course, maybe the gas cost will have a positive impact. But again, in Spain, everything is back to normal, and frequency should… I mean they are already in the first quarter being very normalised, so you should expect that, unless something happens, we are back on track as a normalised year and frequencies are already in line with the normalised year and I should expect a positive impact on that. I mean looking forward I think frequencies will be very normalised.

The second question was on the type of insurance that people are taking. It is true that the crisis on the car industry had an impact on new car sales. Of course, people, when they buy new cars, they tend to buy fully comprehensive insurance as compared to second hand or used cars where people buy third parties.

The situation is still very similar. I mean the breakdown is very similar to last year because the situation in the car industry is very similar. So again, I mean the evolution is that people are buying more third parties than fully comprehensive, not different than on the fourth quarter, or even on the third quarter of 2021, but the situation is the same if you compare the car sales. The new car sales, as compared to last year, or even as compared to 2020, which is still lower than that, you can imagine that the situation is very similar.

And the third question was on digital trends. Well, you know, one of the things that we have done during COVID is take into account that many people have jumped for the first time on the digital market. We worked very much on customer experience because we knew that people jumping for the first time into the digital, if they were happy with their experience, they would remain on the experience. So, I think we are very happy on that because we have a lot of clients that tried for the first time the digital approach and they remain on that. And the situation is still on the same grounds. I mean we work on customer experience and the evolution of the digital market in Spain or the direct market in Spain is growing, which means that people are using more and more digital platforms, more than the presential, so happy doing that. And what we try to do is that the customer experience for the first time for a client is good, because if a client is happy the first time, it will remain digital.

Phill Ross: Right, thank you for the responses.

Conference call operator: Thank you. We currently have no further questions on the phone lines. I hand over back for the webcast questions.

Beatriz Izard: Okay, thank you. So now we continue with the questions received from the webcast.

The first question comes from Carlos Peixoto from CaixaBank. He's asking whether you could elaborate on your expectation on the combined ratio evolution in motor business, during the year.

Carlos Rodríguez-Ugarte: Well, the combined ratio, I think as compared to last year, in the motor business grew by three and a half percent. I think, again, frequencies are starting to pick up and severity for us was very good on the first quarter. My expectations are that a combined ratio for the motor industry will increase during the year and that is going to happen for Linea Directa, and my perception is that it is going to happen for the entire market. Again, at the end, our gap compared to the market is quite good and we will remain with that positive gap. But you should expect the combined ratio on the motor insurance to slightly increased during the year.

Beatriz Izard: Thank you. The next question comes from Patrick Lee from Santander.

You commented a few times on the extraordinary expenses seen in Q1. I believe that could be around one million. Can you comment on the nature of this? Is this related to the regulatory changes? Could there be further changes in the remainder of the year? Thanks.

Carlos Rodríguez-Ugarte: Hello Patrick. Well, the good thing is that it's a one-off. You know when you talk about additional expenses, it is good that they will be one-off. No regulatory relation, I mean we don't have any additional regulatory requirements in terms of expenses. There are more expenses of reorganising the company. As I explained in my previous presentation and, we have decided to change a little bit the organisational structure of the company, trying to focus more on customer-centric than on policies.

Keep in mind that we are a company that we were born back in 1995 by selling only one type of insurance. So even though we do a very good job on cross-selling both in the home and the health insurance business, we were very much focused on policies, and I think our new CEO, has decided, and I think it's very positive, to change a little bit the structure of the company towards customer-centric and those extraordinary expenses are linked to that. So, you shouldn't expect more expenses or more extraordinary expenses on those grounds looking forward during the year. Again, no regulatory requirements there.

Beatriz Izard: Thank you. The next question comes from Close Brothers Asset Management, from Alejandro Velez. You've mentioned retention rate a couple of times. Could you give us an indication of whether retention is improving above levels disclosed in the IPO? Thank you.

Carlos Rodríguez-Ugarte: Well, it's not that much that retention levels are increasing. I mean our retention level, on the motor insurance especially, is very close to 90%. What I tried to explain is that the cost of retention is lower than we have seen in previous years, and I think that this has a positive impact on the company.

It's very difficult to keep on increasing the retention of clients when the retention is well above that of the market and very close to 90%. But what it is very good is that we are seeing that the expense of retaining clients is decreasing. Probably that means that also average premiums on the market are more stable than before.

Beatriz Izard: Thank you.

So, thank you, Carlos. It seems like there are no further questions and this concludes our meeting. Thank you very much for your time, bye.

Carlos Rodríguez-Ugarte: Bye, thank you very much.