Q2 2017 Earnings Call - Pre Recorded

Company Participants

- Luigi Lubelli, Group Chief Financial Officer
- Philippe Donnet, Managing Director and Chief Executive Officer

MANAGEMENT DISCUSSION SECTION

Philippe Donnet {BIO 4657671 <GO>}

Good morning, everyone, and a warm welcome to our First Half Results Review. We have had a strong performance over the first six months of 2017. We increased profitability in what is still a challenging environment. We are executing our strategy with discipline and will complete our industrial turn-around plan by the end of next year, fulfilling our commitments to the financial community.

I will present you with a progress report in a little while. We are a uniquely positioned group, largely thanks to our geographic base as well as our strong distribution network. We have deep European roots and are present in some 60 countries around the world. However, to optimize our footprint, we are proactively reviewing and exiting from non-strategic markets. We pride ourselves on one of the strongest proprietary distribution networks in the industry. It is one of Generali's true competitive advantages, and we continue to innovate. For example, we are implementing our important digital agent program to ensure the relationship between Generali and our clients becomes even more efficient.

Today's results are underpinned by our outstanding in-house technical and operational capabilities. Thanks to this internal know-how, we are successfully rolling out our new asset management strategy across Europe and have seen robust growth in our capital-light products. And finally, our on-going efforts to innovate and transform, where we always strive for best practices.

Generali's commitment to innovation was recognized during the first half of this year when the Group won the prestigious Global Innovator Award given by EFMA and Accenture. The award highlights the company's commitment to changing and transforming the industry. It is recognition of the Group's drive to find new ways and new best practices to help grow the business and improve the client experience.

Now, let me give you some high-level numbers. Our financial performance in the first half was strong. Thanks to the management team and our international employee base, we delivered €2.6 billion of operating profit, and over €1.2 billion of net income, both up by 4% year-on-year.

Furthermore, the Group's operating return on equity stood at 13.6% in the first half, above our target of 13%, a result of which we are very proud.

Our balance sheet is sound. Our solvency has become even stronger, standing at 207% based on our full internal model, up by 13 points since the year-end. We are able to deliver these results thanks to the strength of our core insurance business.

In Property & Casualty, while we have experienced a negative cycle in a few countries, where we have seen increased frequency and at times severity, Generali still boasts an impressively low combined ratio of 92.9%. This confirms our strong pricing, underwriting and claims management capabilities.

In Life, the careful management of our in-force portfolio and our innovative product offering are bearing fruit. Our new business margin improved significantly in the first half of the year, driven by actions on product design and product mix. Even where we still sell traditional guaranteed products, the guarantees we offer have continued to decline to just 17 basis points in the first half of 2017 in the Euro area, remaining far below the risk free rate.

These strong results and the trends in our technical performance are no coincidence. They are aligned with and the result of our strategy. Let me remind you of the six strategic key pillars of it. The first pillar is to optimize our international footprint. We want to redirect our resources so that we reinforce the markets where we can or could have a stronger performance. Where we don't see any possibility to achieve this aspiration in the medium-term, we are releasing capital and resources. Just recently, we announced our exit from Colombia after Guatemala and Liechtenstein. We have a target of achieving at least €1 billion of cash proceeds.

Secondly, our operating machine itself. We have made good progress, but there is more to do. We are aiming to streamline processes and to integrate platforms and entities. This will have a positive impact on our performance as well as on the costs. The overall aim is to cut costs by a total of €200 million in mature markets, in an effort to eliminate inefficiencies. We are on target and expect to have it completed by next year.

Third, we will further enhance our core insurance capabilities and our technical excellence, thanks to our tradition and experience of nearly 200 years in the business. Our goal is to have the best combined ratio in the industry. In Life, we will go beyond improving the quality and profitability of our new business. We will bring our guarantees down to 0% by next year. And as you saw in the previous slide, we are already down to just 17 basis points in the first half.

These three areas share the common goal of improving our overall operating performance. In order to secure longer-term value creation, there are three further key areas where we have already made progress.

First is the structure of our business portfolio. We are transforming this so that we become more resilient and be in a position to increase our growth potential. Our commitment is to lower the average portfolio guarantee by 30 basis points to 1.5% by the end of 2018.

Regarding asset management, three months ago, we announced our new asset management strategy. The new asset management business unit will become a greater profit center going forward. The objective is to add at least an additional €150 million to the group's bottom-line by the end of 2020. We are confident in the potential of this business for Generali.

Second, customer and distributor innovation. We are experiencing a revolution in customer behavior and technological innovation. We will continue to be focused on these trends. We will become simpler, smarter and faster, not only in our internal processes and operations, but also in the way we interact with customers and understand their needs. We are committed to modernizing the triangle among Generali, its vast distribution network and our clients.

We are a global leader in the connected insurance arena, and we intend to strengthen this position. To do this, our goal is to increase client retention by 2 percentage points. We will accomplish this by leveraging innovative technology to engage today's social, mobile customer.

And finally, our brand. We have a very strong brand, built on quality, excellence and heritage. We have yet to unleash the full potential of the Lion of San Marco. We aim to grow the mature market brand preference, as we increasingly shift from traditional marketing to digital.

I would like to do a short deep dive on one of these topics, the life insurance portfolio mix. We continue to innovate our portfolio to enhance Generali's overall technical performance. We are strongly steering our new production so that it is more focused on capital-light products such as unit-linked, hybrid or an evolution of the traditional guaranteed savings.

We will continue to build new and innovative concepts for unit-linked and further increase the group's focus on protection and health. In fact, in the first half of this year, all the net inflows we have generated are already unit-linked and protection. This same kind of work is behind the rapid increase in new business margins which I mentioned before. And we are successful not only in new business production. We are working hard on the in-force liabilities of the group, for example, by recycling high capital intensity products into lower capital intensity, and carefully working on demand driven liability management.

As a result of all these actions, our mix of liabilities is moving exactly as planned. We have added €23 billion to capital light reserves in the past 18 months, which has increased their weight on total reserves by 3 percentage points, exactly on track for the 6 percentage point swing we promised to deliver over the three years to 2018.

Based on the results we have delivered, we are confident and committed to delivering the financial targets announced in 2015. We will achieve more than €7 billion of net operating cash between 2015 and 2018, of which we already delivered €3.5 billion by the end of 2016, mid-way through the plan.

Cumulative dividends will reach at least €5 billion between 2015 and 2018. And again, we are well on track, having already paid €2.4 billion half way through the plan. The operating return on equity will be above 13%. As of June 30, it stood comfortably above the target at 13.6%.

To summarize, based on today's results, our strategy is the right one. We are over halfway there, and with focus, determination and discipline, we are delivering the results, some faster than anticipated. However, we are still hungry for change. We will continue to push forward to ensure that our operational performance on the one hand, and creation of long-term value for the group, on the other, will continue.

I would like to take this opportunity to recognize the managerial talent that we have around the world that has made these results and this industrial turn-around a reality. Whether it be in the information technology area where we are driving innovation or the leadership of the newly-created asset management business unit, we all have a mission. And our management has been given the mandate to be part of a transformation process, a process where we continuously strive for excellence in everything we do, every day, everywhere.

We have implemented a fast board roll-out program so that all business units are equipped with industrial and strategic KPI's to monitor their progress and objectives. We have also strengthened our management team with a number of new hires in key strategic positions throughout the group. All of these serve as cornerstones for a simpler, smarter and faster governance as we work to complete the industrial turn-around.

Again, I am very proud of the results we have achieved thus far. So, I would like to extend my gratitude to all our stakeholders for their unfailing support and to the managers who have the power, the will and the professional capabilities to execute the plan.

I would now like to pass the floor to Luigi who will give you more details on our first-half financials.

Luigi Lubelli {BIO 4108780 <GO>}

Hello, I am Luigi Lubelli, Group Chief Financial Officer of Assicurazioni Generali and I have the pleasure of guiding you through the main figures of our half-year results for 2017.

Let me begin by joining Philippe in saying that the figures for this first half are strong and confirm the successful execution of our strategy.

I will dive into the details in a moment, but let me recap the main financial highlights. Our top-line continues to reflect our selective underwriting policy: P&C is confirming its return to growth path in both Motor and Non-Motor, and Life net inflows are at a high level and came entirely from the sale of unit-linked and protection products.

The operating result posted a robust 4.1% growth, reaching almost €2.6 billion and positioning our rolling operating return on equity at 13.6%, once again above our target level. Our net result also improved in a similar fashion, up 3.7%, to more than €1.2 billion.

The very strong improvement of the Life new business margin demonstrates a relentless effort to redirect our new production towards more profitable business lines. This is what we told you we would do a year ago, and that's precisely what we are doing. Here, as you can also see, we are changing our main metric to the margin of new business value on the present value of new business premiums. I will explain to you later why.

This excellent momentum is of course also reflected on the APE basis we used before, where the margin rose to 40.5% in the first half, up to (sic) [from] 25.5% in the first half of 2016. The new business value we wrote in the first six months of this year is twice as large as the amount we were reporting only two years ago at the same close. I find this a remarkable development.

Our Solvency II ratio further strengthens, due to the strong contribution of normalized capital generation, which this year was complemented by positive financial market trends. It reached 188% on the regulatory view and 207% based on our full internal model, up by 10 percentage points and 13 percentage points, respectively from the year-end level.

Let me get straight into the details, starting with a look at the operating results by segment. The 4.1% increase of our operating result has been achieved primarily thanks to good development of the Holding & Other Businesses segment and was complemented by a resilient and strong P&C result. The Life operating results decreased by almost 3%, due to some negative foreign exchange effects, as well as higher expenses, primarily driven by business development in Asia.

Moving from the operating result to net profit, we start with the non-operating investment income, which had a neutral contribution to the bottom-line, compared with a €45 million negative balance last year. In both years, realized gains substantially offset impairments, although I must note that, on each side, gains and impairments, the figures were about €100 million lower this year. Hence, the main driving factor of the year-on-year variation was the minor, albeit positive, development of assets held at fair value through profit and loss.

Non-operating holding expenses decreased €14 million to €392 million. Interest expenses on our financial debt decreased by €31 million, mainly due to a double counting effect we had last year, without which they would have been substantially stable.

Other non-operating expenses increased by €14 million, reflecting a reduction in restructuring expenses, but on the other side, a larger appropriation to a fund for future payments to the so-called Solidarity Fund in Italy, which is also related to our restructuring efforts.

The overall income statement effective tax rate was 32.5%, 0.9 percentage points higher compared to last year, due to lower tax-exempt income sources and a positive effect of tax recoveries, primarily in Germany last year. Minority interests were €25 million higher and mainly linked to the good performance of Banca Generali.

Let us now turn to look at the balance sheet. Shareholders' equity decreased by 3.4%, to €23.7 billion. The positive contribution from the net result of the period has been more than offset by the 2016 dividend paid in May and by the €0.7 billion negative impact that rising yields had on government bonds within the available for sale reserve. Sensitivities remain essentially unvaried both directionally and in amount.

Turning now to our solvency ratio, we can see that it further strengthened, reaching a very comfortable 188% level on regulatory view, and 207% from a full internal model perspective.

Looking into the roll-forward of the internal model ratio, we can see that normalized capital generation further increases, reflecting the very strong underlying technical profitability of the P&C business and the improved economics of the new business in Life.

It has already added 9 points to the ratio during the first month of the year, 1 percentage point more than a year ago. Financial variances and other movements were positive this year by 7 percentage points, driven primarily by interest rates and spread movements.

We also had a 1 point positive impact arising from the difference between our preliminary estimate of own funds as published with the year-end results, and the final number that you have subsequently seen published in our solvency and financial condition report.

Finally, as I mentioned last quarter, from 2017 onwards, we are making an accrual for dividends during the interim periods of each year, at a pro-rata based on the last dividend paid. There will then be a true-up in the fourth quarter to whatever dividend will be proposed in our full year numbers. This treatment reduces the solvency ratio by 3 percentage points, taking the closing number to 207%, up to (sic) [from] 194% at year end.

Now I will turn to look at the business segments, starting with Life. As we told you a year ago, we have continued to take steering actions to improve our business mix, limiting or ending sale of products not meeting our risk-adjusted profitability requirements. These actions translated into a margin improvement which by far outweighed a slightly negative development in volumes.

Overall new business value came to €942 million, up by more than 50% from last year. I strongly believe in this strategy and these numbers prove it is the right one. It is not by chance that now also our Life business margins reached best in class levels compared to the European industry, as was already the case with P&C.

Let me start with the drivers of the Life operating result, which posted a 2.8% reduction overall. The technical margin recorded a €20 million increase, mainly driven by France, where management fees have been revised and the business mix shifted into higher fee products. Germany also performed well, while in Italy, the very positive result we had related to some group Life contracts last year, did not repeat itself.

The investment result decreased by €33 million. This was a function of foreign exchange translation effects, and in particular the US dollar, arising primarily from the collateral backing some reinsurance contracts and the US exposure of our Generali Employee Benefits business. Therefore, we usually do have some impact from the euro/dollar exchange rate over time, which are more noticeable this year due to the particularly sharp move of the currency. Losses were €19 million, as compared to a gain of €10 million last year, and explain almost entirely the movement in the investment result.

The expense result decreased by €33 million, largely driven by the development of our Asian businesses, including the opening of new branches in China. Other than that, the figure would be quite balanced with increased acquisition costs in Italy and France, offset by a fall in CEE.

Our net inflows closed the semester at almost €5.8 billion, €1.8 billion below prior year's level. You can see the very strong swing in mix I mentioned before. For the first time, our net inflows are completely driven by unit-linked and protection. This is a trend that, with different magnitudes, can be seen in each of our major operations.

In Italy, net inflows decreased from €3.9 billion to €3.1 billion, with a halved contribution from traditional savings and a booming unit-linked component, driven by particularly strong hybrid production, which almost doubled year on year.

In our main European markets, we also see the same trend consistently repeating as in recent quarters; strongly positive net inflows in unit-linked and protection business, offset by increasing outflows in traditional savings business.

Lastly, in Asia, the decline in net inflows is explained by the strong but lower margin bancassurance production we experienced in China during the first quarter of last year, which was subsequently stopped and replaced with higher margin products. Overall, Life technical reserves increased 2.8% to €397 billion, with a particularly good development of the unit-linked component, up 7.5%.

Now moving to new business value, and as I anticipated at the beginning, we are changing the way we report new business premiums and margins, to the present value of new business premiums measurement. This metric we believe more properly reflects margins, following the move in calculation of new business profits to accommodate for the so-called contract boundary rules under Solvency II.

In fact, we were already publishing this metric in the backup before, but from this report onwards, it will become the main focus. We will continue to publish the old APE measure in the backup material, just for your reference.

In terms of the contract boundaries and their impact on new business value, it is relatively minor: We published a new business value of €656 million last year, and the re-stated numbers adjusting for contract boundaries is €627 million, so a difference of €29 million or just 4%.

What we are also showing you for the first time is the trend by line of business, in addition to the usual split by country that I will show you in a moment. This new analysis should enable you to better understand how our strategic business decisions on mix are translating into value creation.

Overall present value of new business premiums declined by 1.6%, but as a result of opposing trends. The theme is consistent. We had a 23% drop in the savings component, mostly counterbalanced by a strong rise of unit-linked, up 44%, and protection up 8%.

The margin increased very strongly indeed to 411 basis points, up from 144 basis points year on year. As you can see, a small negative impact of financial market inputs was negligible compared to the strongly positive effect of management actions on business mix, guarantees and product design.

Overall new business value consequently reached €942 million, up by 52% from the first semester of last year, and in fact double the level of the first semester two years ago. So we really have had some remarkable momentum. Each business line had a positive development from a value perspective, even in the savings component where the margin expansion significantly overcompensated the strong reduction in volumes.

Looking at the country perspective, there is a margin expansion in all territories, like we saw at the end of 2016, but it was not yet the case a year ago. This is testament to the consistency of the execution around the world. Conversely, the development in volumes was more muted due to our disciplined underwriting approach.

In Italy, for example, we had a 7.7% reduction in the present value of new business premiums, driven by a decline of 25% in the savings business, which was the major component. However, protection rose 35%, while unit-linked doubled. The 1.5 percentage points margin improvement as a consequence of this led to a 37% increase in new business value.

This particularly high new business margin in CEE has been reached, thanks to a high weight of protection businesses in these countries.

As a last example, in Americas and Asia, we refocused our Chinese business, which is by far the biggest contributor to this area, launching new and more profitable products. This led to a volume contraction, including the reduction of bancassurance business I mentioned before, accompanied by strong margin and value improvements.

Let's look now to the Life investment portfolio. Life general account investments increased slightly, reaching €351 billion, with a mix which is quite consistent with the one you saw at year-end. Overall, current investment returns were broadly stable at 1.6% not annualized. In absolute terms, the equity returns in 2016 included some private equity income which was not repeated this year. On a quarter-on-quarter basis, the volume of dividend received in the second quarter was comparatively larger in 2017. The new money reinvestment rate in Life amounted to 1.9%, against 2.1% in 2016.

Turning to Property&Casualty, in summary, gross written premiums increased by 1.5% to €11.3 billion. The combined ratio worsened slightly, but is still excellent at 92.9%. The overall P&C operating result marginally improved, to almost €1.1 billion.

Looking in more detail at the components of this operating profit, we see the technical result has fallen by €36 million, explained by the combined ratio, which I will return to, in a moment. The investment result was broadly stable, while the result from Other improved by €50 million, and this was mainly due to a lower net allocation to risk provisions.

Let's look now at premium and combined ratio developments by geography. What we can see from a high-level perspective is that premium growth is driven by most markets, with the exceptions of Italy and France.

Secondly, the 0.5 point combined ratio worsening is concentrated in Italy, the Americas and our international operations, outpacing positive evolutions in other countries, primarily France which continues to improve at a good pace, CEE and EMEA.

But let's now have a deeper look at our main countries. Italy's top-line is down 4.4%, at €2.7 billion. Motor decreased by 4.9%, still affected by the decline in average premium, but also by a reduction in the number of policies, due to our strict underwriting criteria.

Primary Non-Motor is down 4.6%, particularly driven by the evolution of Global Corporate&Commercial business, and especially by lower writing of Casualty business. The other Non-Motor business was down a more modest 2.3%. In terms of profitability, Italy again confirmed its outstanding level, with a 90.5% combined ratio. The 1.9% deterioration from last year is explained by 2 percentage points impact from nat cat, which were absent in the first half of last year.

In Germany, premiums increased by 2.2%. This was driven in particular by the Motor business, which rose 4.2%, still benefiting from a stable pricing environment. Primary Non-Motor posted a more modest 0.7% growth. The combined ratio recorded an excellent 91%, an improvement of 0.4 percentage points, mainly driven by a lower nat cat burden.

France declined by 1.2% to €1.35 billion, but with Motor finally turning to a positive 0.8% growth rate, despite the ongoing pruning activities. Primary Non-Motor decreased by 0.5%, due to the competitive market environment in commercial business and the continuation of strict underwriting guidelines.

The combined ratio in France improved once again, by 1.9 percentage points to 98.3%, also helped by 1.3 percentage points lower nat cats that were exceptionally high last year.

CEE continued on its growing path, showing a 5% growth with a positive development across all main countries in the region. The combined ratio remains excellent at 89.2%, falling 1.6 points mainly due to the abnormally high combined ratio in Poland in the first half of last year. Also, EMEA confirmed a positive topline trend, with premiums up 2.1% to €2.7 billion. The combined ratio performed well across most markets, improving by 1.1 percentage points overall to 93.6%.

In the Americas, we had a strong topline growth on a like for like basis, partially inflation driven, but a negative evolution of the combined ratio, due to Argentina. There, we had a specific issue caused by the emergence of a gap between inflation rates and the reserving discount rates, which created the actuarial need for a reserve strengthening. We believe this should be a temporary effect, as such a deviation between inflation and interest rates is unlikely to persist in the long run. Nonetheless, we have made the provision on the grounds of prudence, and this explains the large change in combined ratio which you see there.

Let me provide you now a closer look to the drivers of the combined ratio movement at group level. The loss ratio remained stable. A slightly worsening current year result, which was affected by a number of mid-sized weather-related events and some large claims in Motor insurance in Germany, was compensated by lower Nat Cat experience. Prior year development remained stable at 4.4 percentage points, even if it does include the impact of the reserve charge in Argentina, which I mentioned before.

The expense ratio increased by 0.6 percentage points, due to the higher acquisition expenses linked to specific actions aimed at increasing the penetration of the Non-Motor business in our retail and SME client base, in particular in Italy. The admin expense was slightly lower by 10 basis points compared to last year.

P&C investments remained stable, compared to the end of last year, at €39 billion. In terms of asset allocation, there has been a slight decrease in corporate bonds and other fixed income, with an almost corresponding increase of cash instruments. Total P&C current returns were overall broadly stable at 1.6% on a six months basis. The average reinvestment rate in P&C during the first half 2017 was 1.5%, marginally higher than the 1.4% achieved last year.

Let me finally turn to our holding and other businesses segment, whose overall contribution to the group operating result improved from €102 million loss at the first half of 2016, to a €30 million profit this year.

As I mentioned before, this result has been mainly driven by a good performance of Banca Generali, which increased its contribution by €47 million, and by higher profits from private equity and real estate investments. Also, the other financials, which includes the asset management business, performed strongly with operating results growing following increased fees.

Holding company expenses were modestly lower at €230 million, an €8 million improvement from the prior year figure reflecting our efficiency efforts.

Lastly, other businesses produced a positive result of €16 million, compared to a €37 million loss last year. Around half of the swing is explained by gains related to some private equity holdings, which tend to emerge not consistently over the quarters. In addition, we had slightly improved results from some real estate companies.

Let me now wrap up with some final remarks. Our excellent combined ratio and the particularly strong performance of our new business value and margin are proof of a successful implementation of the right strategy. Life net inflows are at a high level with an improved mix, and P&C premiums are beginning to accelerate.

Our Operating ROE once again exceeded our target level. And finally, our solvency has strengthened even further, to 188% on regulatory and 207% on full internal model view, a level that I consider to be very robust. Thank you for your attention.