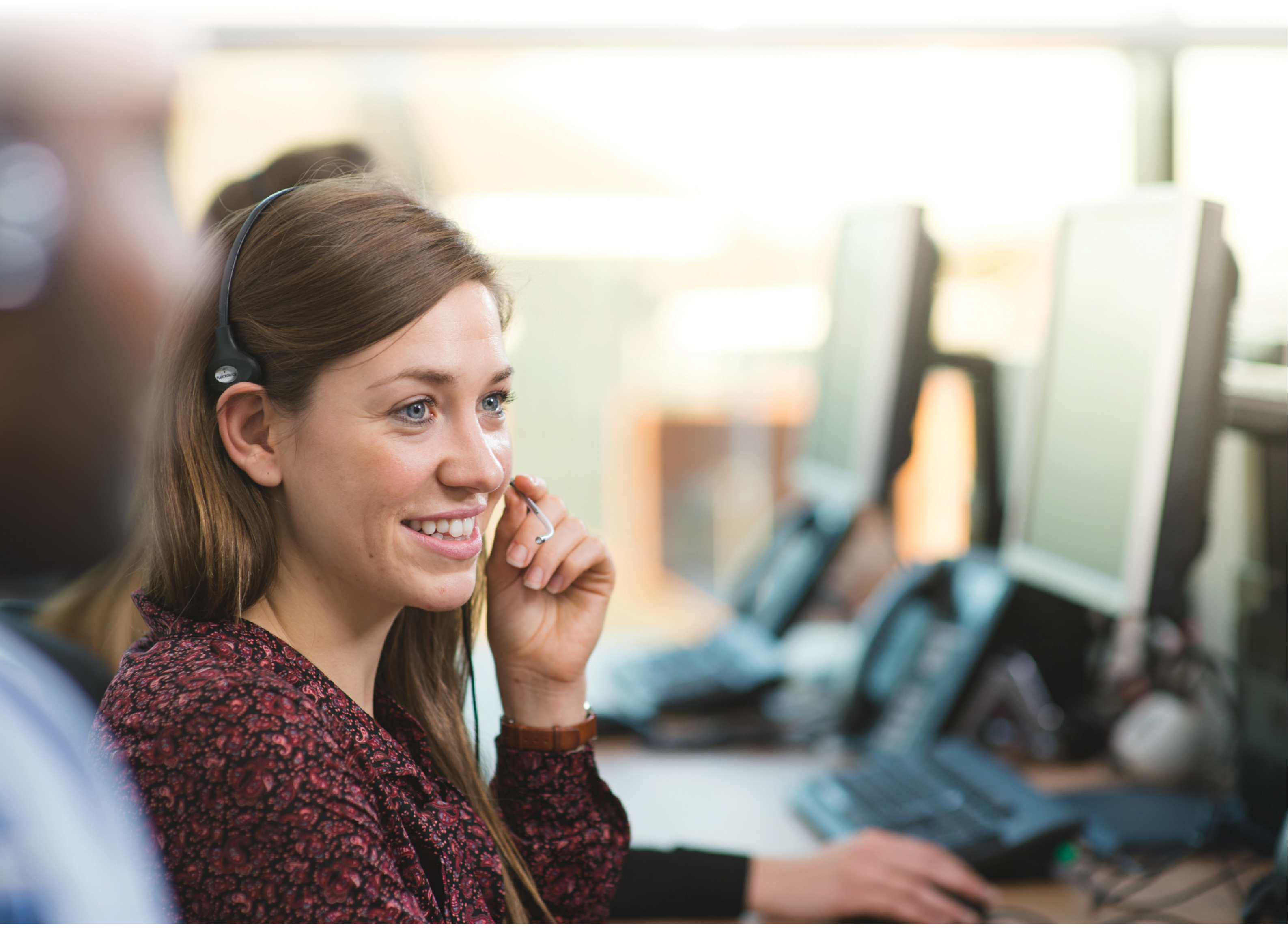
2019 Half Year Script



PENNY JAMES, CEO

SLIDE 2

Good morning everyone and welcome to our Half Year 2019 results presentation.

Before I begin, I'd like to thank Morgan Stanley for hosting us today.

To simplify your lives, we will post the script from today on our website straight after the presentation.

SLIDE 3

I'm so proud and excited to be presenting to you today as we start the next stage of our journey.

This is a great business with real potential and I'm pleased with the progress we have made this year.

SLIDE 4

Let me summarise the first half on slide 4

- With the backdrop of a highly competitive motor market, we have delivered a good financial result.
- We are on track to meet our financial targets helped by our diverse business model and our cost and underwriting discipline and
- Operationally, we've hit some key milestones on our path to transforming our competitiveness and strengthening our ability to grow sustainably.

Now Neil will go through the financial details later, and give some context on the market environment, but just summarising our performance:

We continued to grow our Direct Own Brand policies, while maintaining our underwriting discipline, which delivered a combined ratio of 92.5%.

As you know, reducing costs is a major lever for us to be more competitive, so I am pleased to say that we remain on track to achieve operating expenses of less than £700m this year.

This discipline meant we could deliver a good operating profit of £274m resulting in an annualised Return on Tangible Equity of 21%.

And we have grown our interim dividend 2.9% to 7.2 pence leaving us with a strong solvency position at the top of our risk appetite range.

We've also made great strides in our operational and strategic journey.

On the operational side, we've launched 3 new IT platforms in the first half, key milestones on our multi-year journey and I'll talk more on those shortly.

And strategically I've used the first few months as CEO to challenge ourselves to look beyond the next couple of years and ask "are we focusing on the right areas so we can thrive in the future?".

So what have I concluded?

Well, I believe we are investing in the right activities and our business model is the right one, and in fact an advantaged one, to capture the opportunities that lie ahead.

Our IT transformation aims to enable

- efficiency
- pace of deployment, and
- flexibility

that will be required to capture those opportunities.

So we must operate and organise ourselves in a way that takes full advantage of that.

And this is a priority for me.

SLIDE 5

On slide 5 I would like to take a moment to paint the high-level strategic picture.

Our aim is to give peace of mind to as many customers as we can through our multi-brand, multi-channel and multi-product approach.

We achieve this today through distinctive strengths that mean we can reach more consumers and offer them more choice.

- We have trusted brands built over many years and innovative propositions that give us valuable relationships with our customers.
- Our data and insight give us the opportunity to create value for our customers and shareholders.
- Our vertically integrated claims model
    - gives us advantages on claims cost,
    - enables industry leading propositions, and
    - gives us good insight on claims and car technology trends. And
- We have talented and passionate people. You can see this with the three Executive appointments I made last month - home grown talent who, between them, have nearly 35 years at the Group. And this talent runs right through the business - for those that have visited our sites, or used our customer services, you will know first-hand the quality of our people.

Looking to the future, I expect consumers to demand easier journeys and personalised products.

And with this in mind, I believe our comprehensive channel strategy equips us well.

Having a direct channel gives us a relationship with our customers which allows us to know them in a unique way and means we can best understand and meet their individual needs.

As a result, direct is a real driver of value for both our customers and our shareholders and is a channel that will continue to be very important to us.

The intermediated channels, such as price comparison sites or partnerships are significant and evolving.

On price comparison sites, we're good but we want to be great.

And we expect the nature of partnerships to evolve. Combining our partnership skills with the strength of our brands means we can create real competitive advantage.

There are two critical enablers that, when combined with our strengths, aim to underpin sustainable improvements in our competitiveness and will help us respond to customers' evolving needs:

- The first is technology transformation. I've said to many of you before, our legacy systems have made it difficult to compete profitably in commoditised channels, such as price comparison sites. Here cost, speed, data and flexibility really matter. So I'm excited by the technology capabilities we're developing to improve our competitiveness.
- The second is business transformation: to realise the full benefits of our new technology and grow the business, we need to work in a different, more agile way to deliver a faster deployment of change.

Over the coming slides I am going to focus on the IT platforms we've launched this half, the benefits we expect and give a glimpse as to how the transformation of our IT is fuelling the transformation of our business.

SLIDE 6

So on slide 6 we're trying to show the overall IT platform picture.

You can see I'm not exaggerating when I say we are transforming virtually every IT platform in this business.

2019 has seen us achieve some significant milestones, but we have been steadily building and delivering for some time now.

As you can see on the slide, each programme is at a different stage in its delivery with benefits also likely to emerge over different timescales.

Our investments aim to materially improve our competitiveness for the market as it is today and set us up for the future.

Of these, the most significant programme is on our Motor and Home portfolios.

We expect the benefits from this to start to emerge from next year.

In a similar way, our commercial broker business, NIG, is already starting to benefit from a string of platform led improvements helping it strengthen its pricing and underwriting capabilities.

Some of our other investments have the long term more in mind, to enable us to access and serve our customers in new ways with new products.

- Direct Line for Business is now well established and has the potential to grow profits meaningfully over the medium term
- Travel, which is focused on partnerships today, offers promising opportunities in the future, particularly in providing another touch point with our customers.
- And Darwin, our new approach for PCW customers, is already giving us insights and could offer another growth opportunity.

Within the next couple of years we expect to

- have implemented nearly all our major insurance platforms,
- reshaped the way we work as an organisation and
- be well on the way with our IT infrastructure.

All of this is designed to deliver benefits through

- reduced costs,
- faster and more accurate pricing,
- greater product flexibility, and
- greater pace of change

So let's take a closer look at some of these platforms.

SLIDE 7

On slide 7 we show the high-level delivery programme for our major Motor and Home platform.

Through this programme we are upgrading nearly all the applications used in the customer journey including

- the policy administration,
- the billing,
- the pricing deployment,
- we're updating the claims system, and
- we're shifting most of the data onto the cloud to provide more flexible and resilient data storage.

So we are doing a lot!

As a result of this the customer will benefit from things such as:

- online documentation and seamless quote journeys
- more product choice and flexibility
- more accurate prices and more targeted marketing through faster pricing capabilities and new and more granular data.

We are progressing well on this, having launched Privilege Motor this half on both direct and on our first price comparison site with the others to follow shortly.

A phased rollout is designed to enable us to do it in a fast, safe and controlled way whilst minimising disruption to the rest of the business.

Once we have delivered the key functionality across motor and home, we will then have the flexibility to expand the product range.

We will have the ability to start to break the products down into smaller components and to build more personalised products, delivering them more quickly and cheaply.

Overall, the new platform is giving us all a real sense of excitement and optimism about the future.

SLIDE 8

Now onto Darwin on slide 8

From the outset our ambition here was to combine the benefits of our scale and data with a new approach to pricing, designed specifically for PCWs and to increase the pace of our learning.

We wanted to use the latest digital and data techniques to create a pricing model that doesn't overlap with the Group's existing model.

And we wanted to do it with a cost base that would give it a competitive advantage.

So we pulled together a team of data scientists and data engineers, gave them the Group's data, and provided them with the support and scale of our claims team.

We are managing the roll out very carefully by placing limits on numbers, so we can test and learn, and I'm pleased with progress.

The roll out will take some time and as it progresses we'll see the degree of overlap with the main book. This will give us a better sense of its growth potential.

But the Group is already benefitting as it learns from the Darwin team's working methods.

And the main motor book is benefitting from Darwin's detailed information, in areas such as application fraud and risk modelling for customers with claims and convictions.

SLIDE 9

Now on slide 9 I'd like to tell you about Travel and our new partnership with Starling Bank.

Starting on the left-hand side with Travel.

We have totally transformed our Travel platform, building a system that

- is fully optimised for tablet and mobile,
- provides online medical screening and self-service upgrades
- and is fully automated for certain claims

Delivering this helped secure the renewal of both our RBS and Nationwide contracts.

But it also provides interesting options in the future, as it provides another touchpoint with customers and lends itself well to emerging distribution platforms.

Moving to the right-hand side of the slide and our partnership with Starling bank.

We've mentioned our API capabilities in the past when we discussed our Home proposition with RBS.

I'm delighted that our strengths here have enabled us to combine our strong Churchill brand with our partnership strengths to be the first major insurer on Starling's marketplace.

It's small volume today but we are already learning what we can do in this environment, where there is potential to access valuable data to improve the customer experience.

So, as you saw earlier, we are transforming our largest business lines with the aim of grow our profitability over the near and medium term.

But also, you can see that we are investing in the long-term, so that we can meet the emerging needs of consumers.

SLIDE 10

On slide 10 we show the evidence that we can successfully grow businesses.

12 years ago we launched Direct Line for Business and today we have half a million customers and over £100m of premium at good and steady margins.

As you know over the past few years we have invested in building the next generation system to give small business owners the confidence to buy their insurance direct.

Those of you who came to our Bristol office last year heard a little about how we work in DL4B, which is a really agile working approach, giving the team pace and real customer focus.

They continue to seek to optimise the current product suite and customer journeys and I'm always excited by their innovation and energy.

They've made good progress to date and have further product launches planned in the second half.

And Rescue is also undertaking a lot of activity under the surface

- re-engineering the way its people work,
- building a centre of excellence with multi-skilled teams,
- successfully relaunching the 'Rescue me' app,
- renegotiating supplier contract and so on – the list is long

We continue to see great potential in Rescue and, in the second year of its five-year plan, we are confident of its progress.

SLIDE 11

Look I hope I've conveyed that there is a real buzz and sense of ambition within this organisation.

We've made excellent progress but as you can see there is a lot of change going on which I just can't do justice to it here today.

So, we'd like to share more with you at our Capital Markets Day on 21 November.

We will be holding this at our largest contact centre which is in Doncaster to bring to life for you some of the things that are so special about DLG.

As an ExCo we love to go to our contact centres to feel the extraordinary energy of our people there and to see in action their commitment to our customers.

We'll also provide you with some insights into the capabilities our new technology brings and how we are using them to transform the business and bring competitive advantages.

I'm really proud that we've been able to deliver so much change whilst also delivering good financial results.

And with that over to Neil to go through the financials.

NEIL MANSER, INTERIM CFO

SLIDE 12

Thanks Penny and good morning everyone.

Now I was talking with Andy the other day, and I realised that over the last 15 years I've listened to nearly 300 results presentations… many of you in the room here have done more…

I know that the presenters always looked forward to my constructive feedback and I very much look forward to yours!

Now let's start on slide 13 in the pack.

SLIDE 13

For me the summary today is – good results, on track to meet both our 2019 targets and our medium-term combined ratio target.

Before I go through the results in detail, I'd like to talk to two key themes these results highlight about our model – our discipline and our diversification.

Discipline shows through in both the trading result and our cost story.

In Motor and Home we priced for claims inflation in what were highly competitive markets and our operating expenses are at the lowest level since the first half of 2015.

The value of our diversification is also showing through with over £100 million of profit from outside of the motor business as well as continued strong premium growth in Green Flag and Direct Line for Business.

These factors have enabled us to report another good operating profit which in turn has helped us grow the dividend again;

all supported by a very strong capital base.

All in all a good first half financial performance.

Now to the detail starting on slide 14.

SLIDE 14

Operating profit was £274 million in the first half, lower than last year due to a few significant items most of which we highlight in the table at the bottom right of the page.

On the positive side, weather has been very benign compared to last year when we suffered the Beast from the East.

But there are a few items going the other way.

Most important is that you'll recall we had exceptional motor performance in the first half of 2018 which benefitted from price increases as a result of moving to an Ogden discount rate of minus 0.75% whilst still benefiting from pre-Ogden reinsurance costs.

Last year we also had a gain on the sale of our old Bristol office and high investment gains.

This year we have had lower gains, a more normal motor market and the confirmation of the new Ogden discount rate which has cost us £17 million.

Now, whilst profit is down in the first half of 2019 a combined ratio of 92.5% is a good result. If we normalise out the good weather we get to 94.6% of which about a point is Ogden related. So net net well within our range of 93 to 95%.

As Penny mentioned, return on tangible equity is close to 21% despite a more conservative solvency position than usual and well ahead of our long-term 15% target.

Moving onto in-force policies on slide 15

SLIDE 15

Overall we saw flat in-force policies in the first half and premiums down 2.2% as our diversified business model helped offset some of the pressure we saw in Motor.

Starting with our direct own brands in-force policies

- Motor, which represents just over half of our direct own brand portfolio, was down 1% since the start of the year with most of this reduction coming through in the second quarter.
    - This reflects our discipline and I'll talk more about pricing later on.
- Home policies were broadly flat, in a highly competitive new business market.
- In terms of channel performance for Motor and Home, we had some good growth in PCW particularly through Churchill but with market shopping levels generally down, we saw fewer opportunities in Direct.
- Green Flag continued to grow with policy count up 5.9% year to date, again achieving double digit growth year on year.
    - The team has great momentum and is looking to pass 1million customers by the end of the year.
- Moving to Commercial, Direct Line for Business grew to over half a million policies with volumes on the new SME platform doubling in the period.

[PAUSE]

The table on the right shows what's happened outside of direct own brands…

- Policy count fell in Motor and Home partners which is due to the partner exits we've talked about before.
- Rescue partners and other personal lines were primarily lower due to package bank account volumes, a trend we've seen over a number of years.
- And, in NIG and other, the team are focused on improving margins particularly in motor lines and this has led to lower volumes.

Now before I move on I'd like to focus for a minute on the long-term trends of our direct own brands because it's evidence of our ability to grow in the most valuable parts of our portfolio.

We've grown in Motor when the time was right and our diversification has balanced that when we've needed to hold our discipline.

You can see that since 2015 we've grown our Motor own brand policies by 13% and delivered 16% growth across the rest of our own brand portfolio.

This gives me confidence in our ability to grow over time.

Now to the segmental results starting with Motor on slide 16

SLIDE 16

Motor delivered a good result and continued to trade to target loss ratios in a highly competitive market.

Overall operating profit of £154m was £86m lower than prior year primarily due to the reversal of last year's exceptional underwriting performance.

- You can see this in the current year loss ratio which increased by 4.9 percentage points to 83.4% and returned to a more normal level.

Prior year releases have reduced, consistent with our purchase of more reinsurance in recent years.

- This reduction also reflects the increase in reserves from the move to minus 0.25% Ogden discount rate. You'll recall we were reserving at 0.0% at the year end.

Turning to top line, headline GWP is down 4.7% but with only a modest reduction in IFPs.

- Underlying this is a reduction in risk mix due to several pricing updates at the end of last year and improvements in addressing application fraud.

- On top of that our free legal expenses proposition on Churchill is performing well in the PCW channel.

Collectively, these actions reduced average premium but have enabled us to find pockets of value where we were able to maintain our margins.

In terms of claims trends, underlying inflation is still at the top end of our 3-5% long term range.

Within that third-party property damage remains high, but has stabilised after a poor first quarter.

Inflation here was in part due to pressure in the motor repair industry from high accident frequency in 2018. But the start of 2019 has seen this pressure ease.

And to remind you, we believe our auto repair centres continue to give us a competitive advantage on damage claims.

SLIDE 17

On slide 17 we show the latest ABI motor premium data.

We said at our full year results in March that while pricing had stabilised in the second half of 2018 we were disappointed that the market - as a whole - was not pricing for claims inflation.

Since then we've seen one or two positive data points, but to date, this has not turned into sustained market pricing improvement.

As we stand here today there are two market trends that insurers will need to make judgements on.

First, the upcoming whiplash reforms and,

Second, the new Ogden rate which was worse than the 0 to 1% range most in the market were expecting.

While we can't predict how the market will go from here, our approach is unchanged:

We remain focused on maintaining our pricing discipline and will continue to prioritise target loss ratios over volume.

While we can't be immune from market pricing pressures, we remain committed to investing in the business with the aim of delivering benefits on cost and underwriting that mean we can, to some extent, carve our own path.

SLIDE 18

Let's look at Home on page 18.

The first thing I'm sure you'll notice is the big jump in profit year on year.

Whilst benign weather is the main cause, the team has also done a great job, improving the normalised combined ratio by around 2 points compared with last year.

This has been achieved by a determined focus on pricing, underwriting and claims actions particularly around escape of water.

Whilst we still expect long term claims inflation around the 3 to 5% range, our latest experience has been better than this.

Moving to the market, we believe most are broadly rating for claims inflation but there remain a small number of players that we see come in and out of the market with more aggressive pricing tactics.

Against this backdrop we've traded in a disciplined way around PCWs – with targeted growth where we see value and pulling back where we don't.

Overall, we've achieved rate increases of 1.5% and a continued reduction in the risk mix.

It's worth noting the commission ratio which continued to fall and is starting to find its appropriate level following the exit of two partnerships in 2017.

In summary £71 million of operating profit, supported by a strong underlying performance.

SLIDE 19

Now, to slide 19. As you can see Commercial and - Rescue and other personal lines - between them contributed £49 million – around 20% of Group profits.

Beginning with Commercial – the segment continued to see growth in top line with Direct Line 4 Business up 8%, partially offset by a flatter picture at NIG as it continued to focus on margin improvement.

Rate carry in the first six months for renewed business was around 6%, with the strongest improvements in motor lines.

Importantly, the current year attritional loss ratio improved by a point due to the margin focus and pricing initiatives at NIG……

And a greater weighting towards Direct Line 4 Business where loss ratios are lower.

Overall it delivered a £32 million operating profit.

Rescue and other personal lines profit increased by a little over £2m to £18m.

This result was largely driven by Rescue which saw a 10% improvement in operating profit to £21 million. There were two key drivers of this growth:

First the earn through of higher Green Flag direct premiums from the previous year which improved the mix away from partners and

Second, better claims frequency following last year's adverse weather.

As I said earlier Green Flag is beginning to show some real momentum and is well positioned to win in the Rescue market.

SLIDE 20

Turning our attention to costs on slide 20.

As you're aware and as Penny mentioned, we are not satisfied with our current cost profile.

Over time we are looking to sustainably reduce this and have over 90 initiatives in train at the moment.

These cut across the whole expense base and include the investments we are making in the transformation programme, many of which Penny has already talked through.

Core areas of focus are

- self-service and digitalisation,
- process improvement and automation
- as well as more traditional forms of cost cutting in terms of procurement activity and managing cost leakage.

You can see the results of some of these actions coming through in the first half with operating expenses down £16 million to the lowest level since the first half of 2015.

Of particular note is the reduction in marketing where we have again improved effectiveness.

The expense ratio was fairly stable as lower costs were offset by lower earned premiums.

Given the phasing of levies including Flood Re in the first half, we are confident of delivering operating expenses below £700 million in 2019.

The next slide, slide 21, pulls the underwriting ratios together in one place.

SLIDE 21

I've already talked to the combined ratio which at a headline level was 92.5% and normalised for weather was in the target 93%-95% range.

So I'll quickly move to the main purpose of this chart. This is to show that we've delivered consistently strong combined ratios over time.

This again, demonstrates the DLG model and the benefit of a disciplined approach to underwriting and a diversified portfolio.

SLIDE 22

Moving to the investment result on slide 22.

Lower assets under management and lower gains led to a £20 million reduction in the headline result.

The net investment income yield was up a little at 2.1% due to lower hedging costs and was slightly ahead of the 2.0% expectation. We are still confident of achieving this for the year end, but, with reinvestment yields down year to date, it's difficult to improve from here in the current environment.

As expected, gains were much lower in the first half compared to the first half last year.

We recognised net gains of £12 million as we consolidated mandates with a view to reducing investment fees.

As you can see on the table on the right, last year gains were supported by fair value adjustments to our property portfolio, which did not repeat this year.

This was expected given conditions in parts of the UK's commercial property market. To remind you, our portfolio is prime with a relatively low exposure to retail.

On a more positive note, the available for sale reserve has improved from an unrealised loss of £37 million at the end of 2018 to a gain of £27 million at the end of the half as credit spreads narrowed and interest rates fell.

Our guidance for significantly lower gains in 2019 is unchanged and I'm not expecting any further gains for the rest of the year.

SLIDE 23

Now to the Group's capital generation on slide 23.

In the first half, we saw a small reduction in the SCR, which reflects our reduced risk exposure. As we've said before we expect this to continue given the greater use of reinsurance than in the past.

Our capital has also been supplemented with positive mark to market from narrowing credit spreads since year end.

Moving across, capital generation is broadly consistent with IFRS profit so no surprises there.

And penultimately, capital expenditure which supports the group's transformation was £90 million, around half of the full year guidance of around £175 million.

Finally, we grew the interim regular dividend by 2.9% to 7.2 pence per share.

And, we end the half with strong surplus capital of £1billion, up around £120 million from the full year.

SLIDE 24

And onto our solvency ratio at the half year on slide 24.

After proposed dividends, it's a very strong 180%, and is at the top end of our risk appetite range.

You'll recall, at the year-end we held back some capital to form a buffer against heightened political and economic uncertainty. This buffer has increased in the first half helped by the tightening of credit spreads.

We said at full year that we'd keep the position under review and since then the environmental factors haven't improved.

Therefore we are not returning any additional capital today and this leaves us at the prudent end of our risk appetite range.

Under normal conditions - as you know - we still expect to operate at a ratio around the middle of the risk appetite range.

In the future we will also consider the most appropriate mechanism for returning any surplus capital and may utilise share buybacks if conditions are appropriate.

SLIDE 25

Before I hand back to Penny, I'd like to close with the outlook and targets on slide 25.

- We're confident that we can again deliver a combined ratio within our 93% to 95% target, normalised for weather
- We've made good progress on costs and are on track to reduce operating expenses to below £700 million this year
- Investments are also on track to generate a 2.0% net investment yield with no expectation of further gains in the second half.
- And as you've heard from Penny, we're making great progress with our transformation agenda which is underpinned by £175 million of capital expenditure in 2019.

Thank you, and back to Penny to wrap up.

PENNY JAMES, CEO

SLIDE 27

Thank you Neil.

So what are the key messages I'd like you to take away from today?

Well first, whatever the market conditions, we will remain disciplined and long-term focused. This is a key ingredient in our objective of sustained attractive returns and our results today, in highly competitive markets, are testament to that.

Second, we are also a business with different sources of earnings, through:

- different products,
- different distribution channels and
- via our different brands and propositions.

This positions us well for steady earnings and dividends for our shareholders and to meet our customers' evolving needs.

Third, we are on track with our operational change agenda and are well down the IT transformation path, albeit with plenty still to do. Across the Group we are moving towards new, faster and more flexible ways of working to realise the benefits from the new technology and then to unlock the potential of our people and leverage the Group's existing strengths.

And fourth, this management team is excited by our plans to deliver a material change in the capability and efficiency of the Group and we look forward to telling you more about this at our capital markets day on November 21.

With that I'll hand over to questions.