Transcription

Domestic & General's Q122 Bondholder Call

26 August 2021

PRESENTATION

Operator

Ladies and gentlemen, welcome to Domestic & General's Q1 22 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 the projections are set out in the latest result statement. In addition, we have included some non-GAAP financial measures in our discussions, reconciliations for which can also be found in the results statement.

With that, let me hand over to David Tyler, Executive Chairman. Please begin.

David Tyler

Well, thank you, and good morning, everybody, and thanks for joining. This is our Q1 FY22 investor call and Joe Fitzgerald is with me. As you may know, Joe is our acting Chief Financial Officer and he's also our Chief Strategy and Commercial Officer, and he will take you through our performance over the last quarter. But before he does that, I just wanted to share a few key financial and operational highlights with you.

So we can flick to the first slide. And you may remember, I mentioned on our last call that one of my main priorities since the tragic death of Ian Mason in April was to recruit a new permanent CEO. So, I'm very pleased to confirm that that process has now concluded, and we've appointed Matthew Crummack, and he'll join the Board of Directors and our Executive Committee on October the 4th.

Matthew has had a great career. He started at Procter & Gamble and then he worked successively in increasingly significant roles at Nestle and at Expedia. He was then the CEO of lastminute.com for five years up until 2015. And for the last five years, he's been the CEO of the well-known price comparison business, gocompare.com. Among other things, while there he's overseen that company's transition into subscription-based services. He stood down earlier this year from GoCompare after the successful sale of the business to Future PLC, the publishing group, which made him available for us. And by the way, Matthew is also the Senior Independent Non Exec Director at National Express Group PLC.

Anyway, I'm confident that Matthew is going to bring D&G strong leadership. He has significant experience developing digital business for consumers, as you can hear from his track record. He's operated in global companies. He understands the dynamics of a compelling subscription model, which we have at D&G. So, in other words, he's got the ideal combination of skills and experience for this position at D&G, as we continue to deliver on our ambitious growth strategy. And I'm looking forward to working with him from October the 4th, at which point I'll stand down as Executive Chairman and return to my position as Non-Executive Chairman.

So, my other priority since April has been to ensure that we continue to perform well in the short term and that we continue to develop the business for the longer term in line with the Group's growth plans. As part of that, a quick word on our American plans.

I'm particularly focused on this opportunity for our business in the US, which is headquartered now in Chicago. Our launch partner there is Whirlpool, and as you know, it's a hugely popular US consumer brand and it's got very substantial scale and market penetration there for us to tap into. We've appointed a man called Gary Mitzner as our Business Head in the US. He's had decades of experience in the US warranties market, notably, with that well known department store, Sears, and RR Donnelley. So we're now scheduled to launch our services to the American public next month and we will update you further on the early performance of that business at future calls.

Now, the figures we're announcing today show that we've had a very good quarter, as you can see on the next slide, slide four. We've achieved revenue growth of 8% over the quarter to £225 million. And, importantly, we've had an uplift of 10% in our subscription revenue to £195 million. I'm always delighted when we achieve a double-digit rise in revenue and that was the case in this first quarter.

The Group's adjusted EBITDA for the quarter, which doesn't yet account for our US operations, was £31 million and that was entirely in line with the same quarter last year. Our net debt is virtually unchanged this quarter compared to what it was three months earlier.

So, in summary, I'm conscious that it's been an emotional few months for our business, and our nearly 3,000 employees since Ian's death, but I have to say I am delighted with the way everyone's responded since then. The overwhelming attitude has been positive and to do what we can to honour Ian's legacy as best we can, by continuing to deliver against our plans for growth and to work hard to deliver for our customers. And I think today's presentation reflects that that collective effort has gone well in difficult circumstances.

So, at this point I'd like to hand over to Joe to take us through the presentation and our performance in more detail, but I'll remain on the call, of course, to take any questions at the end. So, Joe, over to you.

Joe Fitzgerald

Thanks, David. Good morning and welcome to our Q1 FY22 results call.

As with previous calls, I think it would be useful to begin with a quick refresher of our unique business model before getting into our Q1 results.

So, starting on slide five. We protect domestic appliances. We're 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, 87% customer subscription retention rate, and 4.2 million digital users. And how do we do this? We're a specialist in appliance cover and we operate a unique B2B2C model. We have exclusive long-term partnerships with 95% of the UK's white goods OEMs. And we operate a subscription model that drives high renewal rates and delivers embedded growth.

Moving onto slide seven. You can see this strength of our business model, which translates well to our financial results. We've included here a review of results since 2003, which shows our revenue compounding, driven by our subscription model and high customer retention rates, allied to the resilience of our financial performance, which is driven by predictable underlying performance.

Moving onto slide eight. We have multiple levers to further grow our new business and optimise our performance. Our Value Creation Plan is based on continued growth in our UK division, taking advantage of investments in digital and data science capabilities, in addition to new partner growth, such as our recent partnerships with John Lewis and EDF. We are replicating our UK business model in our European territories and are seeing impressive growth in our subscription policies across our EU markets.

Our UK and EU markets are significantly under-penetrated, and the investments we're making in digital and data science allow further penetration of these markets.

As David mentioned, we are due to launch in the US in the autumn and are similarly excited about the scale of the opportunity there. As I mentioned on our last call, our partner Whirlpool sells more appliances in the US than the sum-total of our OEM partners across both the UK and EU, which highlights the potential of the US market.

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

On slide nine, we have a look at our digital KPIs. The main message here is that we are seeing growth across our digital estate. We have improving engagement levels within our customer base for our digital services. A third of all repairs and 75% of replacements are now served digitally and last year we saw 1.2 million customers use their D&G MyAccount, and we've seen strong growth again here this quarter.

We are also increasing levels of our new business on digital and over 40% of our new business involves a digital interaction. What we mean by this, is that the customers either bought the product online or bought our products online, so either the appliance has been bought online or they've bought our product online. We've invested further in our digital capabilities, improving and refining our customer journeys, and making our digital services more accessible to partners and prospective clients.

We are also adding and refining extra services, such as self-help and the related appliance services, such as appliance consumables or one-off repair solutions for non-covered appliances. Ultimately, our aim is to create a one-stop shop for appliance-related needs and we are pleased with the progress we are making towards that.

Moving on to the financials and an overview of Q1 FY22 performance.

So, on slide 11, we have started our year well with trading performance in line with our plans. Our new business levels are strong, which, allied to our high retention rates, are driving overall plan growth and associated revenue growth. Overall, our new business plan sales were 32% up versus last year and our subscription revenue growth increased by 10% year-on-year.

Our EBITDA levels are in line quarter-on-quarter, with the comparative again affected by the early stages of the pandemic, as we took actions to preserve profitability and cash. I will cover EBITDA phasing later on in the presentation.

In terms of operational highlights, we continue with our digitalisation initiatives, and we are seeing high advocacy with 1.3 million MyAccount registered users and 1.8 million visits to our digital estate during the quarter. We've also been making good progress in modernising our facilities, as we outlined on previous calls.

We are well covered from an insurance capital prospective and maintain good levels of unrestricted cash with additional capacity in our revolving credit facility.

Moving on to slide 12. I'd like to start our financial section with our revenue model. The most important factor in the resilience of our business is that 87% of our revenue and our most profitable is generated by subscription. Of this subscription revenue, 80% is renewal business, with the balance being new business generated over the last 12 months.

As we enjoy high and stable customer retention rates, this gives great protection and resilience to our business and allows the compounding growth we saw earlier. A further strength of our revenue model is that our new business is acquired across the life cycle of an appliance, with most of our business acquired post the point of sale. What this means is 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.

Indeed, 40% of our new business acquired has involved a digital transaction either in the purchase of the appliance itself or our products being purchased online. Obviously, over the last year, many more appliances have been sold online than in previous years. And while this has meant fewer bricks and mortar plan sales, our business model has benefited through our digital and post point of sale channels, which have more than made up for this lost business.

Moving onto slide 13. This can be seen with our year-on-year new business performance, up strongly year-on-year at 32%. The year-on-year comparison is flattered as the comparative period was affected by the initial stage of the pandemic, but nevertheless, we are very pleased with this performance which sets us up for a strong new business year overall.

We have also drawn a comparison versus our FY20 performance, which was not affected by the pandemic and here you can see the step change in new business we're enjoying, driven by our digital and data investments.

On slide 14, we show our international performance as a subset of the Group figures. As you can see, we are growing very strongly versus last year, which was affected by the pandemic also. But again, using FY20 as a baseline, we see 39% growth, which we are very pleased with, and shows the success we are having replicating our UK subscription model.

Moving on to slide 15. Whilst the comparative for new business was enhanced by the presence of lockdowns in the comparative period, renewal volumes see the opposite effect, as the number of policies coming up for renewal is reduced by the lower new business volumes we wrote last year.

Obviously, our new business volumes recovered strongly to show strong growth for the full year, and we should therefore see that impact on renewals later in the year. Combining our new business and renewal subscription plans for this quarter gives an overall 10% growth in plans for Q1 year-on-year.

Moving onto slide 16. This strong plan growth for the Group is translated into revenue, as we can see from the chart. There is a lag in plan sales growth, 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 repair and 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. Again, last year's result was affected by the reduced new business levels, which aids the 10% growth year-on-year slightly. We would expect subscription revenue growth for the year to be in the high single digits.

Moving onto slide 17. Looking at the summary Group figures, you can see strong growth in our subscription revenues, which is, of course, where we are strategically focused. This is driven by both increased new 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 across our territories, we continue to expect to see high single-digit revenue growth over the medium term.

On slide 18, you can see some of the key metrics that drive our consistent financial performance. We are maintaining high levels of renewal revenue in our UK business through strong retention rates, growing revenue from subscriptions in our international business, and achieving stability in our underwriting costs. I'm pleased to report that, as we indicated, we've seen an improvement in our underwriting performance, and that the one-off issues we saw in Q3 and Q4 have fully normalised.

On slide 19, you can see our underlying EBITDA, our key profitability metric, which is stable on FY21 levels. We did, of course, take some protective measures on costs during the initial stages of the pandemic, and as such we have an elevated comparator when looking at Q1 last year.

As previously indicated, we expect our EBITDA for the full year to rise more in line with revenue during FY22 for the year in full, as we see the benefits of revenue growth and digitalisation feed to the bottom line. We will see most of this growth in the second half of the year due to some of the phasing impacts caused by the pandemic on our comparatives.

Now, let's turn to cash flow. On slide 21, starting with EBITDA, I have covered EBITDA excluding US and as you can see, we are now starting to see costs relating to our US launch, reflecting initial operating costs. These total 1 million in the quarter. We expect to see a total investment in our US launch over the year in the mid to high teens of millions. This investment comprises initial operating losses, working capital investment, and capital expenditure. We've itemised these items on our summary cash flow. As you can see, we have invested a total of 2.4 million in the US launch during Q1, being the 1 million operating losses and 1.4 million of capital expenditure and working capital.

In terms of capital expenditure for non-US, we are at increased levels versus our historic trends due to heightened investment in our digital capabilities and facilities. We will see increased capital expenditure in FY22 as we invest in our IT, office facilities, and digitalisation, which represents a one-off increase that will generate cost savings in future years and help realise the benefits of digital and contact centre modernisation. We therefore expect capital expenditure to increase on FY21 full year levels by high single digit millions and then moderate post-FY22.

Working capital outflow in the quarter reflects items such as payment of bonuses and payments to HMRC. We expect a full year outflow for working capital to be in the single digits, as we've previously indicated. The comparative period in FY21 was again affected by non-payment of bonuses and delayed payments to HMRC, which were protective measures we took in the initial stages of the pandemic.

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 is lower than the equivalent regulated EBITDA, which is due to greater capital requirements. Primarily, these capital requirements relate to the one-off effect of Brexit and the Part VII transfer, but also reflect to a small degree the general growth in insurance business as a result of overall revenue growth in both the EU and UK.

We expect the gap between regulated EBITDA and the associated increase in regulated distributable reserves to remain in FY22, but to narrow compared to what we saw in FY21 to somewhere in the mid-teens for the full year. This will be due to growth 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 this gap to narrow further still to low single-digit millions.

Tax was a modest outflow, and we expect an outflow in the single digits in FY22.

In terms of our net position on unrestricted cash and accounting for all the items mentioned, we 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 for digitalisation and 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, with 30 million of course being ringfenced in respect of our ancillary own funds. We are, therefore, in a sound position financially to pursue our plan.

Moving on to capitalisation. Net debt and leverage at the end of Q1 FY22 was £677 million and 6.4 times respectively, which are largely unchanged versus Q4 FY21. Inclusive of uncalled letters of credit in favour of our regulated business, our revolving credit facility is undrawn with 100 million of capacity, which allied with our unrestricted cash, leaves significant headroom in our facilities.

Moving on to slide 23 and to summarise. In summary, it's been a good start to the year, and we are trading in line with our plans, with growing new business levels, high retention levels, and stable financial performance. 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.

And now, I would like to hand over for any questions.

Q&A

Operator

Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad. If you wish to withdraw that question, you may do so by pressing 02 to cancel. There will be a brief pause while any questions are being registered.

And as another reminder, if you do wish to ask a question, please press 01 on your telephone keypad now.

And we have a question from the line of David Oti from O'Connor. Please go ahead. Your line is now open.

David Oti

Hi there. Thanks for the presentation. I'm just looking at your unregulated business adjusted EBITDA; it's down nearly 20% over the quarter. Can you just explain to me what's driving it exactly?

Joe Fitzgerald

Yes, I mean there's a number of factors on the mix of business between regulated and unregulated. As you know, we saw the Customer First transition a number of years ago, and most of our new businesses is now written in our regulated business. Our unregulated business still carries some new business but also has a much larger renewal book. Basically, we write our new business marginally, that is marginal to loss making, and we obviously accrue our profits on renewals. As most of our new business is going through regulated, it does cause some strain in the figures as we grow our new business. That's essentially the reason.

David Oti

Okay, great. And if I think about the distributable reserves in the regulated business over 2022, what kind of level do you expect in terms of cash flow?

Joe Fitzgerald

I wouldn't want to guide on the EBITDA at the divisional level, but I think the important point to note on EBITDA versus distributable reserves in regulated is, as I said, we'd expect whatever EBITDA comes through the regulated business for our capital requirements to increase, essentially, in the mid-teens.

So, if you look at the overall Group number for EBITDA, where we've indicated how we expect that to perform, we expect most of that to translate into distributable reserves across regulated and unregulated, less an increase in the mid-teens for capital.

David Oti

Okay, so I should take about 15 million or so off that EBITDA and then that will come through in the cash flow

Joe Fitzgerald

Yes.

David Oti

Okay. And then moving forward beyond 2022 in terms of those distributable reserves, there's just a permanently higher capital costs to the business, is there?

Joe Fitzgerald

Yes, as I said, we'd expect that to moderate after FY22, so we would expect the capital increase - our business is growing, so we will always need a little more capital to support that, but we would expect the growth in said capital to be in the single digits post FY22. In FY22, we still have some impacts of Brexit which continues to cause us inefficiency in the future, but causes us particular inefficiency in the first couple of years.

David Oti

Okay, great, that's very clear. Thank you.

Operator

Thank you. And as there appear to be no further questions, I return the conference to the speakers for any closing remarks.

David Tyler

Well, if there really aren't any other questions - just pausing if there is one - we will bring this to an end. But look, can I just simply say thank you for support. We look forward to continuing a good relationship with everybody and will be back in three months to talk about our second quarter and we wish you a good day.