AozoraStep

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Exit Direct Line Insurance Group: Some headwinds could slow the turnaround

Company:	Direct Line Insurance Group (DLG LN)	**Market Cap:**	£2.7bn
Industry:	Insurance	**Solvency II:**	197%
Country:	UK	**Revenue:**	£3.5bn*
Date:	20th June 2024	**Net Income:**	£300mio*
Dividend:	-	**Net insurance margin:**	>10%
Entry:	£2.5bn	**Exit:**	£2.65bn (+6%)

*estimated based on 6% net insurance margin in motor

Why exit Direct Line Insurance?

- Mostly to reallocate capital to another opportunity
- Political risks from a Labour government that wants to ban the sale of new petrol cars by 2030 instead of the current 2035 target
- More competition from new entrants
- FCA investigation ongoing with political pressure from Labour to reduce consumer insurance prices

Tougher competition and regulatory headwinds

Although the main reason for exiting Direct Line Insurance Group is higher implied returns elsewhere, there are a few other reasons to be cautious. On the one hand, competition heats up with large global players seeking to take market share in the UK home[1] and car insurance market[2]. At the same time, a Labour government is thought to seek a ban on petrol vehicle sales from 2030 instead of the Conservatives'

[1] Allianz UK rolls out new home insurance product | Insurance Business UK (insurancebusinessmag.com)
[2] Markerstudy Group and Atlanta secure FCA approval for merger | Insurance Business UK (insurancebusinessmag.com)

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extended deadline of 2035. The impact this could have on used vehicle prices is best described by UK vehicle retailer Vertu Motors CEO Robert Forrester, who expects the projected legislation to have a large impact on new vehicle supply and rising used car prices[3]. Stellantis recently flagged that the proposed legislation of fining OEMs for producing too few EVs or too many ICE vehicles could reduce car production in the UK[4]. According to Direct Line's management, 40% of car insurance claim inflation are due to used car price movements. While the valuation factors this in, it remains a risk, and Labour is also urging the regulator to keep car insurance prices low[5] [6].

Potentially higher returns elsewhere

While overall Direct Line is facing some headwinds from the government and regulators, I generally believe that the Capital Markets Day on 10th July is going be a success and a revaluation should follow. However, due to other opportunities that potentially yield higher returns, I have sold Direct Line and reallocated the capital to Oil States International. The market might also react harshly when Direct Line shows a loss of client count and negative motor insurance margins in H1 2024, which in turn could present itself as a new entry.

[3] https://investors.vertumotors.com/custom/126811.pdf

[4] https://www.bbc.co.uk/news/articles/cn44v3e7nggo#:~:text=Stellantis%20makes%20electric%20vans%20at,Luton%2C%20with%20more%20to%20come.

[5] https://www.postonline.co.uk/personal/7955395/how-labour-could-reduce-the-cost-of-motor-insurance

[6] https://www.mirror.co.uk/news/politics/labour-promises-crack-down-unfair-32952223

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