Call for Analysts and Investors

Transcription

July 22nd | 9:00 AM CET

Speakers:

CFO Carlos Rodríguez-Ugarte

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Presentation

Beatriz Izard: Good morning and welcome to Línea Directa's conference call to discuss June 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 as usual with the highlights for the period in slide number 5. In a context that we can describe as extraordinary and uncertain with a sharp uptick in inflation, we are happy to present strong performance in the first six months of the year:

- Policyholders grew 3.8% and premiums by 4.0%. By line of business, we are displaying very solid development across all segments. Motor grows at 2.5%, with an acceleration in the second quarter;
- Combined ratio stood at 90% and return on equity at 28.3%;
- Additionally, it is noteworthy to mention the excellent performance of the expense ratio, which stood at 19.8%; and
- Solvency ratio as of June was 206.7%.

Moving on, slide number 7 provides our regular update on the Spanish Motor market, which is still presenting a complex environment.

With the main developed countries all making progress in their vaccination rates and with COVID-19 becoming somewhat less severe, economies are now focusing their attention on the conflict unfolding in Ukraine. The war has had major impact on the economy, at a time when the recovery from the health crisis was not yet complete, leading to a sharp increase in prices:

- CPI rose to 10.2% in June, with underlying inflation rising to 5.5%. Correspondingly, the cost of claims in the sector is on the rise.
- Sector premiums are up 2.3% in the first quarter and average premiums show timid signs of stabilization following the sharp decreases experienced over the last few years.

Turning to slide number 8, Home continues with a positive development. Property purchases have continued at a good pace despite higher borrowing costs. House sales are up 24%.

Revenues for the sector increased by 5.1% as of June and average premiums remain stable.

As with regards the Spanish Health market, the growth in policyholders slowed down, while turnover continues to report significant growth, with premiums adjusting for higher healthcare costs and hospital tariffs.

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

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

- Premiums were up 4%. Customers increased by 3.8% together with excellent retention rates.
- Our technical result as of March was fully explained by higher frequency. Please note that the mobility of 2021 first quarter was still limited due to Covid. The second quarter is also marked by additional frequency and higher personal injury compensations and repair costs as compared to last year.
- Financial result includes 4.5 million of realised gains, mainly in mutual funds with the aim of reducing P&L volatility prior to the entry into force of IFRS 9 in 2023. We also took advantage of the window of opportunity to realise notable gains. Excluding such effect, financial result would have grown by 9.1% driven by higher dividends on the equity portfolio.

So, all things considered led to a solid combined ratio of 90% and a profit after tax of €49 million, down 15.9%.

Please turn to next slide, page number 12, where you see the breakdown of policyholders and Gross Written Premiums by line of business. The portfolio increased by 3.8%, supported by excellent retention rates. Policyholders reached 3.4 million, with solid growth across all segments.

Company premiums grew by 4%. Motor displays positive momentum with premiums up 2.5%. Home and Health continue their very positive trend.

More specifically, if we turn to next page, the Motor segment grew 2.5%, 0.2 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 89.3%:

- Expense ratio was superb; and
- The performance of the loss ratio was driven by a gradual increase of frequency in the 1st and 2nd quarter and higher cost of claims as compared to last year. Net premiums earned, however, increased at a lower rate with the rise of the unearned premium reserve.

- Combined ratio is well below the sector, almost 7 p.p. Please bear in mind we are comparing with the sector's latest available data as of March and we expect the market to deteriorate its margin in the first half.

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

- premiums maintain its very positive trend, up 10,6%, a growth twice that of the market.
- combined ratio stood at 90% 1.2 percentage points below that of 2021 with remarkable performance in both the expense and loss ratio.

Moving now to next slide, Health continues its path. Premiums grew more than 13%. The message here is that we continue with a prudent subscription policy and a careful risk selection.

As we did last quarter, the expense ratio has been adjusted to take into account lower expense deferral (unadjusted ratios fall to 32.2 and 42.1% in June 2022 and 2021, respectively).

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

- Motor loss ratio had an outstanding performance, up 3.5% in the quarter, in a context of higher frequency and higher bodily injury compensations and repair costs. Home had an excellent semester and Health improves by 6.3 percentage points.
- Expense ratio dropped to 19.8%. Noteworthy to mention the expense ratio achieved in the Motor Line of business, of 17.3%, which I think is remarkable.
- Overall, we display strong operational resilience in a very inflationary situation or context.

If we move to the next slide, consolidated loss ratio was driven by the Motor line of business as I just explained. The first quarter was marked by higher frequency and the second quarter begins to take into account higher average cost of claims.

On the next slide we elaborate on the expense ratio, which again, was remarkable. We remain firmly committed to efficiency and technology together with a strong control of overheads. Acquisition expenses are contained thanks to higher retention ratios.

Let's please now move to slide 19. As I mentioned before, we took advantage of a window of opportunity to realised gains: (i) equities and mutual funds were sold at 56 and 17% average return, respectively: and (ii) we also unwound an interest rate swap and the underlying bond generating capital gains of €1mn. Excluding those gains, investment result would have grown by 9.1%, on the back of higher dividend income.

On slide 20 you can see equity mutual funds have fallen from 8 to 7% of the total asset allocation. As with regards investment returns, the overall return of the total portfolio (rolling 12) stands at 3.9% (2.7% excluding realised gains).

Moving on to our solvency position, the Company's solvency margin stands at 207%. The main impact on eligible own funds was the drop in the mark to market of the AFS portfolio, particularly the fixed income portfolio as a result of rising rates.

Set aside the profit for the quarter, other adjustments include a positive variation in the Best Estimate for Premiums.

For its part, SCR decreases by 10 million in the quarter. This is largely explained by lower exposure to equities and the symmetric adjustment dropping to minus 5.34% (compared to a positive 1.4% as of March).

I would like to conclude by saying that we expect the Board to keep the same dividend schedule as last year's.

Thank you all. 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: Thank you. If anyone would like to register a question, please press star, followed by one, on your telephone keypad. If you would like to withdraw your question, please press star followed by two, and when preparing to ask your question, please ensure you are unmuted locally. So that's star followed by one on your telephone keypad to register a question.

Our first question is from Max Mishyn from JB Capital. Max, your line is open, please go ahead.

Max Mishyn: Hi, good morning. Thank you for the presentation and taking the questions. I have two. The first one is on motor. I was wondering how do you see premium dynamics in the sector going forward? It seems that your peers have already reverted discounts, and some are hiking premiums, but it should take some quarters until we see the impact on the combined ratios. And I was wondering in terms of lag between hikes to premiums and the impact on technical results, do you think you have an advantage over your peers because of the direct sales model? And can we see the improvements faster?

And then the second question was on frequencies. I was wondering if you could please update us on how you see frequencies in what of evolving over last week or last month. Are there signals suggesting that high gasoline prices can reduce mobility? Thank you.

Carlos Rodríguez-Ugarte: Well, thank you very much, Max. In terms of our premium dynamics, I´ve been always saying that my expectation was that in 2022, we will see a change in the cycle. I think we are experiencing that. It's still slow, I think in traditional companies it's kind of difficult to turn around the pricing strategy, but the perception is clearly that the market is turning around and starting to increase prices. In our case we have posted a 2.5 increase in premiums, but if you take the last quarter isolated you will see that our increase was 3.5%. Indeed, the growth on the second quarter on to the first quarter was above 10%. So, my perception is that of course, premium growth translated to the PNL, it takes quite a time because at the end you basically put on the PNL the earned premium, and not the gross premium, so it would take a while until it impacts the technical result. On the other hand, the claim side of the business, any impact is immediately translated into the PNL, so it will take a time, but my perception is that the market clearly is starting to turn around in the pricing study. Having said that, keep in mind that the market as of June grew gross premium by 2.3% and Línea Directa was able to outperform the market, growing by 2.5%.

On the second question, frequencies. Well, I still don't see that impact that you were posting in your question. I mean, in terms of gas and all that, it is true that frequency is very much in line with 2019, I think in our case frequencies in the neighbourhood of 17% more or less. I think we will see a change in the frequency evolution after summer. My expectation is that frequency will drop in the second part of the year, but still today, we don't see that evolution. The frequency is very much in line with first quarter, so we still need to see some evolution of the impact of inflation, of the impact of the gas prices... Still today, I don't see that impact.

Max Mishyn: Thank you.

Conference call operator: Thank you, our next question is from Thomas Bateman from Berenberg. Thomas, your line is open, please go ahead.

Thomas Bateman: Alright, good morning. Thank you very much for taking my questions. I was hoping you could just give me a little bit more colour on what your expectations for the market-combined ratios are, and hence, you know... why aren't we seeing a faster increase in premiums year to date and over the course of the rest of the year?

And my second question is just on the yield and the investment portfolio. There have been a few moving parts recently. What do you think like a running yield is on your investment portfolio, and how would you expect that to pick up over the next couple of quarters?

Finally, you just mentioned that claims frequency is only 17% for Línea Directa. That seems quite low. I don't really know how to think about that number. Could you give me a little more colour? Because if that goes up to 100%, that feels like that could be quite negative. Thank you very much.

Carlos Rodríguez-Ugarte: Thank you, Tom. Well, the combined ratio, first quarter of the year still was impact a little bit by COVID. The second quarter, you know, frequency starts to pick up, combined ratio for the companies, as a whole, is in the neighbourhood of 90%, much lower than the market, I would say. I don't have the numbers for the first half of the year for the market, but my expectation is that the market is going to be very close to 96/97%. In our case, looking forward for the entire year, I think we will be over 90%, in between 91 and 92%. The key here is to be able to maintain that positive gap that we have with the markets, which I still think that is the case. And if you take a look at the first quarter results of the market, combined ratio was already close to 90/95. So, we'll see what happens next week when we see the numbers of the market, but my expectation is that combined ratio will start to pick up, not only for frequency but also to the average quotes of a repair, which is very much impacted by inflation.

On the investment portfolio. The running yield is in the neighbourhood of 2.1%. This quarter, what we did, as I explained in my call, is realised gains on the equity portfolio. You know, we don't want to put a lot of volatility next year on the PNL, so we realised some capital gains on the mutual fund business. The return on that capital gains were very good. It doesn't mean that the company is going to use the investment portfolio to compensate the PNL, it's basically we took an opportunity on their equity market. But still, it's a very prudent portfolio with 75% of the portfolio fixed income products. There was an opportunity. We took it. We made capital gains, but the running portfolio is in the neighbourhood of 2.1%.

And then on frequency. Well, frequency, 17% for me is high, you know. I don't know your perception, but my expectation is that it's going to keep in that path during summer, and probably you will see a drop on frequency on the second half of the year. I mean, 17% is very similar to the frequency that we have in 2019; 2021 was lower, was in the 16% and now it's in the 17%. Looking forward for the entire year, I think it's going to end up below that 17% due to the lack of the use of car in the second half of the year due to inflation and so on, but 17% is very much in line with a normalised year.

Thomas Bateman: Thanks very much for that and I think I misunderstood the frequency. 17 % is a good number. Alright. Thank you, Carlos.

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

Francisco Riquel: Yes, good morning, Francisco, from Alantra. Thank you for the presentation and for taking my questions. I want to focus on pricing in motor insurance, in particular. So, in slide seven, you mentioned that average premiums for the sector are up 0.9%. When I look up your average premium, is lower than that, so I wonder if you can comment on this average premium. How much is due to prices, tariffs? And how much is due to the product mix? Just to have a better sense of the underlying pricing trends. If you can also comment on how is the pricing for the new production versus pricing for the renewals of existing clients? You mentioned that you have an excellent retention rate. I guess it might be coming at the expense of lower prices, whereas the new production might be coming with higher prices, but net, is not yet a main positive.

And then, how do you see pricing in the market? Are you ahead of competition in terms of price hikes, or you are typically slower because you can afford with a lower combined ratio? Thank you.

Carlos Rodríguez-Ugarte: Thank you, Paco. Well, on the mix of the portfolio of the motor insurance business, there has not been quite a change. I mean, given the situation of the car industry, you should expect people taking more third parties more than fully comprehensive, but if we look up the weight of the fully comprehensive policies in the companies, it's still in the neighbourhood of 40%, so it has not changed. The pickup on the gross premium has been driven by, you know, an increase in average premium and of course increasing the portfolio.

The number that you were posting, 49% I think is high. The number of the first quarter, I think. My perception is that pricing is starting to go up. I mean, if you take a look at the last numbers, gross premium for the market was growing at 2.2%. It's somewhat contaminated by the mutual impact of the dip of two months last year. But in the case of Línea Directa, basically, the increase in gross premium is driven by increasing average in average premium.

And regarding the mix between new business and the portfolio, we are not lowering the price on the portfolio. I think it's a matter of having a very competitive average premium in the portfolio, maintaining that average premium, and providing quality to the clients. Of course, the gathering premium for new clients is probably a little bit lower than the portfolio, but we are not increasing our maintaining our retention supported by lower average premiums. I think, as a whole, the average premium of the company in the motor insurance business is picking up on the market. I always say the same thing. Changing pricing strategy for a direct company is faster than a change in pricing strategy for a traditional company, and I think that is the case.

The third question…

Francisco Riquel: Yes, if you are …

Carlos Rodríguez-Ugarte: If we are ahead… I don't know. Probably we are a company faster in anything that we do, because we are direct. Keep in mind that when we change the strategy, all our selling force is in the same building; we can do that very fast, and it takes much shorter than the competition. But I think, the move for the market is changing pricing or start to pick up on pricing. I'm not sure if I'm faster on or not. What I'm sure is, even with an increase in average premium, our premium is much more competitive than that of the market, but I couldn't comment on whether we are faster or not. I can say that we are very fast in any strategy change that we try to accomplish. I don't know the market.

Francisco Riquel: Thank you.

Conference call operator: Thank you, our next question is from Carlos Peixoto from CaixaBank. Carlos, your line is open, please go ahead.

Carlos Peixoto: Yes hi, good morning. So, most of my questions have already been replied … when I look at the gap between the growth rates, we've seen growth rates and premiums and net earnings premiums. I was wondering if this is mainly related with some sort of accrual effect, or whether it is a bit of a change in the reinsurance pattern policy within the group; and if so, if you could leverage that change.

Carlos Rodríguez-Ugarte: I have some difficulties hearing you, Carlos… but I think I got you. Well, no changes on the reinsurance scheme of the company. I mean we have an excess loss programme which is the same as we had last year, so no change of that. The difference between the gross written and the year premium is the difference of the accounting. I will try to explain. If we were to sell all our policies January 1st, there will be no difference between the gross written premium and the earned premium, but the thing is that you sell policies every day of the year, so you only can account the earned premium on the proportion of the premium used. Again, if we were to sell January 1st, all the policies, gross written premium was very similar to the earned premium. No changes in accounting and no changes in their insurance programme. We have a small insurance programme with an excess loss, both in the motor and in the home insurance, as well as on the on the health insurance, but it's the same as in the past.

Beatriz Izard: I think Carlos, you will be seen this acceleration of premiums at the top line. You will see it included in our PNL on an earn basis next year.

Carlos Rodríguez-Ugarte: The thing Carlos, I tried to explain during the presentation; is that any impact on the claim side of the business or on the expense side of the business is completely translated into the PNL at the first moment. The growth, in gross written premium, it takes a while. So, the thing here is being able to grow much more on gross written premium than on earned premium because that will have a very positive impact on the future.

Carlos Peixoto: Okay, very, very clear.

Conference call operator: Thank you, our next question is from Patrick Lee from Santander. Patrick, your line is open, please go ahead.

Patrick Lee: Hi good morning everyone, Patrick from Santander. Thanks for the presentation and for taking my questions. Just looking at the multisegment, I think that claims went up by around 9% in the first half, even though you managed to lower the expenses by some 5%, which is obviously encouraging. But if we were to break down the claims increase into components hypothetically, can you give us a feel of how much of this increasing claim is driven by higher frequency? And how much of it by current inflation rate environment? And I guess my underlying question to it is that how much of the inflation pressure we are seeing today are in this set of numbers? Or is there going to be a further headwind in the second half of the year, affecting both claims and expenses? Thanks.

Carlos Rodríguez-Ugarte: Well, thank you very much Patrick. It's kind of difficult to do a split between frequency and inflation, you know? I remember when I posted first quarter numbers. I was saying that inflation is still what's kind of mild in the PNL. Second quarter has not been the case. I mean, inflation impact has increased by 6, 7%. Looking forward in the year, CPI is still on the double digit or close to double digit; that is going to be even worse for the end of the year. I mean, inflation on the on the second quarter has been very much important. Indeed, frequency was a little bit better than we expected, but inflation really impacted the second quarter. I think it has done to the entire market, not only in the insurance business, but in any in any kind of sector. If we maintain that, 9%, 10%, you know inflation, the second part of the year is going have an impact for Línea Directa and it's going to have an impact for the market.

Having said that, I mean, if you take a look at the combined ratio, you know, our gap with the market is still there 6, 7% of points, and my perception is that we will be able to maintain that. Again, you know inflation has an impact on the claims side of the business, but we did a real good effort on the expense ratio of the company, and having an expense ratio of 17.3 in the motor insurance will help us very much to cope with that inflation pressure that will come in the second-half of the year, as well as it has been impacted in the second quarter of this year.

Patrick Lee: Great, thanks Carlos.

Conference call operator: Thank you, we have no further questions, so I'll hand back… any other closing remarks.

Beatriz Izard: Alright, thank you. And now we continue with the questions received through the webcast. The first question comes from Jaime Pallarés from GVC Gaesco. He's asking, with the share price at this level, are you considering a share buy-back plan?

Carlos Rodríguez-Ugarte: Thank you. Well, share buy-backs are not on the roadmap. Our intention here is, we have been working since, April 29 last year to increase liquidity on the share, that is the effort that all the Investor Relations team and myself are trying to do, and there's no share buy-back programme looking forward in the medium term.

Beatriz Izard: Thank you also Jaime Pallarés is asking on the combined ratio and what could we expect in the coming quarters?

Carlos Rodríguez-Ugarte: Well, I think I already answered this question. Combined ratio is 90% and we should expect a little increase looking forward by the end of the year. It's difficult to say a number, but we will be over 90%, between 91 and 92%. Again, we'll see what happens with the market, but the market is going to be very close to two 97, 98%. That's the way I see it.

Beatriz Izard: Thank you, the next question comes from Phil Rose from Mediobanca. For motor, you mentioned lower net-earned premium due to higher unearned premium reserve. The gap to gross-written premiums looks larger than last year. Are there any changes here?

Carlos Rodríguez-Ugarte: No changes. Again, I tried to explain that before, the accounting of the company is very similar. Yes, I mean, it depends very much on the selling calendar of premiums. It depends very much on when you sell the policies. An earned premium basically is discounting from the gross-written premium, the proportion of the premium that it doesn't enter the place, you know. So, no changes. It's a seasonable impact more than anything else. Again, what is important is that the gross written premium is above the earned premium, and that will have a very positive impact looking forward in the coming months and in the next year.

Beatriz Izard: Thank you. He's asking as well about the motor line of business and our expected combined ratio. What kind of forecast are we making for year end?

Carlos Rodríguez-Ugarte: Well, I think we already talked about that, you know? Again, you should expect an increase on the combined ratio, mild compared to the market, but an increase on the combined ratio. Not that much frequency, because again, I expect frequency to drop a little bit on the second half of the year, but I think inflation pressure is going to be in there. We'll see what happens when, you know, with the latest interest rate increase, whether it will have a positive impact on inflation, but if inflation is on the neighbourhood of 8%, of course the claim cost of the business is going to be is going to be impacted by that.

Beatriz Izard: Thank you. And the last question comes from Mario Santos Saenz from Soros Fund Management. He's asking whether, you can expand on the comments made in the press release regarding a target to which, 1000 million of turnover, I see no year attached to that. So, we understand this is a 2023 target. Thanks.

Carlos Rodríguez-Ugarte: Well, that's an ambition of the company to reach that one billion, you know, of gross written premium. It's difficult to put a date there, because, when we have COVID then we have the Ukraine war, so it's very difficult because we are not in a stable situation regarding the economy. So, it will depend very much on the economy, on higher work. Of course, we are close to that, very close to that, and it's going to be on the short term. But I couldn't put a date on that, whether it's going to be 2023 or not. I mean, if you take a look at the number and the growth rate, of the gross-written premium, you can figure out when it's going to happen, but it depends very much on how the economy evolves, how, you know, things evolve, but we are very close. It's a target of the company, but we don't put a date on that because I mean, when we decided to put a target then came over the COVID, then the Ukrainian war, now the inflation, so it's difficult. But we are very close to that.

Beatriz Izard: Thank you. We have a final question. It came in from Richard Lake. He's asking whether the inflation in claims cost in motor is very broad based or are there key areas driving these, for example glass, paint…?

Carlos Rodríguez-Ugarte: Well, it's spread around all the weaker costs, but it is true that, you know, there are some areas, for example, the painting has increased quite a bit. The painting is basically ruled by a couple of companies in Spain, so there's a lot of pressure on pricing there and also in labour costs, you know? But it's very much spread around all the material costs. It is true that in our case, I mean, we try to manage these with our own repair shops with our networks, but, you know, if you break down the increasing costs of materials, it's very much spread around. If I were to pinpoint something, I will pinpoint the painting materials which would have increased quite a bit since January.

Beatriz Izard: Okay, thank you, Carlos. It seems there are no further questions, and this concludes our meeting. And thank you very much for your time. Bye.

Carlos Rodríguez-Ugarte: Thank you very much. Be careful with the car in summer.