Market Intelligence
by Oxbow Partners

Direct Line reports 40% growth in operating profit at H1

03 August 2021

Summary

- Underwriting profit of £229.3m, +59.7% YoY
- Operating profit up 39.6% to £369.9m due to strong prior year reserve releases and low weather-related claims
- Current year attritional loss ratio improved by 3% pts to 62.3%
- Attritional benefits aided by prior year reserve releases, removal of COVID-specific claims and weather – COR 6.1%pts better than 1H20

Analysis

Direct Line has reported its H1 2021 results this morning, with a 40% increase in operating profit. Operating profit increased by £105.0m to £369.9m, stemming broadly equally from strong prior-year reserve releases, agreeable weather conditions, better investment returns and the elimination of excess COVID claims in Travel and Commercial (See page 2 for a detailed chart). The combined ratio for the group improved significantly to 84.2% (1H20: 90.3%) thanks mainly to the factors noted above. Adjusting for normalised weather losses the combined ratio was 86.3%, still 4.1%pts better than 1H20.

Slight drop in new business in H1

Direct Line has managed to continue to grow its own brand portfolio by 1.3% YoY during H1, with growth across Commercial direct own brands, Green Flag and Home more than offsetting declines in Motor. Both NIG and Direct Line for Business in Commercial saw GWP growth of c16% in 1H21 showing evidence of the new platforms and systems working to deliver results. Total policies reduced 1.1% as lockdown restrictions impacted partnership volumes in Travel. Overall GWP declined 1.5%.

Motor claims frequency still low

The first half of 2021 saw similarly low levels of Motor claims frequency to that of 2020 but the business is seeing increased frequency in H2 with a return to previous driving levels, particularly at weekends. The reduced frequency in the first half has driven down market premiums and with the increased driving in H2 DLG expects the Motor loss ratio in 2H21 to be around 79% vs 53.1% in 1H21.

The Oxbow Partners View

These results are undeniably strong in terms of the increase in the operating profit of the business, however much of the benefits have come from good weather, good outcomes on bodily injury claims and a return to normality in terms of direct COVID claims. Direct Line is still on a journey to transform the business. The tech aspect is largely done but the margin benefits are yet to fully come through and the next stage (growth) is a different challenge. The Commercial business is leading the way, the rest now needs to follow.

Paul De'Ath (Head of Market Intelligence)
pdeath@oxbowpartners.com
+44 7799 416 704

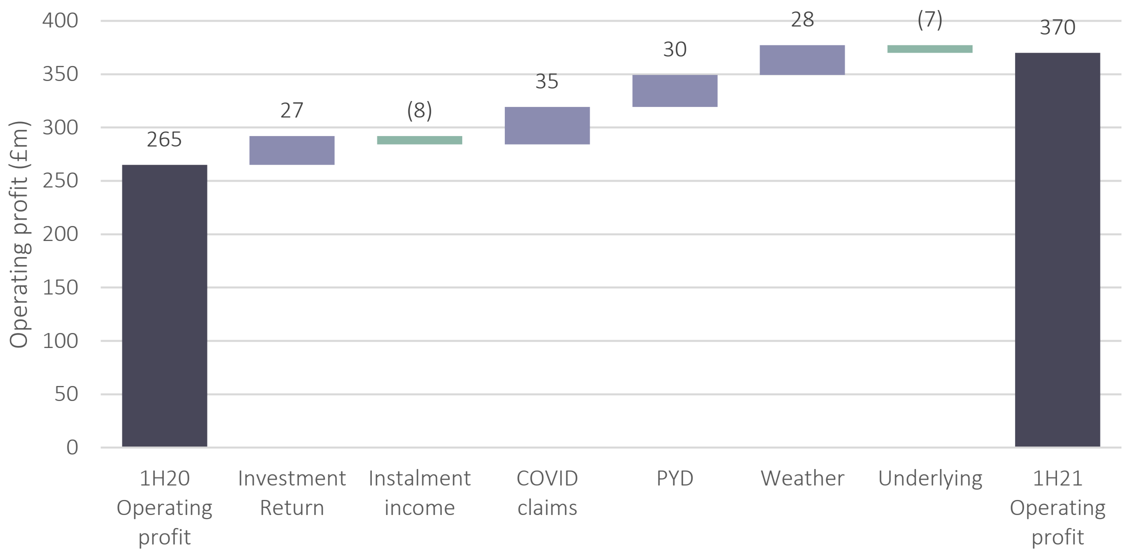
Hélène Miravalls (Analyst)
hmiravalls@oxbowpartners.com
+44 743 265 2830

Chris Sandilands, ACII (Partner)
csandilands@oxbowpartners.com
+44 203 947 8624

Operating profit drivers

Given the significant rise in the operating profit year on year, we have delved a little deeper into the main drivers of the £105m increase.

Figure 1 – Operating profit has increased significantly due to COVID, weather and PYD, Source: Company reports



- **Investment Return:** Has increased by £27.1m in the first half of 2021 to £68.4m following £16.8m of realised and unrealised gains across DLG's investment property and credit portfolios (H1 2020: £13.9m of net realised and unrealised losses). DLG's investment strategy has been refreshed and aims to continue delivering a suitable risk-adjusted investment return commensurate with their risk appetite.
- **Instalment Income:** Instalment and other operating income, primarily driven by premium and claims volumes, decreased by £7.8m to £72.2m. Instalment income fell primarily due to lower Motor GWP, whereas other operating income reduced due to lower Motor claims frequency and lower recovery after accident volumes.
- **COVID claims:** The impact of COVID in last year's report was most prominent in the Travel (£25m claims) and Commercial (£10m business interruption claims) segments. This has subsided as lockdown restrictions ease and new policy wordings have been adjusted to exclude COVID. The impact on Commercial is less marked as the frequency of claims also reduced during lockdowns (and has picked up again in 2021).
- **PYD:** 2020 was a low watermark for reserve releases, sitting at £123 in H1 2020. As expected, 1H21 experienced an increase in profit due to higher prior year reserve releases (£153m). H1 2021 reserve releases were £30m higher due to favourable development on large bodily injury claims in Motor (£18m), and escape of water claims in Home (£15m), partially offset by small reserve additions from Commercial and Other.
- **Weather:** Extreme weather costs in H1 2021 amounted to £0 compared to £12.7m in H1 2020. Most of the weather benefit has come from Home and Commercial, which experienced a £39.4m and £18.3m increase in operating profit respectively, with Commercial also seeing a reduction in its combined ratio to 90.2%.
- **Underlying:** Progress has continued in improving the underlying profitability following a reduction in operating expenses (£30m reduction excluding levies, amortisation and depreciation, which increased by £20.6 million, primarily due to the roll out of the new Motor platform) and good current-year trading across the book. Despite the improvement in performance of the business, this has been masked by claims frequency starting to increase post lockdown (though still at a lower rate than 'normal').

Figure 2 – Key figures from Direct Line's results, Source: Company reports