Transcription

Domestic & General's FY21 Bondholder Call

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07 July 2021

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Domestic & General's FY21 bondholder call. Today's discussion may contain some forward-looking statements relating to future events and expectations. As usual, the factors that could cause actual results to differ materially from these projections are set out in the latest results statement. In addition, we have included some non-GAAP financial measures in our discussion, reconciliations for which can also be found in the results statement. With that, let me hand over to David Tyler, Executive Chairman.

David Tyler

Well thank you, and good morning, everybody, and thank you for joining our call today. I suspect I don't know many of the people on this call, so let me just briefly introduce me. I'm David Tyler. I'm the Chair of Domestic & General, as you've just been informed, and indeed, have chaired the business now for nearly six years.

I've got with me Joe Fitzgerald. Joe is our acting Chief Financial Officer. He's also our Chief Strategy and Commercial Officer, and he'll take you through our performance for the last financial year. However, before I hand over to him, I'd just like to say a few words about recent events at Domestic & General.

The last two months have been a particularly sad time for everyone at the company. You'll almost certainly be aware that Ian Mason, our CEO, died suddenly and unexpectedly in late April. This was a huge shock to everybody in D&G, and his loss has been felt very deeply around the business because of his charismatic leadership style, which helped to create a strong and inclusive culture in the company. We all really, greatly miss him and miss his upbeat presence around the place.

Anyway, following this tragedy, the Board of Directors asked me to take on the position of Executive Chairman, rather than Non-Executive Chairman, for an interim period until we appoint a successor for Ian. And of course, I'm supported day by day by an extremely strong group of executives around the Executive Committee table - indeed, widely throughout the business. We've been working very happily together over the last two months or so, and the company has been performing well during this period.

I've got two main priorities during this interim period. Firstly, it's to ensure that we continue to progress the Group's growth plans and its strategy. Indeed, it's testament to our 3,000 colleagues throughout the company that we've been able to move forward with our plans over the last couple of months, largely unaffected by this terrible tragedy. The view right across the Group is that the very best way to honour Ian's legacy is to continue to deliver against the customer-centric growth strategy he was overseeing. And I guess that's been a positive outcome arising from this awful event.

My second main priority, naturally, is the appointment of a new permanent CEO, and I can simply say today that I can confirm that this process is well underway. We'll, naturally, update you on this as soon as we can.

During the last quarter, we also parted ways with James Davies as CFO. He left the company for personal reasons. So, this brought Joe's return as acting CFO, a role that, you may be aware, he's successfully and very capably fulfilled in the past. And I'm delighted we're able to draw again on his experience and his expertise. So, thanks, Joe.

And maybe I can move on to our performance in the 12 months to the 31st of March. As you can see from this slide, we achieved strong growth in revenue in the year. As you can see, 872 million of revenue was 5% up on the previous year, and growth in subscription revenue, which is the key part of our strategy, was a very encouraging 8%. EBITDA came in in line with last year, at £107 million, and net debt ended at £681 million, which was up 23 million from a year earlier.

So, with that, I'd now like to hand over to Joe. He will take us through the full presentation on FY21 and I'll remain, of course, on the call to take any questions at the end. So, over to Joe, please.

Joe Fitzgerald

Thanks, David. Good morning, and welcome to our FY21 full year results call. Before I start with the main results, as with previous calls, I think it would be useful to begin with a quick refresher of our unique business model. So, starting with slide five. We protect domestic appliances. We're a large international and high service, with 9 million subscription plans, 2.4 million repairs every year, and half a million replacements. Customers love the service we give them, and renew their cover with us year after year. We have an 84% first-time fix rate, a 98% second-time fix, and we have an 87% customer subscription rate. And this is the key to our business model, which is based on high service and loyalty.

We have a rapidly growing digital estate, with 4.2 million digital users every year. And how do we do this? We are a specialist in appliance cover, and we operate a unique B2B2C model. We've exclusive long-term partnerships with 95% of the UK's white good OEMs, and are replicating those across Europe and now the US. We operate a subscription model that drives high renewal rates and delivers embedded growth.

So moving onto slide six. This looks at our partnerships. And our partnership model is one of the keys to understanding our success. As the chart on the right illustrates, we are part of a mutually-beneficial ecosystem that gives us an exclusive distribution platform, a strong service advantage, and a predictable stream of recurring revenues. The ecosystem delivers values to our partners as well, through additional revenue streams, incremental repair and replacement volumes, and operating efficiencies in their own engineer networks. And together, we deliver high levels of customer service efficiently.

I'd now like to cover on slide seven our VCP programme and investment priorities, which are already delivering value across our estate, and pave the way for enhanced EBITDA and revenue growth in the future. Our businesses are at different stages of maturity, but each has a clear strategy for growth. In the UK, our subscription model drives compounding growth, and we have many opportunities which we are exploiting to further this growth.

Increasing our reach into our current customer households is a priority. Each of our subscription customers has, on average, 1.6 appliances covered, but with 13 appliances in the average household, there remains a huge opportunity for growth. And to further access that potential, we are looking to continue our progress in data science, digital marketing, customer-based price optimisation, and new partner wins.

And you can see, with these opportunities, why we are so excited about our growth in our core UK market. These initiatives have borne fruit in FY21, with a 12% increase in new subscription plans. During the year, we also started trading with John Lewis, and have recently acquired EDF as a partner. Both have been long-term strategic targets for the business, and we are delighted to be working with them as partners.

You've heard us describe our international businesses as having established all the building blocks needed to deliver growth. The key here is that we've very much replicated the UK operating model of driving subscription business. We did this by leveraging our pan-European partnerships with OEMs and key retail partners, and these partnerships are going from strength to strength. We are seeing increasing customer acquisition across all channels and territories, and as a result, we saw a 27% increase in our subscription revenues, and this is the key to driving long-term value in our business.

As previously announced, we have now signed a long-term contract with our key partner, Whirlpool, who sell 19 million appliances in the US. For context, that gives access to more appliances than our UK and European OEM relationships combined. We therefore see the US as an incredibly exciting opportunity and a market that has strong customer demand for our products.

We are building our US team and have appointed our US CEO, Gary Mitzner, who is in the process of appointing his own lead team. Gary has a wealth of US warranty experience gained at Sears and RR Donnelley over the last 30 years, and this includes product underwriting, contact centres, and operations. This experience will be invaluable as we launch in the US. We are scheduled to launch in the early autumn, and we are very excited about the long-term prospects for our business.

And finally, digital, which is a key focus for us across all of our territories and where we have concentrated investment over the last few years. The foundations of digital transformation - to reduce our cost to serve, to vastly improve the customer experience, and to generate and expand customer relationships - are now firmly in place. Last year, we saw 4.2 million digital users across our estate. 1.2 million customers have a D&G My Account, and a third of all of our repairs are arranged online, and 75% are product replacements. In addition to the obvious customer benefits in going digital, we expect these investments to provide significant cost efficiencies, which will allow our EBITDA returns to grow ahead of revenue in the coming years.

Overall, we are excited about our strategic direction and the investments we're making, which we believe will position the business well for top-line and bottom-line growth in the future.

Moving onto slide nine, and the financials and an overview of FY21 performance. We've had a good year. We've continued our track record of revenue growth despite difficult and unprecedented conditions caused by COVID. Our business model adapted well to the changes in customer behaviour we saw, such as the move to online appliance purchasing, and we saw the full benefit of our business model, which operates in store, online, and across the appliance lifecycle. Our post-point of sale and digitally-sourced revenues have thrived in the climate we've seen over the last year, and I will talk more about the source and resilience of our revenues later in the presentation.

As a result of these factors, our new business volumes have increased strongly year on year. We've also seen strong customer renewal rates, highlighting the strength of our proposition in uncertain times and benefiting from the full-service providers in lockdown.

Before talking about our financial performance, I should mention that our results are preliminary, pending finalisation of the annual audit. The audit is well-progressed, and we expect to be able to issue signed accounts within the next couple of weeks.

Turning to the numbers, revenue has increased by 5%. And it was particularly pleasing to deliver 7.6% growth in our subscription revenues in line with our strategic focus. Whilst revenues have grown, EBITDA has remained stable. We did see extra costs to maintain service, and I will expand on that and other factors, including our outlook for EBITDA, later.

Operationally, we have established the foundations of our digital strategy, and we are seeing progress across all metrics in this area, with increasing levels of digital sales and service transactions. We also saw the benefits of home-working across all aspects of our business, from our frontline to our head office, and we are investing in our facilities to enable permanent hybrid-working moving forwards, both to take advantage of the benefits we have seen, and to allow full leveraging of digital and contact centre modernisation investments.

This investment also ties in with our ESG aspirations, where we are at the start of a process to drive a strategic ESG agenda. In early 2021, we were awarded a bronze sustainability rating by EcoVadis, and we have plans in place to build on our environmental ambitions, which are centred around our repair-first ethos over the next 12 to 18 months.

We are, as mentioned, also making good progress on our US launch, and we are scheduled for the launch in the early autumn. And we completed our Part VII Brexit transfer process during the year. And I will expand on that shortly.

Finally, we raised 100 million in finance in July 2020, which will allow us to both invest in our US launch and to continue our investments in digital whilst maintaining significant financial leverage.

So, on slide ten, and as I just mentioned, I'd like to cover Brexit. In the year, we successfully completed our Brexit transition, with the Part VII process completing on the 31st of December 2020. This, as we previously advised, has an impact on our insurance capital requirements due to the inefficiency of running two insurers, which became a necessity through the loss of passporting rights to the EU. We have managed this as efficiently possible, and the impact of this transition on our capital position is a circa 25 million-effect in the year. There will be a much smaller effect next year, also in the single-digit millions, and we expect the effect of Brexit on our solvency position will, then, be minimal. We have secured a BBB investment grade credit rating for DGI Insurance PLC which mitigates the impact of non-equivalence, which is a risk we have highlighted in previous updates. We are pleased that we've completed this complex and time-consuming piece of work, and now feel we have a solid platform to continue to grow on European operations.

I'll now talk about – on slide 11 – the impact of COVID on our business. In summary, whilst there was an impact on our operations, we fared very well as a business, and showed again the strength and resilience of our business model. We provided the full service without interruption throughout the pandemic, and maintained our service levels in what we believe to be industry-leading performance. Inevitably, we did incur some costs - which were in the low single-digit millions - in delivering this service, due largely to supply chain issues; the impact of change of phasing in our repairs; and in places, due to engineer availability. There has, of course, as well, been some impact caused by Brexit and other factors, such as Suez. We are pleased that these issues have now normalised and we are not seeing the same issues in Q1 FY22.

We also saw strong customer retention levels throughout FY21, which, we believe, highlights the strength of our proposition in uncertain/recessionary times, and which we also believe was due to the excellent and full service we provided. This service was, in part, due to how quickly we transitioned to home working, and this was achieved in a matter of days. The success of this approach and the positive reception it has received among our employee base has convinced us to move to a hybrid working model more permanently, and we are now investing in our facilities and sites to achieve this. This does require investment, but we will reap the future cost savings as we realise the full benefits of our digital transformation and our contact centre modernisation programmes. And lastly on COVID, which we will go through later, we traded strongly on new business and I would like to start with slide 12 to explain the features of our business model that enabled that performance.

So, moving on to slide 12, the most important factor in the resilience of our model is that 86% of our revenue and our most profitable is generated by subscription. Of this subscription revenue 81% is renewal business. As we enjoyed high and stable customer retention rates, this gives great protection and resilience to our business and allows compounding growth. A further strength of our revenue model is that our new business is acquired across the lifecycle of an appliance, with most of our business acquired post-point of sale which has protected the business from the store closures we saw during lockdown. What this means is that if an appliance is purchased online, we either attract business through our online retail partners or we receive data through our various partners, which we can then convert post-point of sale.

Obviously, this year many more appliances have been sold online than in previous years. Whilst this has meant fewer bricks and mortar point of sales, our business model has benefited through our digital and post-point of sale channels, which have more than made up for this loss of business.

Moving onto slide 13, this can be seen in our year-on-year new business performance, which ended up 12%. Whilst Q1 was subdued, we've seen very strong quarterly performance since, as our digital and post-point of sale channels made up for the initial drop-off of in-store activity.

Moving onto slide 14, we have also, as mentioned, seen high customer retention rates, and as a result, have seen 10% growth over the year in our renewal volumes. Strong renewal performance is vital to our business model and our profits, and we are delighted that, once again, our retention rates have remained strong in uncertain and recessionary times. This growth in renewal plans resulted in subscription plans, overall, increasing by 10% year on year, which is a fantastic result and one we are very proud of.

Moving on to slide 15. This strong plan growth is translating to revenue, as you would expect, and as we can see from the slide on chart on slide 15. There is a lag in plan sales translating to revenue growth as new plans typically come with lower average fees as they relate to younger appliances, and we defer revenues to match with when repairing replacement costs will arise. So, in the example of a 12-month contract where a customer has been charged £60, we will recognise £5 per month on a straight-line basis. Obviously, we will also typically collect that £5 a month on a monthly basis as well.

Moving onto slide 16, and looking at the summary Group figures. Subscription levels, which is where we are strategically focused, have grown by 7.6%. As you can see, growth has accelerated over the last year's comparative figure of 4.4%.

This is driven both by increasing business in our UK and International divisions and the compounding effect we see from our high customer retention rates. Given the growth we've seen in new business, and the success of our data and digital initiatives, we expect to see a continuation of current revenue growth trends in the medium term.

Moving onto slide 17, you can now see some of the key metrics that drive our consistent financial performance. We are maintaining high levels of renewal revenue, as I've mentioned, growing revenue from subscriptions in our International business, and achieving stability in our underwriting costs. I would draw attention to the growth in the proportion of our revenues that's driven by subscription. An increase in this metric is the key to the long-term health of our business. We have, as noted, seen a slight increase in our underwriting costs in Q3 and Q4 due to the supply chain issues I mentioned, and I am pleased to say these have normalised in Q1 of FY22.

Moving onto slide 18, underlying EBITDA, our key profitability metric, is stable, on FY20 levels. Whilst we've seen increased revenue, we have also seen some cost pressures in FY21. Firstly, the effect of the pandemic, which I've mentioned. We've also seen a continued effect from the Customer First product transition, where we moved our service-based business to insurance. This increased our indirect tax costs and lowered our underlying UK margins. I'm pleased to say we do not expect to see these factors continue to impact EBITDA growth materially in the coming years. In that, the supply chains we encountered, we see very much as a one-off. And the tax impacts of Customer First will not be growing materially post-FY21.

Outside the UK, we saw a positive impact in our International business, where lower repair levels on portable devices provided an underwriting benefit, with a net cost at a Group level of the pandemic in the single millions. Assuming more normal trading conditions, we would expect our future EBITDA progression for our established businesses in the UK and Europe to more closely track revenue and move ahead of revenue growth in the medium term, as we realise the benefits of our digital investments.

Now, let's turn to cash flow on slide 20. I've covered EBITDA, and now I'd like to cover the other elements of our cash flow. Starting with capital expenditure, we are at increased levels versus our historic trends, and this is largely due to the heightened investment in our digital capabilities. We will also see increased capital expenditure in FY22 as we invest in our facilities and continue our digital investments. The facilities investment represents a one-off investment that will generate cost savings in the future and help realise the benefits of our digital programme. We therefore expect capital expenditure overall to increase on FY22 levels in FY22 by high single-digit millions and then moderate significantly post-FY22.

Working capital has improved in FY21 versus FY20, which is due, as previously advised, to FY20 being greatly affected by the Customer First programme. We expect a small outflow in the single-digit millions in FY22, reflecting the working capital strain of increased levels of business and some of the positive working capital we saw in FY21, relating to COVID-related liquidity actions, such as the delayed payments to HMRC.

In the cash flow table, we show EBITDA of the regulated business adjusted out and the increase in distributable reserves of the regulated business added back, in line with our definition of free cash flow. It can be seen that the increase in distributable reserves of our regulated businesses is lower than the equivalent regulated EBITDA, which is due to greater capital requirements. Primarily, these capital requirements relate to the one-off impact of Brexit and the Part VII transfer, but also reflect the smaller impact due to general growth in the insurance business as a result of overall revenue growth.

We expect the gap between regulated EBITDA and the associated increase in regulated distributable reserves to remain in FY22, but to narrow compared to FY21, to somewhere in the mid-teens. This is due to general growth, again, in the insurance companies such that they require further capital in addition to some further capital being required in FY22 in our EU business as a result of Brexit. Beyond FY22, we expect the gap to narrow further still to low single-digit millions, which is what we would expect in a growing insurance business that will require more capital. Cash was a net outflow in the period reflecting the recovery of UK overpayments made in prior years offset by tax payments in our international business. We expect an outflow in the single digits during FY22.

I should also mention that we will be seeing an investment in our US launch during FY22. This will comprise initial operating costs, capital expenditure, and the funding of working capital requirements. We expect FY22 to require in the mid- to high-teens-millions, which we would expect to reduce post-FY22 as the requirements of capital expenditure reduce, and we see contribution from trading revenues.

In terms of our net position from unrestricted cash, we therefore expect to see a net reduction over the next year. We see this as investment, and the reduction will be broadly the size of our investment in the US and the heightened level of capital expenditure and digitalisation in facilities. We will therefore maintain a good level of unrestricted cash and an undrawn revolving credit facility, which would give access to £70 million of liquidity. £30 million is, obviously, ring-fenced in respect of our ancillary own funds. We are, therefore, in a sound position financially to pursue our plans.

Moving on to capitalisation on slide 21. The position reflects the new capital structure following completion of the refinancing exercise in July. Net debt and leverage at the end of FY21 was £681.1 million and 6.4 times, respectively. Leverage has increased marginally, due to IFRS 16 lease liabilities, within gross debt, and with cash affected by investment in digital and our US launch, which we anticipate will ultimately be EBITDA-enhancing. Inclusive of uncalled letters of credit in favour of our regulated business, our revolving credit facility is undrawn with £100 million capacity which, when allied to our unrestricted cash, leaves significant headroom in our facilities.

Moving onto slide 22, I would now like to summarise. We delivered full service in FY21 to our customers, and this is a priority of our business. At the same time, we generated increased trading volumes year on year with a 10% increase in subscription plans sold, and we were particular pleased with the performance of our International division. Our FY21 financial performance saw another year of revenue growth, with stable EBITDA in the face of headwinds, and we have a stable cash position with headroom. The business continues to meet its strategic objectives, with progress across digital transformation, growth in our international business, and the impending launch in the US, all of which enable future growth. So, in summary, FY21 was a very positive year, where our business models showed strength and we significantly advanced our strategic agenda.

And now, I would like to hand over for Q&A.

Q&A

Operator

Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad now. If you wish to withdraw your question, you may do so by pressing 02 to cancel. Once again, if you have a question for the speakers, that's 01 on your telephone keypad now.

And our first question comes from the line of Chris Malon from Palmerston Capital. Please go ahead. Your line is now open.

Chis Malon

Good morning. Hopefully, you can hear me OK. Could we just talk a little bit - you have already - about the repair costs. I think, from my notes at the end of the last conference call, it was said that you had seen some normalisation, but it looks like this was deferred or something because I note the repair costs look stubbornly high for the last quarter of the year. So, could you maybe talk about if there was a frustration of the expectations, and then, maybe, readdress what you said earlier that this is now normalised. Can you just tell me what does normalisation mean? Are we back to mid-40s percent of revenue? If you could just put some numbers on that, that would be really helpful.

Joe Fitzgerald

Yeah, sure, What we did see at the end of Q4, and indeed during Q4 - we probably peaked with the supply chain issues, I would say, around December/January - we started to see improvement in February and March, and that trend has continued. So, as we come into April, the differences or the variance to our expectations were minimal, really. So, yes, we are seeing a kind of return to what we would expect normal claims patterns to look like. Obviously, our claims patterns vary by quarter, so summer is typically lower than the average anyway. But if you refer to the underlying contribution chart in the financial performance section, we would not be too far away from where we were: a typical Q1 of a financial year.

Chris Malon

OK, great. That's really helpful. Thank you. And then on CapEx, on the digitisation programme could you maybe give us a sense of what the overall budget for that programme was? We've seen a little bit of an uptick in the quarter, and obviously, you've guided towards a little bit of higher spend next year. Could you tell us how far we are through the programme maybe? And what the programme budget was in its entirety, please?

Joe Fitzgerald

I wouldn't give specific numbers, but we are spending roughly in the mid-teens on digitisation per year, and we've spent roughly that amount last year, and we expect to continue that in FY22. Then, we would expect that investment to moderate, obviously unless we see opportunities to spend more, but we believe we'll have a lot of the digitisation platform in place by that point.

Chris Malon

OK, that's helpful. Thank you. And what are you actually spending it on? Are we talking about computer programmers or consultants? Where's the money going to?

Joe Fitzgerald

Obviously, digitisation is about people, really. So, developers - front-end developers, back-end developers – we're building various functionality for our customers such as - I've mentioned the online repairs. We're optimising those processes, making the customer journeys more efficient, we're looking at our sales engines and upgrading those, we're looking at other functionalities, offering extra services to our customers. So, we're looking at all elements of the digital customer journeys, really, and as you say, it's about hiring people with that expertise in addition to our in-house team, indeed. We have a strong in-house digital team.

Chris Malon

Great. Thank you very much.

Operator

Thank you. Ladies and gentlemen, once again, I remind you if you do have a question for the speakers, please press 01 on your telephone keypad now.

And our next question comes from the line of Lenny Senkovsk of Eaton Vans. Please go ahead. Your line is now open.

Lenny Senkovsk

Hi, guys. Thanks for taking my question. Just a couple from me. Firstly, can you tell us what was the revenue of the regulated business for the year?

Joe Fitzgerald

I don't have that number off the top of my head, to be honest. If you pop that in an email, we will try and answer quickly.

Lenny Senkovsk

OK, I will do that. And then secondly just a clarification on the Part VII transfer. On the last call, you guys had mentioned that that was completed on December 31st, and there is an impact of 26 million, but largely, that was a temporary impact, and I believe, as of the last call, you said, as at the end of January, 16 million of that had already unwound. It sounds like, now, that perhaps something has changed there, where it was the 25 million impact for the year, but you expect it to be a single-digit million impact in fiscal '22. So, has something changed where there are now longstanding capital requirements there? Because I was under the impression that it was temporary due to you having to fund two regulated insurance businesses that overlap.

Joe Fitzgerald

I think what it is is that we have a capital requirement that's in excess of what we would have needed were we just running a single UK insurer. I think, probably, the messaging was that the impact of that is - in the year that it happens, which obviously was this year, FY21 - to restrict reserves because our capital requirement goes up in that year, and that we expect minimal capital requirements in the future, which remains true. We will see some impact of Brexit next year, but in the single-digit millions. And then, for it to largely go. So, we expect, overall, Brexit to have required capital, excess capital, so to speak, of over 30 million. It is a one-off impact, obviously. Once you've had capital out of the business, that's it 'capitalised'. So, yes, I think that messaging is probably right. Unfortunately, we can't take the capital out. The capital needs to stay there to support the business.

Lenny Senkovsk

OK, So, you don't expect any of that impact to unwind any more.

Joe Fitzgerald

No. We are looking at optimisation, which we continue to do, but at this stage, I think, unfortunately, Brexit just requires extra capital. It's an inefficiency of having to run two insurers. It's going to, as I say, take up over 30 million of capital. That will be an ongoing requirement to operate in the EU, but as you've seen, most of it has been taken through FY21 results.

Lenny Senkovsk

So, the 30 million of additional capital to operate in the EU, you don't expect that you now require 30 million less capital in the UK because you've moved those policies over from the UK entity to the EU entity?

Joe Fitzgerald

That's right. Unfortunately, it's very frustrating, but it is an inefficiency of the way Solvency II works. It is just less efficient by far to run two insurers, and particularly in the EU, because we don't have the track record data in the EU. The way Solvency works is that you get in a way punitised for that. So, that's all wrapped up in that number.

Lenny Senkovsk

OK. Thanks.

Operator

Thank you. We currently have no further audio questions. I will hand back to the speakers for any further remarks.

David Tyler

I'd just say thank you, everybody – it's David Tyler again – for your support. Thank you for attending today's conference call, and we look forward to talking to you again when we're talking about our Q1 FY22 numbers. Many thanks, again. Bye, now.

Operator

This now concludes our conference call. Thank you, all, for attending. You may now disconnect.