Intact Financial Corp. Conference Call: Q1-2017 Earnings and OneBeacon Acquisition

Q1-2017 Earnings Prepared Remarks

Samantha Cheung – *VP, IR*:

Thank you and good afternoon everyone.

Background information for the call is posted on our website at www.intactfc.com under the Investor Relations tab.

Before we start today's call, I'd like to advise that this call and presentation do not constitute or form an offer to sell, or a solicitation of an offer to buy or subscribe to securities, nor shall it or any part of it form the basis of or be relied on in connection with or is any inducement to enter into any contract or commitment whatsoever.

For purposes of inclusion and completeness, I'd also refer you to the detailed disclaimer legends contained in the front of our investor presentation with respect to additional matters, including the disclaimer with respect to Non-IFRS Measures which is also reproduced in our press release. In addition to the foregoing matters, I'd also like to reference the forward looking statement contained in our press release of today's date and the forward looking legend and disclaimer contained in our presentation materials, which will apply to any forward-looking information we may discuss today as part of this call.

Finally, I'd like to point out that we are currently in a period of distribution under applicable Canadian securities laws. And accordingly, we may be limited in what we can say on this call.

With respect to this particular call, we will be reviewing our first quarter earnings first followed by a review of our proposed acquisition of OneBeacon Insurance Group. Given the concurrent securities offering, we will not hold a question and answer period on this call.

Joining this call from Intact are Charles Brindamour (CEO), Don Fox (Executive Vice President), Louis Marcotte (CFO), Darren Godfrey (SVP Personal Lines), Alain Lessard (SVP Commercial Lines) and Patrick Barbeau (SVP Claims) .

With that, I'll turn it over to Charles to review our first quarter 2017 earnings.

Charles Brindamour – *CEO*:

Good afternoon everyone and thank you for taking the time to join our call on short notice.

Earlier today, we released our first quarter 2017 earnings and simultaneously announced the acquisition of OneBeacon, a pure play specialty insurer operating in the US. We will discuss the acquisition in a few minutes but before we do so, I would like to review our Q1 earnings.

We announced first quarter net operating income of $0.90 per share driven by solid underlying underwriting results and strong distribution income offset by elevated CAT losses and weather driven frequency in personal auto. Our financial position at the end of the quarter was very strong with over $1 billion of excess capital and our book value was up 8% from last year to $43.14.

I was pleased to see our top line grow 4% in the quarter on the back of growth initiatives despite our pricing and risk selection actions across the country. Top line growth was muted in commercial lines due to the ongoing difficult economic conditions in the West and competitive pressures but we are seeing positive momentum in specialty lines as our initiatives are paying off.

The combined ratio was 98.2% in the quarter, after absorbing 4.5 points of CAT losses, well above historical levels for a first quarter. When looking at our underlying results, I see sound performances in all lines of business, particularly in personal and commercial property. Our personal auto results were impacted by higher weather related losses and lower prior year development. Overall, I see improvements in our underlying performances in all lines, a clear sign that our corrective measures are effective.

Our operating return on equity was 10.6% at the end of the quarter but keep in mind that 3 out of the last 4 quarters included unusually high levels of CAT losses. We outperformed the industry by a margin of 580 bps in 2016, above our target of 500 basis points.

So let’s now look at our first quarter results in more detail.

Personal auto grew 3% on a combination of early rate actions taken across the country and customer driven growth initiatives. The combined ratio deteriorated 6.2 points to 102.6% on higher weather losses and lower prior year development. When excluding the weather impact, our underlying performance improved by approximately [2] points, which is consistent with the actions we’ve taken so far. And there are more improvements in the pipeline. Our written premiums reflect rate increases of nearly 5% while our earned rates have only risen by 2% on average. This gap will continue rising for another quarter and be earned over 12 to 18 months. Beyond that, we expect benefits from the 2016 Ontario reforms and our claims action plans. We therefore remain confident in our ability to deliver mid-single digit improvements in personal auto’s combined ratio.

We continue to anticipate a rational competitive environment in personal auto, with low to mid-single-digit growth in the coming 12 months as cost inflation will be compensated by rate increases.

In personal property, premiums grew a healthy 8%, as new products and continued rate increases were deployed in favourable market conditions. This line of business continues to perform well, with a combined ratio of 92.8% this quarter, after absorbing 12 points of CAT losses primarily from severe wind storms. With healthy top and bottom lines, personal property continues to be well positioned going forward.

In terms of the industry outlook for personal property, we see no change there. We expect firm market conditions to continue as the industry adjusts to changing weather patterns, with mid to upper single digit growth over the next 12 months.

Our commercial P&C business is also performing well with a combined ratio of 95.8% after absorbing 7 points of CAT losses.

Commercial auto premiums grew 9% in the quarter on the back of multiple initiatives in specialty lines including products for the sharing economy. The combined ratio improved by 1.3 points to 96.2% as higher weather related claims frequency was offset by higher favorable prior year development. We remain on the right path to reach our low 90’s target in this segment.

We expect low single digit growth in the coming year for commercial lines as markets continue to be competitive across Canada and economic conditions remain difficult in Western Canada.

In summary, the 98.2% combined ratio for the quarter is disappointing but it does include 4.5 points of CAT losses, well above our expectations. All our lines of business are performing well or improving on an underlying basis and I am confident the actions we are taking in personal auto will have a positive impact over the next few quarters.

With that, let me turn the call over to our CFO, Louis Marcotte, to provide his view on the quarter.

Louis Marcotte - *CFO*:

Thanks Charles.

For the first quarter, net operating income was $123 million, lower than last year as elevated catastrophe losses and higher non-CAT weather claims frequency obscured a solid underlying performance, especially in the property lines of business. We saw strong growth in our distribution income and stable investment income. Book value per share increased 8% from a year ago to $43.14 thanks to our resilient operations and a significant appreciation in the value of our equity portfolio.

We experienced elevated catastrophe losses of $88M net of reinsurance, due to wind storms in Central and Atlantic Canada, and two commercial fires. This is 4x higher than historical averages for Q1 and thus triggered our pre-announcement on April 5th.

In addition, there was challenging winter weather in the metropolitan areas of Western Canada, where heavy snow fall days led to spikes in auto collision frequency and water damage to properties.

Our expense ratio improved by 1.5 points on lower commissions and general expenses. The recent softer underwriting performance translated into lower profit sharing commissions and lower variable compensation, while our cost savings initiatives also reduced general expenses.

Our distribution activities delivered $24 million to our pre-tax operating earnings in the quarter, $10 million higher than last year primarily due to growth in our broker network and improved margins. We continue to expect distribution income to growth north of 15% in 2017, albeit with seasonal variations.

Our investment portfolio delivered consistent investment income at $105 million, slightly above last year.

Our Q1 non-operating results improved by $89 million in the quarter, driven by realized gains on our equity portfolios. Our unrealized gain position increased $44M in the quarter to $313M, with all portfolios in a gain position.

In summary, we reported quarterly EPS of $1.08, 3% lower than last year as our operating results declined on the back of CAT and non-CAT weather, while our non-operating results improved materially on higher investment gains.

Our balance sheet remains very strong with total excess capital exceeding $1 billion and our MCT standing at 223% at quarter end, a good position to be in as we announce an acquisition.

Charles Brindamour – *CEO*:

Thanks Louis.

Before moving on to the acquisition of OneBeacon, perhaps I can ask Darren to provide additional color on the progress we’ve made in personal auto so far this year and his expectations for the remainder of the year.

Darren Godfrey – *SVP of Personal Lines*:

Thanks Charles. I was disappointed with our results in Personal Auto with a 102.6% combined ratio, particularly when we have a 6.5% deterioration in PYD and a 0.9% increase in current accident year compared to Q1 2016.

With respect to PYD, a meaningful proportion of this deterioration was driven by short tailed physical damage claims. We do not expect any further impact from this in the remainder of the year.

Looking at the current accident year results, we see 3 points of CR explained by a tough winter, namely in Alberta, impacting frequency in the quarter. This suggests that our underlying performance improved in the quarter, once you look through the noise from weather.

We can see that our action plans are starting to show traction.

Our rate momentum continues to build, as Charles said, with a gap in written to earned rate increases in Q1 of 3.0%. The gap will continue to grow for another quarter. All rates are now implemented or about to be implemented across the country, giving us confidence that we will generate 3 points of loss ratio improvement due to rate activity and segmentation strategy alone.

Our additional actions, namely improvements in our risk selection models, claims action plans, as well as ongoing Ontario reform impact, are gaining traction and are expected to contribute a further 1-3 points of loss ratio improvement.

Although our Q1 auto results were disapointing, we remain confident that our actions will deliver 4-6 points of improvement with the majority of the benefits to materialize in the latter half of the year.

Charles Brindamour – *CEO*:

Thanks Darren.

Patrick, do you want to comment on weather and reforms in Ontario ?

Patrick Barbeau – *SVP of Claims*:

Weather certainly affected our results in Q1. The elevated amount of catastrophes, totaling $88 Millions in Q1, was almost entirely in property lines, primarily caused by severe winds. But winter storms and variations in temperature have also significantly affected driving conditions and automobile results. The volume and size of claims in automobile has been higher than expected for the major part of the winter, starting in early December until mid-March.

With regards to the Auto Ontario environment, the reforms are so far producing the benefits that we were expecting and will start to have full impact in Q3 this year.

The Ontario Government continues to be pro-active in trying to reduce costs in the automobile system. The provincial budget released last week refered to specific recommendations coming from the recently introduced Marshall report aiming at making the Ontario auto system more cost efficient. There are positive recommendations in this report and consultations should start in the coming months. In the mean time, we remain focused on executing our own plan to improve our auto results including rate increases, segmentation, risk selection and claims cost containment.

Charles Brindamour – *CEO*:

Thanks Patrick.

Alain, can you provide your perspective on how Commercial Auto is performing?

Alain Lessard – *SVP of Commercial Lines*:

Yes Charles.

The strong growth of 9.2% was affected positively by the sharing economy product. As we mentioned a few times in the past, the premium for these products is closely related to usage, and the popularity of ridesharing and car sharing is still very strong. This was partially offset by the profitability actions we are taking on our trucking portfolio, where we are still taking double digit rate increases on the least profitable business. We also saw some impact from weak economic conditions in Alberta, but overall growth was strong.

On the profitability side, we are pleased with the improvement in the combined ratio. Considering the seasonality of the first quarter and the fact that we have still 2 to 3 point of rates to be earned, we are in good position to operate this line around 90%.

Most of the increase we saw in the underlying current year loss ratio was due to increased frequency from weather related events, mostly in western Canada. The level of large losses was in line with last year.

This was partially offset by an improvement in PYD, where we saw a 4.6 point improvement despite 1.7 points more large losses. The 2017 level of PYD is more in-line with what we would normally expect for a first quarter.

Overall I am quite confident that this line is trending in the right direction

Charles Brindamour – *CEO*:

Thanks Alain

This concludes the earnings part of our call and I hope we have provided a good overview of our first quarter results.

Let me now move to the other news of the day, our acquisition of OneBeacon.

OneBeacon Acquisition Prepared Remarks

Charles Brindamour – *CEO*:

Today, we've taken an important step to building a world-class P&C insurer. I'm thrilled to announce that Intact has entered into an agreement to purchase OneBeacon, a leading US specialty insurer for total consideration of US$1.7 billion. Combined with our own specialty lines division here in Canada, we are creating a leading North American specialty insurer focused on small to mid-sized businesses, with over C$2 billion in specialty lines premiums.

As you know, we've been looking to grow our business outside of Canada, and identified the US small to mid-size commercial and specialty market as an attractive entry point. The key was finding the right company – not only from a strategic, operational and financial perspective, but also for overall fit. I'm very pleased to say that OneBeacon checks all those boxes.

OneBeacon has built a high quality organization – thanks to their commercial and specialty lines expertise, strong broker relationships, and the depth of their team – led by their CEO Mike Miller. Mike and I firmly believe that combining OneBeacon's deep commercial and specialty lines expertise, with Intact's track record in commercial lines and strengths in data, claims and digital will create a formidable platform to serve brokers and customers and to capture growth opportunities. There is no doubt in my mind that we are a great fit. Together, we have the scale, the people, the technology and the expertise to build a leading North American specialty insurer.

While we continue to be well-positioned to participate in the consolidation of our industry here in Canada, the acquisition of OneBeacon opens up new and significant growth opportunities for Intact.

It bolsters Intact's Canadian business with new products and cross-border capabilities. It allows us to deliver broker and customer experiences that are second to none, and better positions us to compete with international insurers.

Our business profile improves significantly once you add the two businesses together, with commercial and specialty lines representing nearly half of our total premiums. Our business mix is more balanced and we have increased our geographic diversification.

The financials are compelling. The transaction is neutral to net operating income per share in the first year and generates mid-single digit accretion within 24 months. The IRR is attractive, in excess of 15%, due to multiple top and bottom line opportunities and a strong financial position to start with.

The transaction is conservatively structured. Our financial leverage will be below 20% within 2 years and at closing, we will have purchased $200 million of downside protection against adverse reserve deployment. Our balance sheet remains strong and well protected, allowing Intact to capture future opportunities.

We have built a strong track record of successful M&A transactions to become the largest P&C insurer in Canada – insuring 1 out of 4 small to mid-size businesses. Working alongside our new colleagues at OneBeacon, I am confident that we can leverage our track record to grow our organization further by consolidating a fragmented market. This is an exciting time for both our companies.

I will now ask Don to provide further color

Don Fox – *EVP*:

Thanks Charles.

OneBeacon is a unique, pure play specialty insurance company operating in the US and writing approximately US$1.2B in annual premiums. It is publicly listed on the NYSE, domiciled in Bermuda and headquartered in Minnesota.

It offers a wide range of specialty insurance products and is focused on small to mid-size customers, as we are. OneBeacon is a company with a strong focus on underwriting. It is licensed in 50 states, has differentiated distribution channels, and strong values similar to ours. I have been particularly impressed by their very experienced management team, as well as their flexible and scalable technology platform.

This acquisition is consistent with Intact's strategy. We have for some time now communicated our interest in growing outside of Canada, particularly in the US and particularly in small to mid-size commercial and specialty lines businesses. This market is attractive because it’s still quite fragmented, it’s more profitable than personal lines and we can leverage our strengths as the largest writer of small to mid-sized businesses in Canada.

The combination of our businesses will bolster our Canadian operations and drive cross market synergies. We expect to use the expertise of OneBeacon’s management team combined with our own capabilities in Canada to serve our customers and brokers better. This will certainly help get our Canadian specialty lines premiums to our targeted $1B level within a few years.

The strategic merits of the transaction are very clear. The financial merits are also quite clear, which is particularly important as we complete our first significant acquisition outside of Canada. This deal is the right fit, and it’s a manageable size while still making meaningful impact.

The price offered for the shares of OneBeacon is $18.10 for a total price of US$1.7B. This represents a P/B ratio of 1.66x based on OneBeacon’s latest balance sheet and 15.8x earnings.

The IRR is in excess of 15% and we expect the transaction to be immediately accretive to BVPS by 5%.

Charles already mentioned that the acquisition is neutral to NOIPS in the first year and mid-single digit accretive within two years, as the combined ratio improves and synergies materialize. These numbers are especially compelling for a company entering a new market.

We look forward to working with Mike and his team to operate our specialty lines businesses with combined ratios in the low 90’s.

I will now let Louis provide some insights on the synergies and the financing structure.

Louis Marcotte – *CFO*:

Thanks Don.

We believe this acquisition creates significant value for shareholders as evidenced by the expected returns and accretion levels Don highlighted earlier.

Our plan to create value is very clear and is built on the following 6 levers:

1. Grow OneBeacon's industry leading lines of business

2. Improve underperforming lines

3. Leverage Intact's risk selection, analytics and claims expertise across OneBeacon's platform

4. Capture expense synergies in all our businesses

5. Bolster our Canadian business by adding OneBeacon's products to our shelves and expanding our cross border capabilities, and

6. Pursue consolidation opportunities in both markets

With regards to synergies, we see opportunities in three main areas:

- Supply chain management, where we will leverage our Canadian experience and combined purchasing power to drive savings

- We expect efficiencies from leveraging best practices in claims, IT, operations and shared services, as well as from managing our investments internally and delisting the company.

- Lastly we see benefits from reinsurance through combining the OneBeacon programs with our own.

This brings me to the financing of the transaction. We are paying approximately $2.4 billion for the acquisition including costs. OneBeacon's existing debt remains outstanding.

Our proposed financing structure is consistent with what we've been telling investors for some time now. It also takes into consideration the needs of regulators and rating agencies.

This is a great opportunity to deploy the excess capital we've been accumulating. We plan to use approximately $700 million of our excess capital and still remain well capitalized with MCT estimated above 200% at close.

We expect to use a combination of debt and preferred share instruments up to $1 billion with a goal of maintaining debt to capital below 25% at closing. We will use the significant cash flows generated by the combined businesses to bring that leverage ratio below our target level of 20% before the end of 2019. Accordingly, we are temporarily halting purchases under our NCIB.

The remainder being $700 million will be financed by the issuance of subscription receipts, $340 million of which have already been sold on a private placement basis, a strong testament to the merits of the transaction. The remainder is being issued as we speak. The subscription receipts are convertible into common shares at close of the transaction which is expected to take place during Q4-2017, subject to regulatory approvals.

We hedged the USD purchase price to avoid any material change to its CAD equivalent between now and closing.

A quick word on the assets of OneBeacon. Their investment portfolio is conservatively managed with over 80% of total invested assets in fixed income securities, and their total portfolio has a similar risk profile to ours. We plan to manage those assets internally along with our existing investment portfolio.

In summary, our financing plan is conservative and our balance sheet strength is maintained. This is important to us as we believe the consolidation of the Canadian P&C market will continue and we want to be in a strong position to capture those opportunities as they arise. This acquisition is not a pivot away from the Canadian market, but one step on the path to building a world class insurer.

Back to you Charles.

Charles Brindamour – *CEO*:

Thanks Louis.

Alain, you're the expert in commercial lines and you've spent a bit of time with the OneBeacon team. What can you share with us on the opportunities the acquisition brings and the fit between our companies?

Alain Lessard – *SVP Commercial Lines*:

Happy to Charles.

I have had the pleasure of meeting with the senior management team of One Beacon and I was impressed by their expertise in Specialty Lines. They have built from the ground up a very strong specialty insurer with leading positions in the niche areas where they operate.

Intact has its own strengths in Specialty lines. Over the past few years we have developed a portfolio which has a volume just north of $600 million and operates at a high profitability margin. We also have leading positions in lines that are complementary to One Beacon's lines of businesses.

In my mind, both companies share the same philosophy: We believe our employees are THE competitive advantage; in specialty insurance, profitability is attained by risk selection and segmentation, and growth is generated by the quality of product and broker relationships. Both these elements require a strong underwriting team. Over the years OneBeacon has attracted top talent with expertise and deep technical knowledge. We are very excited to be joining forces and leveraging the talent in both organizations.

Going forward, we have established a plan on how best to leverage the acquisition of OneBeacon to maximize growth both in Canada and the United States. Don, Charles and Louis have already mentioned the opportunity for cross border business but there are also other avenues by which we intend to accelerate our plan to achieve $1 billion of premium in specialty lines within Canada. We will utilize OneBeacon's expertise and bring some of their products into the Canadian market – products such as Technology, Entertainment, and Environmental Insurance would be some examples of the many possibilities. The same opportunity also exists in reverse. We believe that our leading position in certain lines such as Contract Surety and Farm could be used to expand their own offering in the US.

In addition, we will also leverage Intact's capabilities in data, claims and digital to support the operations of OneBeacon in the United States. As an example, we believe that the digitization trends we are seeing in personal lines and small commercial lines will also spread to specialty lines. We intend to use Intact's web capabilities to stay ahead of this trend.

It is clear for me that between OneBeacon's strong team and Intact's proven track record, we have all the necessary ingredients to build a leading North American specialty insurer that will operate with high profit margins

Charles Brindamour – *CEO*:

In summary, the OneBeacon acquisition is an important step on our path to be a world class P&C insurer.

The deal provides a scalable platform to grow organically both in the US and in Canada in specialty lines. It also provides an opportunity for us to leverage our M&A track record to consolidate a fragmented market. These avenues of growth are substantial and we have the team to pursue them.

On the operational side, we are clearly bolstering our capabilities in specialty lines. Between the deep expertise of both teams and Intact's strengths in data, claims and digital, we are building a powerful engine to serve small to mid-sized businesses on both sides of the border.

From a risk point of view, we've been very careful. Our financing is conservative and consistent with past acquisitions. We've maintained the strength of our balance sheet and protected ourselves against significant adverse development by partnering with a reinsurer. And I believe the diversification of our business mix, with better balance between commercial and personal lines, and our expanded geographic footprint reduces our overall risk profile.

On the financial side, the numbers speak for themselves. We are entering the largest commercial P&C market, in one of its most attractive segments, while driving near term accretion and creating value for shareholders.

On behalf of my colleagues and all the employees at Intact, I would like to take this opportunity to welcome the entire crew at OneBeacon. They have built an outstanding organization based on their expertise and strong values. We are very proud to join forces with them as we continue building a world class P&C insurer.

On that, I will return the call to Samantha,

Samantha Cheung – *VP, IR*:

Thank you, Charles. Please note that a telephone replay will be available for a period of one week, while the webcast will be archived on our website for one year. A transcript will also be available shortly on our website.

We also invite you to listen to our Annual General Meeting of shareholders which will take place tomorrow at 10:30 am Eastern Time or 11:30 am Atlantic time at the Lord Nelson in Halifax, Nova Scotia. Our second quarter 2016 earnings call is scheduled for August.

Thanks again for your time today.