Q1 2021 Sales and Revenue Call

Company Participants

- Lotz Mahlangeni, Chief Actuary & Chief Risk Officer
- Paul Hanratty, Group CEO

Other Participants

- Francois Du Toit, Analyst
- Larissa Van Deventer, Analyst
- Michael Christelis, Analyst

Presentation

Operator

Good day ladies and gentlemen. Welcome to the Sanlam 4 Months Operational Update.

(Operator Instructions)

Please note that this call is being recorded.

I'd now like to turn the conference over to Paul Hanratty.

Please go ahead, sir.

Paul Hanratty {BIO 7445748 <GO>}

Claudia, thank you very much for hosting us nicely as usual.

Good afternoon, ladies and gentlemen. Thank you very much for joining us on this conference call.

I'm joined today on the telephone line by Abigail Mukhuba, who is our Finance Director; and then Chief Actuary and Chief Risk Officer, Lotz Mahlangeni; and Head of Investor Relations, Grant Davids.

Sanlam released its operational update for the 4-month period to the 30th of June 2021, earlier this afternoon. I'd like to just make a few introductory comments before we proceed to questions.

From a strategic perspective, Sanlam continued to make progress with the execution of its strategy this year. The purchase of a 25% non-controlling minority shareholding in the subsidiary of African Rainbow Capital Financial Services was completed in April.

In May we announced the intention by the Sanlam JV, SAN JV, to purchase a further 22.8% of SAHAM Assurance Maroc, taking our shareholding in that business to 84.5%. The sale of Sanlam's U.K. holding in Nucleus is expected to complete in August with shareholders having voted for this transaction.

From an operational perspective, there were two key themes that shaped the group's performance over the first four months of 2021. Firstly, there has been a very supportive environment created by increased savings levels in the economies and an improvement in both equity and credit markets. Secondly, there was a very significant increase in mortality related to the second wave of the COVID-19 pandemic, which detracted from our operating results.

The group achieved a strong recovery in sales performance over the period. New business volumes were 20% higher than 2020 and 58% higher than 2019. The value of new business -- covered new business was up by 81% on 2020 and was 41% higher than the same period of 2019. The new business, that's covered business, business margin was 2.82%, which was higher than the margins that we saw both in 2020 and 2019.

Net fund flows into the group were more than double that of 2020 and was 73% higher than 2019. Sanlam Investment Group was a key contributor to this performance, assisted, in part, by the enhanced ownership credentials of this business, while Sanlam emerging markets also performed well.

Sanlam Life and Savings paid risk claims that were ZAR 2.7 billion higher than in the same period in 2020, partly because of a strong growth in the cover provided on our book to clients, but significantly due to the impact of the second wave of the COVID pandemic.

Claims above the long-term expected level of claims were ZAR 1.2 billion. This being net of reinsurance and net of the positive annuity and disability experience within Sanlam Life and Savings. So this experience loss of ZAR 1.2 billion was fully offset by the release of discretionary reserves.

Our Pan-African general insurance portfolio recorded a net insurance margin of 13.7% for the period. Both the underwriting margin and the investment return on insurance funds were within their respective target ranges.

Overall, the net result from financial services for the group increased by 18% on 2020, but remained 7% below the equivalent period of 2019. We normally wouldn't refer to one year earlier than the previous year. But in this case, 2019 is a relevant period for comparison as this was the last year in which results were not impacted by COVID-related factors.

Weaker risk experience related to COVID-19 in 2021, higher new business strain from the very strong life insurance volume growth, lower reserve releases in Shriram General Insurance in 2021 as compared to 2019 and the sale of a stake in our asset management business during 2020, with lower interest income on our dividend pool were the key items that detracted from earnings growth in 2021 relative to 2019.

If we take these items out that I've listed, the net result from financial services would have been 7% higher than the corresponding period in 2019. I hope that this comparator to 2019 gives you some guidance as to where we are in this whole cycle of COVID.

Overall, our persistency trends remain steady and at satisfactory levels. The group also remains well capitalized with the Sanlam Group solvency capital requirement cover ratio at 181% on the 31st of March, well within the target range set by the company. Our performance for the four months to April 2021 reflects the strength of the underlying operations and the ability to maintain value creation for our shareholders in challenging times.

In conclusion, Sanlam remains well positioned to execute our growth strategy with a robust balance sheet and solvency position, diversification across geographies, lines of business and market segments and an exceptionally strong depth of skills in all our businesses. We continue to actively manage the consequences of the COVID-19 pandemic and the emergence of the third wave in South Africa.

We expect that Sanlam will be able to absorb an increase in claims during the remainder of 2021 from further discretionary margins and other reserve releases, together with the positive impact that repricing of the group risk business in South Africa that has already taken effect will have on earnings for the remainder of the year. The eventual claims experience from COVID-19, however remains uncertain, and it must be dependent on the success of the vaccination program. Over the medium to long term, we remain confident of the growth potential in all our markets, including South Africa, and we will continue to deliver value to our shareholders and to other stakeholders.

I now want to open the call to questions, and I'll ask my colleagues to please help me in answering those questions. I'm sure Claudia will give you some instructions as to how to register a question.

Questions And Answers

Operator

The first question comes from Larissa Van Deventer from Barclays.

Q - Larissa Van Deventer {BIO 20764470 <GO>}

Three quick questions, please. The first one, you mentioned that you had adequate reserves to cover the second wave of COVID, but what are your expectations for the third wave?

The second one is -- actually, I'm going to stick to it. The second one is on your exposure in India. You do mention the very bad COVID wave hitting India at the moment. What -- can you help us get a bit of understanding of your exposure to business interruption claims, mortality, and then also the extent to which you may have reinsurance to cover the losses in India?

A - Paul Hanratty {BIO 7445748 <GO>}

Larissa, thanks a lot. I guess there are 2 questions you had. The first was, if I got this right, what is our expectation for the size of the third wave or the second wave of this year, I suppose. Your second question related to the COVID impact in India.

So I'll start by answering the first question and particularly, Lotz, if you disagree or want to add anything, please feel free. By the way Larissa, you've beaten Michael to the first question. So well done.

So on the question of the wave, look, I mean the truth is we don't know any better than anybody else how big this next wave is going to be. We've obviously got a set of assumptions about it, but we don't have any greater insight than anyone else. We all, I guess track the same data. We certainly are constantly comparing our own data and our own experience to what we see in the population. Our base case is that the third wave will be the size of the first wave but with the demographic impact of the second wave.

And I think I have alerted you, I think at the time we did our results to the fact that what we saw with the second wave in January and February was that the demographic impact of it seemed to be quite evenly distributed across the population, whereas in the first wave, it appeared to be focused on the lower income segment. So that's our base case. We also model for ourselves a third wave at the same intensity as the second wave. In either case, we would be able to deal with that. But of course anything beyond that would obviously be a different situation. Those are the only ones we've modeled.

Turning to India. Just to remind you. And I always struggle to explain this and Grant is really good at it all or Abigail. But we report three months in arrear. So what we show is the First Quarter for 2021 is in reality the Fourth Quarter of 2020. So in a sense, our results are always behind the curve, if you'll pardon the pun. We've got a very small life business with a very small overall level of claims.

So even in a very worst-case scenario, I don't think that the COVID situation is going to really move the needle much on that front.

What we have seen as a very big impact on us is on our General Insurance business. We don't sell business continuity insurance in India. And -- but what we do, do is we sell a lot of bodily injury insurance. The process there is one of settling claims through a court process. The courts in India have effectively ground to a halt. So what the management in India is doing is that they are reserving the full premium and assuming that the claims will absorb all of the premiums.

And it's pretty unlikely that, that is the case. But it certainly dampens the reported earnings in the short term. Of course that situation will only normalize once the courts get back into full swing, and then there's going to be a backlog. So in a sense, we're going to have some, I guess messy GI numbers coming out of India, I would imagine for, well, one doesn't like to speculate, but I think you can see that, that could be for quite a period of time.

The more likely impacts, going forward, would be in the credit business because if there were further lockdowns and further impacts on the economy in India and the ability of people to repay loans, that could, of course affect your provisions in your credit book. I think you're well aware, Larissa, that credit is, in reality, the biggest exposure in our Indian business. But the other aspect is if the government were to reintroduce, as a result of COVID, further repayment holidays on loans, that, again would give rise to greater provisions.

So we are signaling that there could be some impacts in the second in the second half. In fact, the business took some steps to recapitalize on the credit side. Just to make sure that there -- it's extremely solid, it is already very well capitalized, but they've taken steps to capitalize even further. So I hope that gives you some color.

Operator

The next question comes from Michael Christelis from UBS.

Q - Michael Christelis {BIO 15233664 <GO>}

I hope you guys are well. Thanks for all the detail. Obviously we'll wait to see all of full detail when we get to results. I mean maybe if I can start with the first question. We've seen quite a few senior departures, obviously from your group over the last sort of 12 months, particularly in the last week, we've now heard of both Robert and Lize. Is there -- do you think this is possibly a different view on maybe strategy? And what sort of comfort can you give shareholders that this is not something that they should be worried about? It's certainly something that's been raised to me a few times in recent weeks. So that's my first question.

My second question, if I can, just on the mortality that you have experienced in the first four months, particularly sort of March and April. It seems like it's a younger issue then wave 1 by virtue of the fact that we had lower annuitant offsets. But when I look at the excess data that's coming out, it looks like it only older people or largely older people that are buying all these things. So I'm just trying to understand why it is the experience does seem to be different. And possibly, if you can explain why your corporate business appears to be hit so hard when, in theory, COVID tends to hit older people worse? That's my second question.

Then I guess the third question, just around commentary you've made before about sort of FY '19 not being a base that we should be growing from to try and sort of establish FY '21 now. In the absence of mortality, in other words, if we ignore whatever positive variances there were in 2019 and whatever negative variances are going to be there this year, is there anything else we should be thinking about that would likely be lower than FY '19 in your view?

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. I'll try to answer, if I'm right, you're asking around the management changes. Your second question was around the age profile of the COVID claims. The third question was this back to 2019 and what should you adjust for other than mortality.

So let's start with the first one. Michael, I've known you for years, but are you a sports fan or not?

Q - Michael Christelis {BIO 15233664 <GO>}

I am indeed. I'm not just going to say some good great tennis plays at the moment.

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. I'm not going to use the analogy of tennis. But if you think of great football teams or rugby teams or whatever they do very well, and they've got experienced and good players. I think Sanlam finds itself a little bit in that territory. I always admire the stability and the experience of the Sanlam management team. But of course stability and experience, if you roll them for long enough, also means that at some point, you get to a point where a significant number of people start reaching retirement age.

And of course I noticed from one of the notes you wrote that you referred to early retirement. But in fact, nowadays, there isn't so much anymore the concept of a fixed retirement age. And people do want to move on to other things. One doesn't want to get into people's individual circumstances. But I think it's fair to say that both Lize and Robert are keen to move to -- move into a different space. This is something that we need to -- we just need to deal with. We've got a huge amount of talent and depth in the company. I think we are very well placed to deal with succession. You will have noticed that in Lize's case, she's committed to stay to whenever she needs to stay into next year.

So that gives us quite a bit of scope to have some overlap if we need it. And Robert will be here until the end of this year. And all I can say to you is that we're deeply embedded to them for the work that they've done over many years. We would hope that in the sort of slightly less full careers going forward, we may also be able to use them to help us. But we will follow a very rigorous process and make sure that we get the right leadership to continue the work that they've done and that we have a smooth transition, and that's something that I think we'd be perfectly capable of achieving, given the depth of resources we have. So I think that answer the first question.

The second question, I must admit, I'm a little -- I'm no expert on this. My reading of things is actually that this wave had affected young people and not just old people. In fact, for us, right through the second wave, it's been consistent that we have seen a little bit less in the wave of annuitant mortality than in the first wave. There's no question that the heaviest impact is in the group risk books. That sort of will tell you again that it is hitting people at least of working age. I suppose it all depends on how you define young. But there have been very severe mortality in those group risk books. And a different way of looking at it is how those books have been repriced and the average repricing of books.

And I think -- I think it's right to say that on average, those premium group risk, premium rates, you understand that I'm sure that they get repriced not in 1 shot, but each scheme is repriced at its annual renewal. But the average price increase that we're seeing across all schemes, and I emphasize average because it varies tremendously depending on the scheme, but I think I'm right in saying it's around about 35% increase in premium.

So that will give you a sense that, yes, indeed, in the working population, there has been a very severe impact from this. Lotz may want to expand. But certainly, I am not of the -- I haven't seen any data to suggest there's only old people that die from COVID. In fact, I think one of the features of the second wave is, in fact, that it is much younger people than in the first wave, it was generally (inaudible).

Operator

Ladies and gentlemen. if you could please remain online while we reconnect Paul's line. Ladies and gentlemen. if you could please remain online. Thank you.

Ladies and gentlemen. we have been rejoined by the main speaker. Paul, you may proceed.

A - Paul Hanratty {BIO 7445748 <GO>}

Thanks very much, Claudia. I didn't know we had landline drop there. I'm not sure what that was about. Michael, I apologize. I've been talking to myself for minutes and wondering why you didn't say anything. I'm not even sure where I lost you.

Q - Michael Christelis {BIO 15233664 <GO>}

I think (inaudible) -- until you asked Lotz -- you were just asking Lotz if he had anything to add, I think.

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. So then you've missed my whole 2019 story. So let me do that again. At least I'll be better the second time. Yes, Lotz.

A - Lotz Mahlangeni {BIO 21927635 <GO>}

Yes. I can add something on that. I mean when we have released our results, we did indicate that we had seen differences between the first and the second wave, not just in the level, but also in the demographic profile as you've described.

So if one could look at some of the national data because, I mean our population is different from national data that's clearly because it's a short population rather than the national population. So the insurance population tends to be slightly older from a coverage perspective. But what would be important is when you look at the data, then the proportion of lives that are older than 59 in terms of COVID deaths, that number is close to -- if you look at the peaks, it was 40% of total death were in those -- that age range, that is 59 and older. When we come to the second wave, that proportion is closer to 32% and 33%. So that does show that there was a disproportionate impact on younger life in the second wave compared to the first wave. Thanks, Paul.

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. Thanks. Michael, I'm just going to answer your 2019 question. When you compare 2021 to 2019, the first thing you need to adjust for, as you pointed out, is the mortality. So 2019, you would have had a positive mortality experience, whereas in 2021, you would have had a 0 number because we've had losses which we've neutralized with releases. So that's one delta.

The second delta is new business stream. I always say to the people who work here, that if you have a constant rate of growth of new business, you can ignore new business stream because it adds the same impact each year. But I think you'll appreciate that I think our new business volumes are so much higher in 2021 than in 2019. I think it's 58% from memory, something like that, that it has a major impact on your profit, your operating profit.

The next thing is a -- you've got to think through the Shriram General Insurance results. In 2019, they released reserves -- excess reserves in that business. In 2021, because the courts are closed, they're reserving the full premium. So they're actually doing the opposite. So that gives you a swing in the other direction.

Then there's a structural change. So in 2019, we had 100% of the third-party asset management business in our results. This year, we've got 75% dividend results.

Then finally, there's lower investment in interest income on cash at the group level. So that also has a slight negative impact. So unfortunately, there's quite a list of very different items (inaudible).

Operator

You may proceed, sir. One of the speakers mistakenly put their phone on hold. But you can continue.

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. Sorry. Michael, sorry, my apologies. We're getting a very interrupted line tonight. I was just saying that we've got a lot of different items that we need to adjust for, but I hope that's given you some clue.

Q - Michael Christelis {BIO 15233664 <GO>}

It definitely has.

Operator

The next question comes from Francois Du Toit from Renaissance Capital.

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

Just maybe quickly intriguing explanation around the Group Life environment and the increases in premiums of up to 35%. Surely, that's a fairly temporary, right? I mean we're not expecting -- I know you price one year in advance, but do you anticipate business moving on one year's quotations? Do you have kind of a temporary increase for COVID-19 and a separate base rate for these Group Life schemes? Are you seeing business move on the strength of these 1-year quotes? First question.

And second one, just on your practice now of capitalizing discretionary margins or you're smoothing out the impact of the second wave through discretionary margins. I'm not aware of you having used discretion margins in the past to smooth out negatives. So is -- am I right in that regard? And do you anticipate using that in a bigger way going forward as well to smooth out one-off negatives?

A - Paul Hanratty {BIO 7445748 <GO>}

Okay. So I'll answer the first question as best I can. Not sure I really understood the second question, but I'll also do my best there.

The -- so the issue of Group Life. Group Life business is sold contractually as an annual contract. So each year, when the business comes to the end of its 1-year term, it is renewed. And at that point, it can either stay with you or move somewhere else. So when you're pricing the business, you need to price it for expenses and claims. But you don't need to. You can -- for sure, you can work on the basis that you keep schemes for on average, let's say three years or four years, you could do something like that. I think you've appreciated the risk of doing that in a very fluid environment would be that you might underprice business.

And if it moved at the end of the year and you'd underpriced that, you would make losses. So we take -- we take the view that we price schemes to reflect the mortality that we expect for that year. If going into the new scheme year, there's a different outlook then we would reprice those books. It's really as simple as that. There's no -- there's no hint that it's somewhat temporary. And remember, in any event, you've made huge losses on these things in the months that they were running before you reprice them. In fact, even assume -- let's say you started on the 1st of January, and you knew that COVID was coming on the 1st of January, once the premiums rise up, the losses actually hit you because the wave it comes in January and February, and it's only 1 wave for the year, all the losses come in January and February.

So you can't get to March and say well, the wave has passed, so we're now reducing your premium because, again you would -- you'd face a very severe loss on your book if you operate it that way. If you said to people, look, each month that the wave comes, we're going to put the premiums up, you'd never be able to sold the business on that basis either. So I hope that answers your question. It's hard work.

In terms of discretionary margins, I mean Lotz, you'll probably have to help here. I'm not aware that the group has historically used discretionary margins to smooth out outcomes. So I don't think it has, but I haven't been here for a long period of years, certainly at the time I have been involved, which is probably 3 or four years, we haven't adopted such a practice. I don't believe we would adopt such a practice. But I think that once different incomes in [ph] you're potentially into a different -- people are going to have to rethink their approach to these things.

But not all discretionary margins, I think the way you asked the question implies that these are somehow related to annual -- some sort of a margin that you discount. The reality is some of them were -- some margins work that way but others are not that. So if you think of the investment guarantee reserve, you've implicitly got some surplus sitting in there, and that's not a future margin. But Lotz, I don't know if you understood the question better than me and can answer it.

A - Lotz Mahlangeni {BIO 21927635 <GO>}

Yes. Thanks, Paul. I mean I think as a starting point, we haven't -- I mean we -- I thought that has been an approach to our reserving basis and with the required level of prudence. We haven't used that prudence to smooth out earnings or outcomes. We view that prudence to ensure that we've got sufficient adequacy of reserves on the balance sheet to be able to absorb the risk experience that we foresee from an outlook perspective. Then when you said our reserving basis on a year-on-year basis, it is based on emerging experience with appropriate level of prudence. So we haven't adopted an approach of using the reserves to smooth out outcomes, Francois.

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

Yes. Okay. The bottom line is you are smoothing out the impact of the additional ZAR 1.2 billion of mortality claims. Not doing that would be more similar to your historical practice, and not doing that would leave more profits to emerge in future rather than in this period. Leaving more profits to emerge in the future is, in some regards, in terms of required capital and tax and so on.

That's part of the reason, as far as I understand, why Sanlam, unlike the others, has the conservative approach to new business strain, for example, as well. So that's also not smoothed out, unlike your peers. So I was just wondering whether there's a bit of a break with the past or whether you sort of maybe gradually smoothing your earnings into a new level that obviously will be there in any event following IFRS 17 implementation.

A - Paul Hanratty {BIO 7445748 <GO>}

The answer is no. I mean we have, over the years, periodically released reserves as we do. But as Lotz answered you already, we're not releasing ongoing margins. But of course every reserve that you release now is a margin that's a reserve that could have been released at some future date. So -- but the intention is not to smooth profits. I think I'm right in saying that since the AIDS pandemic, this was probably the first mortality pandemic that the company has experienced in many years anyway. In the case of HIV-1, of course it was a much slower impact because of the nature of the disease, the much longer time between infection and death.

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

Not at all. I'm not disputing the fact that this is a very valid reason to -- you do want to smooth out the impact...

A - Paul Hanratty {BIO 7445748 <GO>}

But I mean the point -- the question you asked is, is there a break with the past in terms of our approach to releasing margins? The answer is no. I wonder are there any more questions on the line, Claudia?

Operator

Sir, there are no further questions.

(Operator Instructions)

Paul, we have no further questions. Can I hand back to you for closing comments?

A - Paul Hanratty {BIO 7445748 <GO>}

Sure. Thanks very much, Claudia. Thank you very much for this. I'm sorry to everybody that we have interrupted telephone line. I don't know what it is today. We have trouble actually joining as well. But thank you all very much for making time. It's always good to talk to you. Best of luck.

Yes. Let's all stay safe. Thanks very much.

Operator

Thank you very much, sir. Ladies and gentlemen. that concludes today's conference. Thank you for joining us.

You may now disconnect your lines.

A - Paul Hanratty {BIO 7445748 <GO>}

Thank you.

Bye, bye.

Operator

Bye.