Domestic & General - H1 FY25 results

Thursday, 21st November 2024

Transcript produced by Global Lingo
London – 020 7870 7100
www.global-lingo.com

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Presentation

Operator:

Good morning, ladies and gentlemen, and welcome to the Domestic & General First Half FY 2025 Results Conference 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 financial statements. In addition, we have included some non-GAAP financial measures in our discussion, a reconciliation for which can also be found in the financial statements. With that, let me hand it over to the CEO, Matthew Crummack.

Matthew Crummack:

Good morning and thank you all for joining us. It's Matthew, CEO here. I've got Joe Fitzgerald, CFO next to me, speaking to you from our Wimbledon office. I'd like to welcome you to Domestic & General's results call for the second quarter of our current financial year. In a moment, I'll give you an overview of developments in the business since our last update. And then I'm going to hand over to Joe, who'll take us through the first half financial results in more detail.

First, however, we are pleased to announce that driven by a supportive market back drop and on the back of our strong trading performance; we are launching a refinancing transaction to address maturities. We have a lender call slated for Monday the 25th, which is next Monday. Monday 25th of November. And we look forward to providing more details in due course. In the meantime, if you do have any queries, please reach out to a member of the Barclay's team.

Let's move on, though, with today's news. On slide two, we have continued growing revenue over the past six months, with revenue of £580 million, up by 8% compared to the equivalent period last year. Within that total revenue figure, we recorded £516 million of subscription revenue, which represents an even stronger 11% growth rate, in line with our strategic focus on high quality subscription revenue.

Likewise, group adjusted EBITDA continued to grow, increasing by 10% compared to the equivalent period last year to £87 million, including the results of our US business, highlighting the quality of earnings flowing from our model. That continued EBITDA growth has allowed further de-leveraging in the business, with leverage now standing at 5 times, based on net debt of £767 million. Unsurprisingly, therefore, we remain financially sound with continued strong levels of liquidity and a robust solvency coverage ratio in our regulated business, which is substantially ahead of capital requirements.

Finally, on this slide, I will pause briefly on our US business, which is performing well and demonstrating great promise, building on the expansion of our partnership with Whirlpool that we've talked about previously. In particular, as of 30th September, we had around 190,000 live subscription customers, up from around 100,000 at our year-end point. And we expect to continue to report strong progress against that metric in the future.

Now turning to our next slide, I'd like to just recap on our strategy, which I most recently covered during the year-end presentation. And as a reminder, for several years, indeed, since 2019, we've been successfully executing a plan to create value for our customers, employees, partners, and investors. And as the business involves, we're now starting to look beyond that plan.

In our international markets, we're increasingly confident of our ability to deliver on the transformational growth opportunity in the US and to exploit significant market potential and headroom in Europe. However, that international growth potential is only made possible by a highly defensible cash generative core UK business, which is the blueprint for success in other markets.

In the UK, we continue to strengthen and extend partner relationships and grow subscription customer numbers through innovative marketing techniques and a compelling customer proposition, and we're very confident in the future growth potential our core UK market has to offer.

The US continues to show excellent potential with really good organic growth, complemented by our acquisition of After Inc. As we announced previously, a joint D&G and Whirlpool team worked hard to secure important enhancements to our joint Whirlpool US relationship, through which we've expanded the scope of D&G's offering to Whirlpool customers, including a wider scope for our subscription programme. We know that this deal is increasing, and will continue to increase, sales over existing and new channels, and we had around 190,000 US subscription customers at our half-year point, up from around 100,000 at the year-end, reinforcing our conviction that we can replicate our successful UK model in the much larger US market.

In Europe, we continue to grow subscription revenue, which is now more than 70% of our total European revenue. And we see really significant headroom for growth in our European markets, which presents an attractive opportunity to scale our business. We expanded our partner base, and as I've discussed on previous calls, we continue to import best practice from the UK whilst we continue to look at innovative and new ways to expand our European offering.

We plan to deliver on our strategy through a group wide approach to providing best in class experiences for both our end customers, consumers, and partners. We'll distinguish ourselves with high quality, customer focused service, and we will use technology and data-driven enhancements in relation to repair solutions and customer communications to further improve our already high service standards. We're going to be product-innovation or

product-development led, including in terms of distribution innovation with partners. And we will continue to encourage customers online in terms of website use, registration journeys, product replacements and repair bookings. We'll also continue our data transformation initiatives via the ongoing consolidation, validation and enrichment of our data sources to drive improvements in pricing, retention and campaigning.

Finally, we'll continue to develop our technology estate, including the build out of a cloud based policy administration system, which will consolidate existing systems and provide greater deployment flexibility.

Before I hand over to Joe, I'll pause briefly on the next slide, which highlights some key features of our business and history. We're now running at well over £1 billion of annual revenue, having breached that threshold in the last financial year, which comes off the back of over 20 years of uninterrupted subscription revenue growth. Our subscription revenue continues to grow at pace and supports EBITDA growth, which exceeded £150 million over the past 12-month period. Our customer retention rate is enviable and consistent, and is supported by the high proportion of consistent subscription revenue across our estate, which comes from our increasing number of subscription customers.

We have excellent, exclusive, very long-term relationships with a large number of high quality commercial partners in both the OEM and the retail space, and they continue to work with us, simply because we're experts at what we do. We bring value to their businesses by bringing reliable value and high service standards to their customers. As I've discussed, we're now also focused on replicating that same successful model in the US.

So with that overview complete, I'm going to hand over to Joe to run through the financial results in a bit more detail. And after that we'll take some questions, which we can either do online through the usual portal or verbally via the operator at the end of the presentation. So over to you, Joe.

Joe Fitzgerald:

Thanks, Matthew and good morning to all of you listening and welcome to our Q2 results call. So turning first to slide five, you can see that our subscription model, which is at the heart of our business, has continued to deliver great results as illustrated by the KPIs on this page. At the top left of the slide, the chart shows that we recorded a rise in subscription customer numbers from 6.3 million at the end of September '23 to 6.6 million at the end of the last quarter, which marks a continuation of our historically strong subscription customer growth rates. This has been driven by a combination of new customer acquisition, despite a marked downturn in the appliance market, and by our strong subscription customer retention rate, which showed a slight year-on-year increase to 86.2% as you can see in the bottom left chart.

In the middle left hand chart, you can see the average revenue per customer continues to increase and now stands at £153 per annum, which is driven by the combined factors of necessary pricing increases and gradual improvement in the average number of appliances

that we cover for each of our subscription customers as we've discussed previously. These factors have combined to deliver growth in subscription revenue to £516 million for the half-year period, as shown in the main chart.

Our next slide examines our principal financial KPIs. As I just outlined, subscription revenue for the period was £516 million, up from £466 million in the first half last year, whilst non-subscription revenue reduced, going from £70 million to £65 million driven by the planned shift to high quality subscription business, which now represents 89% of total revenue for the group.

The lower left hand graph shows the last 12 months EBITDA margin, which held steady versus the equivalent period last year at 13.3%, as we have worked to protect margins despite investing into our US and wider business across the group. The result was a half-year EBITDA of £87 million, inclusive of the result of our US business.

Moving on to slide seven. On this page, we review our revenue in more detail where we break out the results into UK, Europe and other and the US. As the table shows, growth in total revenue to £580 million, included 8% growth for the UK and high early stage growth for the US, partly offset by a small reduction in European and other revenue, which I will talk about in a moment.

Within total revenue, subscription revenue in our UK business grew well at 9%, whilst in our European business subscription revenue grew a very encouraging 12% and now represents over 70% of the division's revenue as we continue to pivot the European business to follow the UK's successful subscription model. US subscription revenue was just over £12 million for the half year, representing very significant growth versus the equivalent half one of FY 24.

Non-subscription revenue, as I mentioned earlier, fell by 8%, which is mostly explained by the reduction in revenue from European non-subscription business. This represents the planned run off of legacy extended warranty term business, which is being replaced by better quality subscription business and so needs to be viewed in the context of the growth of subscription business.

As a result, in total, we expect European revenues to reduce marginally in FY 25 compared to FY 24, but for the European subscription revenue to continue to grow strongly. Overall, for FY 25, we expect group subscription revenue to grow in the high single digits or above, once again.

Moving on from revenue to EBITDA, on the next slide, you can see that adjusted EBITDA for the half year of £87 million rose by 10%, including a small reduction in US early stage losses. Overall, we expect the US EBITDA to be around breakeven for the current financial year, as whilst we continue to invest in the business, we are seeing EBITDA start to flow, and we expect that to continue in the following years.

The EBITDA for our established UK and EU businesses grew well, coming up to £89 million for the half year and driving the EBITDA growth for the group. As mentioned earlier, the last 12 months' EBITDA margin was 13.3%, and we do expect margin growth in the future years due to previous and ongoing investment in capabilities as well as economies of scale.

For FY 25 and beyond, we expect EBITDA to grow ahead of subscription revenue in line with trends from previous years, as the impact of operating leverage is increasingly brought to bear in our results.

Now we'll turn to cash flow for the period. On slide ten. So here, we show our unrestricted cash flow, which analyses the movement from opening to closing unrestricted cash over the six-month period. And to recap the definition once again, unrestricted cash comprises the solvency capital of our regulated business that is in excess of its solvency capital needs, plus the cash and liquid investments of our unregulated business.

So on the first line of the cash flow, you can see our group EBITDA, which excludes the US EBITDA element. We start the cash flow here, with this US exclusive measurement of EBITDA, to best illustrate the performance of our longer established UK and European business.

Next, down from EBITDA, we show the working capital outflow from our established unregulated business, which excludes the Australian run off, which we separate further down the cash flow. And next below that, we show the amount of EBITDA from the regulated business, which exceeds the change in its surplus insurance capital. Again, as we've covered previously, the increase in insurance capital is measured under actuarial solvency rules rather than IFRS principles and any increase in insurance capital will generally be lower than the equivalent regulated EBITDA.

However, it is helpful to think of this last line item as a quasi-working capital movement for the regulated business. The split of group costs between the unregulated and regulated business, and their timing of settlement can create offsets between these two lines. So, we also find it helpful to view both of these lines collectively as a group working capital type movement from EBITDA to operating cash, rather than to consider them in isolation.

After these working capital and quasi working capital items have been deducted, we have a view of operating cash flow of the established business prior to CapEx. And in effect, this important measure demonstrates the ability of our business to generate cash to support debt service costs, invest in growth and expansion in new markets.

So, as you can see from the slide, this measure of cash conversion was 70% for the half year period. And as a general point, we would expect and want pre-CapEx cash conversion to be less than 100% because that working capital strain goes hand in hand with ongoing growth. However, at this stage, the 70% conversion continues to include the impact of running off certain legacy non-subscription extended warranty term business in our European markets, and this adversely impacts working capital.

This impact has reduced since FY 24 and will continue to reduce over the course of the year and into next year, which will allow pre-CapEx cash conversion to normalise into the expected 80% plus range as we've guided previously. After that measure of operating cash, we then deduct capital expenditure of £16 million for the six-month period to show a post-CapEx measure of operating cash. We expect CapEx in the second half of the year to be broadly in line with the first half as we've seen here.

After that, we deduct £3 million of working capital flows associated with funding of the Australian run-off, which are separately analysed for transparency and which are very much now on a downward trend and will be immaterial in FY 26.

Next, the net cash flow for our US business is shown, which includes both net US EBITDA losses and working capital requirements. We expect and plan for cash requirements for the US business for FY 25 and beyond to continue to be significant and to exceed FY 24 cash requirements, given the working capital strain associated with fast growth. We will, of course, continue to analyse this line and guide separately for clarity. The deduction of these items results in our measure of operating free cash flow of £31 million, which is similar to the result for the equivalent period last year, notwithstanding the higher US spend this year. We consider this result to be reflective of a well-funded and ambitious business, which with the support of its shareholders, continuing to invest to secure revenue and EBITDA growth.

This operating free cash flow amount is then reduced for debt service costs and tax payments to give a measure of free cash flow before M&A and significant items. And to close things off, we then show incoming cash flows as relating to debt funding, which for this period, includes a small increase in RCF borrowings over the half year period, which is associated with the US expansion analysed above and includes the acquisition of contract rights as part of our previously announced deal with Whirlpool. We also show separately significant items relating to one-off costs.

The net result is a closing unrestricted cash amount of £37.3 million, which is in line with earlier guidance. And for the current financial year, as guided just now, we would expect operating cash conversion before CapEx to rise, but we would expect an overall cash outflow for the year as the US growth continues before cash flow turns strongly positive again in FY 26.

Finally, moving on to our capitalisation slide, net debt and the total leverage ratio at the end of the period were £767 million and 5.0 times, respectively, improved by 0.1 times from the last quarter end, with leverage shown here on a post-IFRS 17 basis of EBITDA, consistent with recent quarterly presentations. Following on from this, the structuring EBITDA figure of £165 million takes into account two factors, which are not included in the reported figure. These include a £2 million add-back for last 12 months' US losses, given that we expect to be break-even or better in the US going forward.

The second factor is a £9 million adjustment for baked-in profit on business which has been already written over the last 12 months but not recognised in the P&L under IFRS revenue

recognition rules, and we adjust here to better illustrate underlying performance. Overall, the group remains in a strong financial position with good levels of liquidity and a business model, which is proving itself out with excellent revenue and EBITDA growth.

Matthew and I would now like to open the call to any questions.

Q&A Session

Operator:

Thank you. And if you do wish to ask an audio question, please press star one on your telephone keypad. If you wish to withdraw your question, you may do so by pressing star two to cancel. Once again, please press star one to register for a question. We'll pause for just a moment to compile the Q&A roster.

Matthew Crummack:

Thanks very much, operator. We actually have some questions online here. So whilst we're teeing up calls on the line, we'll take some of the ones written down here. Joe, perhaps you could help us out on these here. We've got one from Fabio here. Can you explain the mechanics behind contract assets and the impact on working capital?

Joe Fitzgerald:

Sure. And I think there's two related questions on expansion in US working capital and what is the steady state working capital. So I'll take those three as one if you like. So the reason we have working capital outflow when we grow our subscription businesses is that we have upfront costs of customer acquisition. So that might be marketing costs borne directly by Domestic & General or upfront payments to the partners for their role in distributing the policies. And then obviously what happens post that is that, we serve our customers on a monthly basis thereon. And we obviously make profit from those contracts.

I think I've said on previous calls, our break-even point from when we acquire a subscription, customer is typically on a cash basis just after two years, and then we're into cumulative cash generation thereon. So in a growing book where we're adding new customers, we do have some strain. And that's particularly so in the US, which is obviously a very young book of subscription customers.

What I would say is what should happen over time and in a growing book is we should trend towards where we are in the UK and Europe and where we expect steady state to be once we exclude the European run-off term business is operating cash conversion in the 80s. Now, in a flat book without growth, which we never want to get to, operating cash conversion would get to 100%, I suppose, but we want to be in the 80s because it's representative of strong growth. And that kind of level in the established business allows us to invest in the business to expand in new markets. And that's what we want to see going forward. And

what we will see actually, once we've got rid of the distortionary elements of the European run-off.

Matthew Crummack:

Thanks, Joe. I hope that's clear. Fabio, thanks for your questions. Hopefully I think that's answered all three there. Operator, do we have any questions on the line, please?

Operator:

Yes, we do have our first question coming from the line of Konstantin Chinarov from Aptior Capital. Please go ahead.

Konstantin Chinarov:

Good morning and congratulations with the results. I have a few questions, please. So my first one is, when you distribute insurance or extended warranty products in the UK, is it fair to say that you clearly disclose that there is a commission paid to a distribution partner so that the customer is aware of that? And if so, could you please confirm that the amount of such commission is also clearly disclosed? So that's my first question.

Joe Fitzgerald:

I presume you're asking the question in relation to the recent motor finance case. No, we in common with, I think, the vast majority of insurers, in fact, I don't think there's any insurers who disclose commissions payable when they sell a contract, do not disclose the precise amounts of commission that we pay to partners. I think I've been relatively open on these costs before, and I think it's discernible from our accounts, we pay circa 25% commission to partners on average. Obviously, those results vary depending on the activities performed, those partners, but we do not disclose when selling the contracts. That's not in any FCA regulation as we stand today and it's not customary practice for basically any of the insurance industry to do so.

Matthew Crummack:

Yeah, just to widen that out a bit, I think, and perhaps pre-empting any other questions on this subject. I think the specific ruling in the court case doesn't bear any relation to the insurance sector. And so obviously, Constantin, we're always looking for read across on anything because that's kind of our job and we always take a lot of care over assessing what's going on around us. But that particular case focused on motor finance specifically and potentially across to lending. And not only the court focus on that, but the FCA's response is also around that too. So we see no relation to insurance sector or more importantly, to us.

Konstantin Chinarov:

Yes, it sounds like at this juncture we shouldn't think about any provisioning or anything like that. Any impact until there is clarity. Yeah. And then could you also please confirm what proportion of the acquisition costs we see in P&L is commission compared to the marketing fees? And then maybe you could clarify the nature of the non-commission acquisition costs. So that's my last question.

Joe Fitzgerald:

I don't think I have that split directly to hand, to be honest, Konstantin. But as I said, our commission broadly is about 25% of revenue. So you kind of take the balance, I suppose for everything else, but broadly. The nature of them is really our marketing costs borne directly by Domestic & General. So that might be that we run contact centres that distribute our plans, both inbound and outbound. We have digital costs associated with our post-point-of-sale campaigning, other campaigning costs, such as email, mail distribution. So basically anything of that kind of nature, digital search costs, etcetera, would be included in the balance, if you like.

Konstantin Chinarov:

Got it. Okay. Thank you.

Joe Fitzgerald:

Thank you.

Matthew Crummack:

Thanks, Konstantin.

Operator:

And once again, if you would like to ask a question, please press star one. Your next question comes from the line of Marcus Rivaldi from Jefferies. Please go ahead.

Marcus Rivaldi:

Hi. Good morning, everybody. Thanks for taking my question. I just wanted to come back on that, your response on the question on motor finance. I appreciate it looks very, very different, but - and the Court of Appeal did take a bit of a leap ahead of FCA rules. But there has been - I've seen some legal analysis. Maybe these are people trying to drum up business, whatever it may be, but trying to talk about potential jump across risk into insurance products. So could you maybe give a bit more detailed response on why you really think the business model is currently set up, is immune to any risk of ambulance chasing lawyers, whatever it may be, looking to come back to legal in general for a refund of commissions?

Joe Fitzgerald:

Yeah. I mean, as you say, I think there are possibly people trying to take advantage of the situation, if you like. And we've taken extensive advice ourselves, as you can imagine, a responsible business would do so. I mean, essentially, when you look at the nub of the ruling, it's not about FCA regulation. It's a point of common law. And that point of common law is about the fiduciary duty of a broker to its customers. And essentially, the rule basically says is that the broker had a duty to source the best product for their customers. And that's really the nub of it.

Now, we do not distribute through brokers and we do not do advised sales. So we think our distribution model is entirely different to motor finance to start with, if you like. And I think as a secondary point, our product isn't necessarily a commodity, like loans would be. I'm sure there are better loan providers than others. But in essence, the main point for the customer is the interest rate that they're charged. Whereas obviously we provide a service. So even if you, I guess, felt that we did have a fiduciary duty to find someone a better warranty product or our partners did, I think you'd get to a point where you say it's not a commoditised product. It is very difficult to draw a firm conclusion on that.

So in all honesty, we're very confident we don't have a residual issue here based on the advice we've been given. But obviously it's a developing situation and it's going to go to the Supreme Court, we think, and possibly very quickly. I think I would probably pay heed to Rachel Reeves' comments as well - in her Mansion House speech where I think, they have a concern about the spread of it as well. But what I'm saying, I think, is if we're caught by it, I think the whole insurance market would be, because we do not do broker or advised sales. And that is therefore the lowest barrier you can have.

Matthew Crummack:

It's a different model isn't it.

Joe Fitzgerald:

Very different.

Marcus Rivaldi:

Okay. Thank you. Can I pull up with a couple of other questions on the results as well, please?

Joe Fitzgerald:

Sure, Marcus.

Marcus Rivaldi:

Please. Thank you. I just want to ask quickly a question on the quarterly run rate in Europe, it seems like a slightly weaker second quarter in the European business. Wonder if you could just touch on that.

Joe Fitzgerald:

Weak in terms of revenue?

Marcus Rivaldi:

The PBT, I think the run rate over Q1 was I think it was around eight versus ten, I think in the first quarter, and I think it's more expenses driven than revenue per se.

Joe Fitzgerald:

I'm not really familiar with what number you're looking at, to be honest. But perhaps if you put it in as a query, post the call, we'll answer that.

Marcus Rivaldi:

Okay, great. And then maybe just finally - and I guess this will all be somewhat dependent upon the refinancing that you'll be looking to launch shortly. But on the unrestricted cash end of the year, have you got any sort of guidance you can give around how - what sort of level of unrestricted cash level you would be comfortable running down to before you start feeling a bit uncomfortable with that sort of level?

Joe Fitzgerald:

We've got a plan that allows us to invest in the business. And we do see that, once we've got these short-term cash outflows with the legacy term business out the way, we expect to be highly cash generative next year. So I'm reasonably comfortable with a reduction in the unrestricted cash basis towards the end of this year, because it will be a very short-term impact and still have a good level of unrestricted cash. We're a very cash generative business, and obviously we have high liquidity as well for any opportunities that might arise, through the revolving credit facility.

So, we've got a very comfortable financial position in terms of liquidity, I'd say, given the cash generative nature of the business. And ultimately, the reason we're reducing unrestricted cash this year is planned investment. Obviously we have choices we could make there, but we are investing for growth.

Marcus Rivaldi:

Great. Thank you very much.

Joe Fitzgerald:

Thank you.

Operator:

I'm showing no further questions at this time. I'd like to turn it back to the CEO, Matthew Crummack, for closing remarks.

Matthew Crummack:

Well, thanks very much indeed. Well, if there are no more questions, we've had no more in online. Thank you for joining us again, and we'll see you next time. Thanks very much.

Joe Fitzgerald:

Thank you.

Operator:

Thank you. And this now concludes our presentation. Thank you all for attending. You may now disconnect.