Q1 2011 Sales and Revenue Release - Operational Update

Company Participants

- Johan van Zyl, Chairman and Group Chief Executive
- Kobus Möller, Financial Director

Other Participants

- Brian Mushonga
- Francois du Toit
- Larissa van Deventer
- Michael Christelis
- Risto Ketola

Presentation

Johan van Zyl {BIO 4080290 <GO>}

Thank you so much. Good afternoon, ladies and gentlemen. Thank you for joining us on this conference call after the release of our operational update for the four months to April 2011. Kobus Möller, our Financial Director and Wikus Olivier, the Head of Group Finance are also with me on the call here today.

Let me start by saying that I am very pleased to report on overall solid operational performance for the Sanlam Group in the first four months of 2011. As a result, we're achieving and we what we think is a particularly challenging environment for our business.

As anticipated, the South African economy is reflecting slow, yet steady, progress towards recovery. I know that the growth rates that we've seen in the past two months -- the past two quarters have been fairly spectacular. But we haven't seen the same reaction in employment levels and so. We've seen relatively high consumer debt levels, together with sharp increases in the cost of living, which impacted on disposable income, especially in the middle income market.

As a low short-term interest rate environment also continued to hamper demand for single premium guaranteed solutions. Some of the African countries in which we operate, are also still experiencing recessionary conditions, but with higher resource prices providing some support for future recovery. The South African investment market remained pretty volatile in the first four month period to the end of April 2011, which is inline with what we've seen elsewhere internationally.

The rent spends, particularly on a relative basis, continued to impact negatively on the growth of our non-South African operations. And particularly, if we take it relative to the first four months of last year.

Our strategic focus on earnings growth, cost and efficiencies, optimal capital utilization, diversification and transformation provided us with a resilience to perform under these, what we, as we've said, regard as difficult conditions.

Our resilience is particularly evident in the following key things. Firstly, overall new business volumes increased by 11% on the first four months of 2010, with both life and investment business contributing to the growth. We've seen the continuance of healthy net fund inflows, with a particularly satisfactory contribution from the life business. We've also seen the profitability of new life insurance business being maintained, which is a testimony to our focus on writing quality new business.

We've seen strong growth in operating profits of some 15% and we've seen precipitory levels in all businesses remain at acceptable levels that we've been reporting on in the past few years. And we still have a very healthy solvency position.

Let me provide you with a quick overview of the results. Key aspects of the operational results for the four month period are as follows.

Firstly, let me start with new business. Overall, new business volumes increased 11%, with new life business up 12% and new investment business up 10% for the first four months of -- on the first four months of 2010.

Sanlam Personal Finance recorded a marginal increase in new business volumes. Strong growth in recurring premiums and life business and in the Glacier single premiums were offset by continued weak demand for guaranteed solutions. And also, a 26% reduction in the Namibian Unit Trust sales in a very competitive environment over there from a very high price that we've had in 2010.

In Sanlam Developing Markets, new business grew by 35%. We've seen a reduction in rollovers of discontinued single premium business and a continued focus on the quality of new business in South Africa. And this limited new business sales to the 2010 levels. So although we are writing at the same level, we think the quality though is quite significantly improved. The rest of Africa operations reported another sterling performance with most territories achieving growth in excess of 50% despite strong ramps relative to the first four months of 2010. And we've also seen improved consumer confidence, supporting healthy growth in Sanlam UK's new business sales.

In our Employee Benefits business, we grew new recurring premium sales by a satisfactory 25%. But this growth was more than offset by a reduction in the volatile single premium business, which is quite typical of this market, where you have jointly current business.

At Sanlam Collective Investments, Sanlam Private Investments and Sanlam Investments is non-South African operations at a very strong four month period and contributed to a 12% increase in the investment trust's new investment business.

Finally, in terms of profits, our net result from financial services or what we call or like to call net operating profit, increased by some 15% with all operations apart from Sanlam Investments contributing to this growth. Once-off items and expenditure on new growth initiatives impacted on Sanlam Investment's operating profit and we can talk about that later on during question time.

On the capital, a few remarks. Sanlam remains well-capitalized, with a healthy solvency level. Sanlam Life Insurance levels limited set pretty capital covered. It's a capital adequacy requirements by 3.2 times on the 31st of March, 2011, after allowing for the dividend payable to Sanlam Limited.

The first priority for the utilization of the Group discretionary capital remains strategic investment in growth areas. We've earmarked approximately 3 billion at the end of 2010 for investments in future growth initiatives, predominately in India and the rest of Africa. Good progress has been made in the various initiatives that are currently under investigation.

Now, due to consideration -- due consideration is given to the Group's capital structure, access to funding sources and the potential timing of new strategic investments in allocating discretionary capital. Any portion of discretionary capital that is not likely to be utilized for acquisitions within acceptable time frame is available to full distribution to shareholders. Share buybacks will be considered in terms of shares price weakness, as the most efficient and value accretive manner of returning capital to shareholders at present.

An amount of 1 billion was earmarked for share buybacks at the end of 2010, of which some 715 million was utilized to acquire a 26.9 million shares in the market. Now, most of this was done before the dividend was paid. If you allow for that, we essentially acquired those shares for a net price of roughly R26 a share. And which is substantially lower, when in the embedded value that we see now. Our focus remains on identifying further opportunities to optimize capital utilization in the Group.

To conclude, we remained confident of Sanlam's future growth prospects, with Africa and India being key focus areas to drive accelerated earnings growth of the medium to longer term. Over the short-term in 2011, it is important to take into account our very strong performance in 2010, as well as stronger second half performance in 2010 by most of the Group's other operations, as investment markets recovered. So, it's all about the base being pretty high last year.

The earnings growth reported for the first four months of 2011 may therefore not be necessarily be maintained for the remainder of the year. In addition, investment markets are expected to remain volatile for the remainder of 2011, which will impact on fund-based fee income to returns in the Group's capital portfolio.

The Group remains exposed to a number of external factors. Firstly, a risk played by the Group over the short-term is a deterioration in the economic recovery in South Africa and the rest of Africa, coupled with a sharp downward correction in investment markets.

And I think secondly, the regulatory environment in which we operate will continue to change and develop in future, consistent with the prior few years.

The Retail Distribution Review, RDR in the UK and the implementation of solvency assessment and management, which is our own South African equivalent of the European Solvency II regime, will have the biggest impact in the near term. But we're facing regulatory change on the variety of fronts that will impact our business. And I am ever quite confident that we have succeeded in building in the resilient and diversified group that will continue to prosper, and face of these risks and challenges. We have the necessary fields and depth of staff and management to address these issues as they transpire.

Also, our strategic focus on maximizing shareholder value through optimizing returns on Group equity value remains the main objective that we're driving. The target is to outperform the Group's cost of capital on the substantial basis by quite a margin. The investments in future growth opportunities as outlined before are key in driving this target and therefore, the major emphasis that we give in these opportunities.

Thank you. I will now open the call for questions from the audience, and we look forward to interacting with you.

Questions And Answers

Operator

Thank you, sir. [Operator Instructions]. Our first question comes from Michael Christelis from UBS.

Q - Michael Christelis {BIO 15233664 <GO>}

Hi, good afternoon, guys. Three questions if I may. Firstly on SDM, I noticed the comment of India. So, if you could, maybe give us some color on what's happening in India at the moment in terms of sales growth there? And if you could just talk a little bit about the split of sales within Africa? Are we still talking about predominately Botswana or in the splits volumes even after when some of the other new territories. That's the first question.

The second question, your comment on margins being roughly where they were a year ago, given that very strong growth in certain sector that doesn't always imply that you are getting some margins squeezed in SDM. I wonder if you can just comment on that?

And then, thirdly, on the financial services income that's up 15% now. If I look at the run rate, it's not due dissimilar to half two last year. I wonder, if you can just give a bit of color as to whether the like of SDM, Sanlam, et cetera are showing similar sort of run rates as what we saw last year towards the end of last year. Or was is it something else that you can net financial services income number.

A - Johan van Zyl {BIO 4080290 <GO>}

Okay. Let me just start off with India and the performance there on, with respect to new business. You would recall last year that we had to really come with a whole set of new products and we had to get all the products approved because of the major changes that we've seen at the product level in terms of the regulations in India. We are also reporting the, a bit of a time lag in their reporting structure, with respect to India. So, they were essentially still reporting on, while the rest of the country is in the first four months, there were really talking now reporting in India, with respect to the immediate aftermath of those changes.

And I must say surprising, we were able to come with growth or sales levels at exactly the same levels before the changes, which I think is a remarkable one. Given that in India in total, we've seen insurance sales dropping by between 40 and 50% overall. So, we were flat. And given the first part of this year, we've even seen improvements on those levels. So I think that is one of the -- being flat is great, where everybody else dropped off by about 40% or even more in some case.

With respect to the African countries where we see Botswana is still by far the biggest. We've seen quite good performance in Botswana. But increasingly, we've seen some of the other countries, particularly places like Ghana, Zambia and so forth, also coming through growth rates of essentially more than 100%. So, doubling the growth that we've seen in the first half, the first four months of last year.

So, overall, our expectation that we have in their relatively mature business in Botswana, but still performing at good level in spite of I think the tough economic conditions that they're experiencing and the strengths that they've had, doing quite well. But with the effect of lower basis in most of the other countries that we are operating coming through.

Kobus would you like to say something on the margin, which seems to be a squeezed. It's not what we've experienced.

A - Kobus Möller

No, I think, in general, the margins are very similar to what we have at last year, I think from what you could gather, the slightly lower sales in South African business in SDM, higher component or higher percentage in the African growth at slightly higher margins. So there is a bit of a mix giving a slightly higher margin in SDM.

In SPF, we have seen some shifts from risk business to savings business on the recurring side, the slightly lower margins. But on balance, the margins are very similar to the last year, on average.

A - Johan van Zyl {BIO 4080290 <GO>}

Yes. And I would see the changes in margin that we've actually seen is much more, we can much more contribute to the product mix rather than the products and the margins, see margin pressure on particular products.

In the 15% contribution and operational profits being up, I think we've seen most of the business like you would recall last year SCM did extremely well. They have again done well of the base and made a positive contribution.

Santam as well performed fairly well. SPF did develop. But their the base is much more stable and bigger. So that you can't expect them to come with 15%. So, a bit lower than that. But really I think the upside came from mainly the developing markets business, while we've been writing substantially more business through the past year, as you'd expect that sooner or later to come through on the operating line on that.

Q - Michael Christelis {BIO 15233664 <GO>}

Excellent. But truly the new business growth you've seen in SCM would hurt your financial services result, because of the higher commission volumes.

A - Johan van Zyl {BIO 4080290 <GO>}

Yes.

Q - Michael Christelis {BIO 15233664 <GO>}

So you're just saying that...

A - Johan van Zyl {BIO 4080290 <GO>}

Relatively, on a relative basis. But remember within South Africa, we've said that we will feel effect.

Q - Michael Christelis {BIO 15233664 <GO>}

Yeah, okay.

A - Johan van Zyl {BIO 4080290 <GO>}

And there we've -- it's exactly the same situation that we were in a few years ago. We had the same sales volumes excluded. But we achieved that through these up con down call centers. The moment we realized the quality of business is not the same, it's better to write less. But based additional hurdles in. And this is what essentially we're doing. So, by concentrating on quality and really managing lapses well, I think you create much more shareholder value than just growing the top-line.

Q - Michael Christelis {BIO 15233664 <GO>}

Great. Thanks Johan.

Operator

Our next question comes from Risto Ketola from Standard Bank.

Q - Risto Ketola {BIO 4929572 <GO>}

Yeah. Hi Johan, its Risto here.

A - Johan van Zyl {BIO 4080290 <GO>}

Hi Risto.

Q - Risto Ketola {BIO 4929572 <GO>}

A couple of questions around the CapEx for now. You have about 160 million treasury shares now. And some of that as you've been holding to like 12, 18 months. Is there any reason why you're not canceling those shares? Is there a tax issue or anything like that?

A - Johan van Zyl {BIO 4080290 <GO>}

No. I think it's something that we will do in the foreseeable future. I think it's -- we just do it on our own, through a regular basis. So we'll write until we've got a quite a chunky bit nailed there.

A - Kobus Möller

But there are not tax issues. The way we see treasury shares, we have to apply for reissuing it anyway. So, we treat, putting treasury shares back into regulation exactly as the new share issue. So, for us, it's not an issue. It's being parked there and I think in the foreseeable future, we'll cancel them.

Q - Risto Ketola {BIO 4929572 <GO>}

Okay. I didn't know you had to get a permission to reissue. I mean, obviously that is quite a big safety net from a government's perspective. Then related to the capital amount, you stocked the 4 billion expense. You spent about 750 on barbdex. You should have retained earnings of over a billion again. I mean, the email I've received on the results talks about 3 billion discretionary capital.

A - Johan van Zyl {BIO 4080290 <GO>}

Yeah, I think the retained earnings were around about a billion. I'm not sure where you get that, because our dividend policy is essentially to pay out most of...

A - Kobus Möller

We weren't -- any of our operating profit to the excess before you finalize the dividend at the end of the year. I mean, because in terms of our dividend policy, we'll pay all of that as a dividend.

Q - Risto Ketola {BIO 4929572 <GO>}

Okay, that makes sense.

A - Johan van Zyl {BIO 4080290 <GO>}

And just to margin as well, in terms of your, we'll have to calculate the capital on or retrieve the capital with the return on the shareholder firms. We assume that that will actually be utilized to fund the growth of the life businesses. So, again, we won't have that until, at the half year stage or the full year stage. And we actually do the calculation of the capital requirements for the life business again. So, for the moment, there won't be any additional -- addition or the subtraction of this capital and all of that.

Q - Risto Ketola {BIO 4929572 <GO>}

Okay. Yeah that makes perfect sense. Then, last question is on UK. I mean, you did massively well in your UK operations. And am I a lot of sales on an emerging basis, will you own 100%?

A - Johan van Zyl {BIO 4080290 <GO>}

All of it.

Q - Risto Ketola {BIO 4929572 <GO>}

And has there been some fundamental change in terms of how hard you're driving this business, because these volumes are quite, we find it immaterial?

A - Johan van Zyl {BIO 4080290 <GO>}

Yes, they are starting to get material. We don't -- we're trying to do our best without and trying to maintain some margin. But the market is quite tough over there. So, while the flows have increased quite a bit, we're not necessarily making massive margins.

These, most of what we do over there is on the front management type, really the -- an insurance rep is, and the margins are relatively low. So, most of the benefits that we actually get are downstream, not necessary in the insurance business, but rather in the asset management operations. And hopefully that's where, we will get to some scale. We, at presently, we still subscribe. And in the next year or so, we'll look forward to this business, to start making meaningful contributions. But we're well on track.

Q - Risto Ketola {BIO 4929572 <GO>}

Okay. I'll have to ask a question about the downstream business, because in earnings commentary, only negative seems to be Sanlam Investments. And I'm just wondering, what is the issue there?

A - Johan van Zyl {BIO 4080290 <GO>}

The biggest thing, the biggest difference between this year and last year is that, after the first four months, this business is under, at quite substantial performance fees. And this year, we didn't perform as well at the time when we measured, we hoped that, and looking forward, the prospects are certainly there.

We've had good months since then. It is just when you measure and there has been a major issue there. The other thing, as we started a few new ventures in India or so, with that and if you're really running adjacent on, I think two or three new ventures that we have. But between these two things, the new businesses and this particular one-off, I think it explains virtually everything.

Q - Risto Ketola {BIO 4929572 <GO>}

Okay, and that's fine. Thanks a lot.

Operator

Our next question comes from Larissa van Deventer from Deutsche Bank.

Q - Larissa van Deventer {BIO 19822279 <GO>}

Thank you. Hi, Johan.

A - Johan van Zyl {BIO 4080290 <GO>}

Hi, Larissa.

Q - Larissa van Deventer {BIO 19822279 <GO>}

Few questions please. The first one, could you -- and it's a two part question I suppose. Could you give us a little bit more insight to your increase in the investment opportunity in Sri Lanka that you mentioned. And considering the delay in being able to send that money, have you -- do you have plans to change your discretionary capital or are you going to keep that mainly in money market?

The second question pertains to SCM in South Africa. Old Mutual reported 48% growth in their first quarter. I understand your comment about quality. But my understanding is also that you consider this market to be really steady and saturated. What would it take to drive sales again in this marketplace?

A - Johan van Zyl {BIO 4080290 <GO>}

Okay. I think to share an issue, we're working on trying to structure the deal optimally. It is -- I think we're well advanced in our thinking, in the negotiations in a way we are. It is just putting something that makes sense for us and shareholders. I mean, we could have done the deal substantially earlier and probably paid 10% more.

So, it's really about coming with something that is optimal. It is time-consuming and so. But I think we've done a lot of work that places us on a very good position. Just on the surplus capital being in cash, I think we were quite happy to have it in cash simply because the investment market. If you look at it from the beginning of year from now, it's actually been down, if we had it in equities. So, we would have lost some money. So, at least now we've gained a little bit, albeit at a very, very low rate. So, it's all relative and what comes around and what goes around.

I think we are ready to move in the next month or so, and we will inform you when we have an appropriate deal. Again, as always, we're not rushing into things and trying to do a deal just to get rid of the money. We're trying to do something that makes sense.

Q - Larissa van Deventer {BIO 19822279 <GO>}

You sound pretty confident though that this, that we should have something tangible in the near future and say.

A - Johan van Zyl {BIO 4080290 <GO>}

Yes. And if we can't do something with them right now, they're not going to disappear. We're still part of that business. So, we can do something next year. But we -- it would be very stupid to rush in just to get rid of the capital. I mean, we'll rather we'd rather return the capital, if we think that, that's the better thing to do. But I am pretty confident. But we haven't signed a deal yet. So, let me not try to run too fast.

On the issue of Mutual making 48%, you'll recall that last year, we, when they made 10%, we did about what was it, 38%, a very similar, very high rate. So, there is a bit of catching up to do. And you can't continue these growth rates without stepping back and to see what is happening.

Invariably, when you grow very quickly in certain market segments, you have to look at quality. And what we've seen in here, we still think the market is unsaturated. But we've introduced some of the things around, upping the levels, some skilled levels, introducing our ops model at the lower end of the market, a whole lot of issues that we do to really increased levels. We still lose about 12% of our new business that we'll write in the first year. And the objective is to try and get these numbers down to the levels that we write in SPF.

If we can do that, the increase in the value of new business will be massive, without writing huge amounts of just top-line new business. So quality is really a main driver for us in this market. And instead of just rushing out and trying to take everything that's around, it is really about much more focus, not incurred new business trend, where it's not necessary, anyway the business is not going to stay in the books. And this has been what's really carried us on a relative basis elsewhere.

I think an additional factory in the lower end of the market, we're not trying to or we're not strong into the credit market as Old Mutual in particular. So, a lot of the sales and the increases there has been on the back of credit and in unsecured credit in a market that we not necessarily think maybe that prudent this month.

Q - Larissa van Deventer {BIO 19822279 <GO>}

Okay. Thank you.

Operator

[Operator Instructions]. Next question comes from Brian Mushonga from Credit Suisse.

Q - Brian Mushonga {BIO 16209522 <GO>}

Afternoon, gentlemen.

A - Johan van Zyl {BIO 4080290 <GO>}

Hi Brian.

Q - Brian Mushonga {BIO 16209522 <GO>}

Hi. In your commentary for the 2010 Annual Report, you mentioned that buybacks in 2010 were limited to around 887 million and average price was R33.8, in large part, due to the relatively high share price. Now, in the first five months of this year, you bought back 330 million, at an average price of R27. Have you changed your view on how expensive or cheap the Sanlam share price is?

A - Johan van Zyl {BIO 4080290 <GO>}

No, we haven't. What you do is you compare the buyback price relative to the share price at the moment. What we do is comparing it to the embedded value, the underlying and intrinsic value at that moment in time.

Although we paid R27 per share on average now, most of those shares. And in fact, 95, 98% still at the dividend. So, compared to the share price at this moment where the embedded value is closer to R28 a share, we effectively paid 26. And in fact, I think just lower than 26, if you subtract the dividend from the R27, 10 or 15.

So, we haven't changed our view at all. We're going to buyback, when there is some discount to the embedded value that we calculate on a regular basis and keep updated within the business.

Q - Brian Mushonga {BIO 16209522 <GO>}

Okay. And you've done, about 250 already, will it be revising the allegation of a billion rand that you said decided at the start of the year?

A - Johan van Zyl {BIO 4080290 <GO>}

Yes. That billion rand was of course relative to the capital that we had at the beginning of the year. We hope, because what we regard as discretionary capital is really the liquid part of our excess capital. As part of, what's been locked up in different companies and different structures and those things mature and become available, of course, we'll add it.

So, increasingly, in the next two months, we'll come with and at the half year, we'll give you an exact update. We haven't, we don't do all the work to the, in detail on you know, particularly looking at the capital in, within the last company and what is available. So, but, once we've done that, we'll provide that. And I think, well, there should be a little bit of additional capital available.

The markets haven't done brilliantly for us, in terms of equities and so. So, it won't be a massive number, like what we've seen towards the end of last year, when we've had that run up in November and December, in terms of share prices and equity prices that created a surplus of, way beyond what the normal assumption base was, that didn't get transferred to the discretionary capital. So, we don't expect as much as that coming off. But we don't -- we do expect a little bit, simply because of things that we see and money becoming available from illiquid or all sources that within the illiquid last year.

Q - Brian Mushonga {BIO 16209522 <GO>}

Thank you very much.

Operator

Our next question comes from Francois du Toit from JP Morgan.

Q - Francois du Toit {BIO 16128719 <GO>}

Hi, Johan. I think you've answered most of my questions. I wanted to ask you about, how many of your shares were bought back before and how many after you paid the divi. And can I take that as most of the said margins, that maybe you can give me an exact number, how much was bought back before and how much after dividend?

And then second question, if you can give me some indication of the required capital level on 31st of March and help me put the Solvency level into context, well, just pretty much whether it was down or up or flat at the year-end? And if you can maybe just express the new business growth in ITE terms?

A - Johan van Zyl {BIO 4080290 <GO>}

Okay. Let's see what we can do. Starting with the refi level, I think we're flat for the year and only four months or so. We haven't changed. We haven't seen over three months, we haven't seen a massive change. Kobus, would you like to...

A - Kobus Möller

On the dividend question, Johan had focused about that.

A - Johan van Zyl {BIO 4080290 <GO>}

I would actually say 99% of the that number. We did very little since then. Yeah.

A - Kobus Möller

And on those, we've done very little since that.

A - Johan van Zyl {BIO 4080290 <GO>}

Yeah. And on the reaction of the government, we're not getting more. So, we have to do an exercise for you.

Q - Francois du Toit {BIO 16128719 <GO>}

Okay. It's fine. So, you've bought back -- you haven't bought back much since the dividend has been paid. Would you say it's because, of some fair bit of expenses now. You mentioned then, about R28. Is that pretty much, the ICE level or what dates and time were you referring to?

A - Johan van Zyl {BIO 4080290 <GO>}

Its just the, it's adjusted more or less today's... we're actually, it's not from absolute drop relation. But it's more or less will be either the number of years. And we've been, the regulatory buyback I've shared with you, will be in the market for a few days and then reconsider it. So, it's not, it will be rushed to buyback shares. So, it's not to say we are doing won't go back into the market in next three week or two.

Q - Francois du Toit {BIO 16128719 <GO>}

Okay. Thank you.

Operator

Gentlemen, we have no further questions from the question queue. Mr. van Zyl, would you like to make any closing comments?

A - Johan van Zyl {BIO 4080290 <GO>}

Yes, thank you so much. I would like to thank everybody that's dialed in for their continued support and interest in Sanlam. We remain strongly committed to drive value and superior returns on our shareholder and other stakeholders. And on the capital, the surplus capital is bothering people. We're really working hard at finding solutions that make sense for us. And I hope that we'll be able to announce some positive developments in the next month or two. So, thank you for calling in. We really appreciate.