



Creating a leading UK Commercial Lines insurer

Acquisition of Direct Line Insurance Group plc's brokered Commercial Lines operations

Transcript

Intact Financial Corporation and its subsidiary RSA announced that they have reached an agreement with Direct Line Insurance Group plc to acquire Direct Line's brokered Commercial Lines operations.

September 6, 2023



Shubha Khan – Vice President, Investor Relations

Thank you for joining this webcast.

Earlier today, we announced that Intact and its subsidiary RSA are acquiring the brokered Commercial Lines business of Direct Line Insurance Group, subject to approval by Direct Line shareholders. In addition, we announced that Intact is considering a range of strategic options for its UK Personal Lines platform.

On this call, I am joined by Charles Brindamour, Intact's CEO, and Louis Marcotte, our CFO, who will discuss the strategic and financial merits of the transaction – as well as the strategic review of UK Personal Lines – in more detail.

The press release, presentation slides and transcript of this call have been posted on our website at intactfc.com, in the Events and Presentations section, under the Investors tab.

Before we start, please refer to Slide 2 for cautionary language regarding the use of forward-looking statements, which form part of today's remarks. And refer to Slide 3 for a note on the use of non-IFRS financial measures, as well as important notes on adjustments, terms, and definitions used in this presentation.

Please also note that, as a result of the concurrent common share offering announced earlier today, there will be no live Q&A.

With that, I'll turn it over to Charles.

Charles Brindamour – Chief Executive Officer

Thanks, Shubha. And hello, everyone.

With the acquisition of Direct Line's brokered Commercial Lines business, we have taken another significant step to accelerate our strategy and better position our UK&I business for outperformance. The transaction is a rare opportunity to acquire a market-leading platform that significantly strengthens our position in the UK.

We expect to become a top three player in the UK Commercial Lines market, increasing our presence and our focus on lines where we already outperform.

Direct Line's Commercial Lines business is highly complementary to ours. And it deepens our presence in the attractive SME and mid-market segments of the UK market. This is well aligned with our strengths and I am quite comfortable deploying capital for such an opportunity.

The transaction is not only strategically aligned, it is also financially compelling for our shareholders. The expected internal rate of return is in excess of 15%, and the transaction is expected to be accretive to both Net Operating Income Per Share and Book Value Per Share. And as Louis will speak about in a moment, we are maintaining a strong balance sheet following the acquisition, allowing us to withstand market turbulence, but also giving us the flexibility to pursue new opportunities.

In addition to acquiring Direct Line's Commercial Lines operations, we also announced that we are actively reviewing our strategic options for our UK Personal Lines business, including a possible sale. This would further accelerate our path to outperformance in the UK market. I expect to complete this review in Q4 this year.

Overall, we have been very clear on our ambition to outperform in all markets, including the UK. Today's announcements on both the Commercial Lines transaction and the strategic review of our Personal Lines business are proof that we are executing to meet that ambition.

A few words on the Commercial Lines acquisition. Specifically:

The transaction positions our business as a top tier player in the UK Commercial Lines market, growing our market share to approximately 7%.

With an enhanced market position in UK&I Commercial Lines, we see a compelling opportunity to build on the successes of our existing commercial lines operations across markets where we have a strong track record of outperformance. And this is underpinned by:

- Our focus on the attractive SME and mid-market segments within the commercial market, as well as specialty business;
- Our market-leading price segmentation and risk selection capabilities, enhanced by our strength in data analytics, as well as AI; and
- Our underwriting and claims capabilities

These attributes have allowed us, both in Canada and the US, to deliver Commercial Lines combined ratios in the low 90s, over the last five years.

Before I turn it over to Louis, let me provide some more colour on the business that we are acquiring.

We have been following Direct Line's performance for a while now, and have been very impressed by the quality of its commercial franchise. Direct Line's brokered Commercial Lines business is very well-established, having operated successfully in the market for over 125 years, leveraging the well-known NIG and FarmWeb brands.

We look forward to welcoming a team of approximately 800 talented and skilled employees to Intact. Throughout the due diligence process, it has been clear to us that the two organizations share a similar set of values, including a focus on underwriting excellence.

Importantly, the business is highly complementary to our own. With over 850 broker relationships and a leading online platform for SME clients, the transaction will significantly strengthen our distribution capabilities in the UK.

The largely SME-focused portfolio also complements our mid-market-focused Commercial Lines business in the UK. The economics of both market segments are very attractive.

Overall, we like what Direct Line has built over the years, and we will continue to write similar business going forward.

I'll now pass it over to our CFO, Louis Marcotte, to discuss the financial aspects of the transaction in more detail.

Louis Marcotte – Chief Financial Officer

Thanks, Charles.

The Commercial Lines transaction we are announcing today, combined with the strategic review of our UK Personal Lines business, marks another important milestone in the evolution of our UK&I business, better positioning us for sustainable outperformance. Although it looks small from an IFC point of view, the acquisition will have a material impact on UK&I financials.

The brokered Commercial Lines business we are acquiring from Direct Line generated around £530 million of Premiums Written in 2022. As a result, our UK&I Commercial Lines premium base will grow by nearly 30%, a step-change in the scale of our UK&I platform.

Profitability is also positively impacted. We are targeting a combined ratio of approximately 90% by Year 3, once we have fully integrated the business and applied our proven capabilities. This will be driven by improvements in the loss ratio and improvement in the expense ratio. We expect the acquisition will generate some £100 million of new Net Operating Income within 5 years.

The purchase price for the acquired business comprises an initial cash consideration of £520 million, as well as an additional deferred payment of up to £30 million.

The purchase price, as well as integration and transactions costs, will be funded through a public equity issuance of C\$500 million and the remainder in debt.

The transaction is structured as a transfer of renewal rights, brands, employees, and systems to RSA from Direct Line, and includes a quota share agreement for the premiums written by Direct Line, but not yet earned.

Additional capital required to support the growth in our UK&I Commercial Lines portfolio will be funded through excess capital held at our UK subsidiary, as well as future capital generation.

The transaction is financially compelling for Intact's shareholders. We expect the IRR to be in excess of our 15% threshold.

The transaction is accretive to Net Operating Income Per Share in 2024, and we expect to reach low single digit accretion by Year 3.

We expect to incur approximately £45 million of integration costs in the first 36 months, which is broadly consistent with past transactions.

Book Value Per Share is expected to increase by 2% immediately, primarily as a result of the announced equity issuance. And the impact is neutral on Operating ROE.

Given the conservative funding mix for the transaction, our balance sheet will remain strong. All our regulatory capital ratios are expected to remain at or above target operating levels. Our adjusted debt-to-total capital ratio is expected to be between 24% and 25% at closing, returning to pre-transaction levels expected by Q4-2023¹, and to our 20% long-term target roughly a year later. We will therefore continue to have sufficient flexibility to capitalize on any attractive M&A opportunities that may emerge.

Before handing it back to Charles for his closing remarks, I want to note a few important transaction details.

We will enter into a quota share reinsurance arrangement immediately following receipt of Direct Line shareholder approval. Under this reinsurance arrangement, substantially all of the economics of Direct Line's brokered Commercial Lines business will be transferred to RSA. That said, we will not have any exposure to prior-year reserve development as we will not be acquiring Direct Line's back book.

¹ Please note that our adjusted debt-to-total capital ratio is expected to be between 24% and 25% at closing, returning to pre-transaction levels expected by Q4 2024, and to our 20% long-term target roughly a year later

Direct Line will continue to manage and service all policies until they are underwritten by RSA at renewal. Renewals are expected to start transferring to RSA in Q2 2024. We will work closely with Direct Line to ensure a smooth transition process.

Employees are also expected to transfer to RSA in Q2 2024 to provide ongoing support and service delivery, which will allow us to maintain our excellent relationships with brokers and provide outstanding service to our customers.

Overall, we have taken a great deal of care in ensuring that this transaction is structured in a way that strengthens our UK&I business from the outset, ensures customers continue to receive the high standard of service to which they are accustomed, optimizes financial returns to Intact, and leaves us with balance sheet flexibility for future opportunities.

With that, I'll give it back to Charles for closing remarks.

Charles Brindamour - Chief Executive Officer

Thanks, Louis.

Clearly, this acquisition accelerates our strategic roadmap. It strengthens our leadership position in the UK & Ireland by refocusing our operations towards Commercial Lines, where we have a proven ability to outperform.

I am pleased that we were able to reach an agreement with the Direct Line team that creates compelling value for all of our stakeholders.

For shareholders, it will drive Net Operating Income Per Share and Book Value Per Share accretion, an attractive IRR, and a UK&I business better positioned to grow while it outperforms.

For customers, it will strengthen our offering and distribution capabilities, allowing us to continue to deliver a second-to-none experience.

And for employees, it will create a stronger platform within which they can excel.

To our people, thank you for all your hard work. And to the team that will be joining us, I want to extend a warm welcome on behalf of the entire Intact team. Together, I am confident we will continue to build the leading P&C insurer in the UK market, adding to our strong positions in Canada and Global Specialty Lines.

Thank you and with that I'll turn the call over to Shubha.

Shubha Khan - Vice President, Investor Relations

Thank you, everyone, for joining today. Should you have any questions, please contact the Intact Investor Relations team. This concludes our webcast for today.