Q2 2015 Earnings Call - Pre Recorded

Company Participants

- Alberto Minali
- Mario Greco

MANAGEMENT DISCUSSION SECTION

Mario Greco {BIO 1754408 <GO>}

Good morning, everyone. Welcome to Generali's First Half Results for 2015. I'm pleased to report that we have had an excellent start to 2015 with double-digit increases in both our operating results and net profit. This is a record half for Generali, and reflects strong performances across our group.

If you look back to 2011, we have grown net profit by 13% per annum over the period. More recently, the work of resolving the issues around the so-called strategic investments over the past two years means we're able to report a closing of the gap between operating result and net result. As a key pillar of the new strategy we announced in May was increasing cash generation, these results are a right step in that direction.

The 21% increase in net profit and 11% increase in operating result in the first half has been achieved in the face of very strong headwinds that you all know. Growth in our core European markets is low, interest rates remain rock bottom, and regulatory pressures are challenging the way we run our business and the product and services we offer for our customers.

Now, despite all these, our business is performing very well. We have a strong foundation to build on, excellent and varied distribution networks, a wide product mix. And when it comes to the highly-competitive property and casualty market, we have superior capabilities reflected in market-leading combined operating ratios. Most of all, we have a hunger to reach our goals and become the retail leader in Europe.

As I said in May, we have rebuilt the group's capital position to a comfortable level where we can run the business in a non-constrained way. We did this organically through non-core asset disposals and organic cash generation.

On a Solvency I basis, we are well placed. On a Solvency II world, we are equally in a very solid position. Our internal model economic solvency ratio stood at 200% at 30 of June, which is 14 points above the position at year-end 2014. We're well in line with our peers, but what is important to us is that we run our business for cash and dividends, and we will not be entering into a race to the top. The Solvency II application process is continuing, and we expect to obtain the approval from our regulators for our portion internal model effective from January 1, 2016.

Looking at our main markets, we're seeing good improvements in many of our key financial indicators. On this slide, you can see further details of the performance in Italy and in Germany, our two biggest markets.

In Italy, our Property & Casualty segment continues to achieve excellent underwriting results. Combined ratio remains well below 90%, despite an increase of 1.6% points of natural catastrophes in the first semesters. The Non-Motor line performed very well, driven in particular by our SME business, reflecting the success of our repricing and pruning activities.

In Motor, we continue to be selective, and we will give up volume for a better margin if necessary. Net inflows grew appreciably in Life Insurance to €3.9 billion led by unit-linked products which almost quadrupled. This is consistent with our strategy to move away from traditional guarantee based business.

Banca Generali continues to grow from strength to strength and it provide us an increasingly meaningful contribution to our operating profit headed by a 37% increase in the bank's operating profit that we have seen over the period. This has helped drive the value of our stake in Banca Generali to €1.8 billion, the vast majority of which, I remind you, is not on our balance sheet.

In Germany, despite the challenging economic environment of low interest rates, our Life segment has delivered a resilient performance. The output is a 21% increase in the operating result to €200 million. Our Property & Casualty business continues to do well and we have taken 1.2% off the combined ratio to bring it down to 92.5%. This is notwithstanding the heavier cost of natural catastrophes in the past six months.

Beyond the financial result is the speed and efficiency with which Giovanni Liverani and his team are progressing with the rollout of the new strategic positioning. The discipline and focus we employed with our turnaround at group level and also the approach we took in Italy for simplifying our operations and structures are being well-deployed here in Germany.

The new management team is already in place and adapting the business for the new normal is under way. Our aim is to produce a new business model in Life Insurance that will ensure long-term profitability and a stronger focus on distribution strength through customer-centric operating units.

Moreover, it will also include a more lean and modern operating platform. All these measures aim to successfully reposition Generali Deutschland and enable it to face the challenges ahead. A restructuring charge of €100 million associated with this work has already been booked in the second quarter.

In France, the results have been very good, too. In the Property & Casualty segment, in particular, we see an improvement of the overall combined ratio to 99.2%. A meaningful contribution to this impressive performance has clearly been the absence of storms, heavy rain and hail in the first half.

But we've also seen an improvement of more than 2 percentage points in the underlying combined ratio which, therefore, starts to evidence the success of the turnaround actions which Eric Lombard and his team have taken over the last two years. Consequently, we're confident of delivering a sub-100% combined ratio in 2016 as promised, even without counting on an absence of natural catastrophes as we saw in this semester.

Our Life business in France remains dynamic with a more efficient mix of sales. It is very pleasing to see the significant increase in unit-linked products. In addition, we have started to distribute new pension products with more favorable economics this month. Further initiatives to drive profitability in our Life products will be released in the coming months.

Overall Life net inflows for the first half are €700 million, which is a remarkable improvement in contrasting to this time last year. Again, this is fueled by unit-linked flows, which more than doubled from last year and accounted for 80% of the net total.

Finally, turning to our business in Central Eastern Europe, our results are just as promising. In our Property & Casualty segment, we have seen another excellent performance. We have a Property & Casualty business which is well run and profitable in markets which have greater growth potential than in the other more mature markets of Europe. I continue to be excited by our business here.

Overall, these are very promising results for the start of the next phase of our transformation. The main engines of Generali's core business in Europe are all running smoothly and we're travelling in the right direction.

Let me finish now by giving you a recap of where Generali will be heading in the coming years. After accomplishing a deep financial turnaround of our group, we have shifted our focus to outwards and set clear yet ambitious goals. We want to become Europe's number one retail insurer. This is defined by becoming the first insurer that pops into a customer's mind in terms of service and products is not only size.

Generali's DNA is one of the European retail insurer, and we want to build on this strength. One of the ways we'll achieve this is by enhancing our already powerful distribution capabilities and keeping them for the future, for example, by providing our agents with more efficient digital tools. It also includes better customer insights and transforming that into a brand that comes top of mind in terms of service. Put simply, we want to become more and more important to the customer and the best at serving them.

Secondly, we need to become a fast, lean and agile company with a focus on generating cash. We are putting in place a strong and effective governance and organization which allows us to become more efficient in executing on our ongoing business transformation. Going forward, we will continue to be rigorous in seeking out and taking advantage of group synergies and economies of scale. The goal is to be lean and also agile with cutting edge technical capabilities.

Thirdly, we want to become simpler and smarter. By using data analytics, we want our insurance solutions to be more relevant and appealing to our customers. Generali will be known for offering innovative, efficient, customer-friendly solutions seeking to cut out the complexity and replacing it with ease and convenience. And in order to make insurance solutions more smart and simple, we will significantly leverage in technology and partnerships. We're very much aware of the importance of technology in our sector, like many others.

In order to become a successful retail organization, we will need to leverage on that. We want to further develop simple and smart connected insurance, such as telematics, behavior-based health solutions and domotics. And in addition, we'll leverage on partnerships with innovative providers. Some of this will also bring in-house such as our recent acquisition of MyDrive Solutions, which will become a UK-based hub for the whole group in the field of data analytics aimed at offering tailor-made solutions for our customers.

Generali has clear financial goals. As I mentioned before, cash generation is our main focus. We seek to generate cumulative net free cash flow of more than €7 billion by 2018. Just to compare, last year, our net free cash flow was €1.2 billion. This shows how seriously we are about generating cash for the next three years.

We're also committing ourselves to pay more than €5 billion in dividends through 2018. Remunerating our shareholders and providing an attractive yield are priorities for us. In addition to all this, we're committing ourselves to cutting costs at a pace of €250 million per year to reinvest a big part of this savings into innovations and business development. We remain committed to keeping our nominal cost base flat at the 2012 level of €6.3 billion. At less than € 3.2 billion, our costs in the first half show us to be exactly in line with that.

And finally but not less importantly, we remain committed to generating a compelling operating return on common shareholder's equity in excess of 13% over the cycle. This is a highly attractive return in a world where yields on major European government bonds remain below 1%. We have a very clear vision of how our group should look like by 2018. In order to realize these goals, we will continue to remain as focused and determined as we have been over the past three years. This will be a challenge, and we do not plan for support from the market. And we do expect resistance from our competitors, but these results provide evidence that we are headed on the right path and we're focused on delivery. Thank you for listening.

Alberto Minali {BIO 16909383 <GO>}

Good morning. This is Alberto Minali, CFO of Generali. I'm pleased to report to you this morning an encouraging set of first half 2015 results. Let me start with a brief overview while noting that, as before, prior year's figures had been restated throughout the old presentation to reflect the current geographical perimeter of the group.

The total operating result of the period reached almost €2.8 billion, thanks to positive performance of all business segments. The net result of the period is up 21.6% to €1.3 billion. It's fair to say that last year's result had been affected by the €190 million impairment of Ingosstrakh. This year's results have been nevertheless influenced by higher restructuring charges. The operating return on equity has improved by 110 basis points from 7.2% to 8.3% year-on-year on a basis which is not annualized.

Shareholders' equity remained substantially flat from year-end 2014, decreasing in the second quarter of the year due to rising interest rates. Our strong pro-forma internal model economic capital ratio further improved by 14 percentage points from the end of 2014, reaching the 200% threshold. Overall, operating result increased by 11.3%.

Looking at the segments in more detail. The Life operating result posted a strong 13.2% increase to €1.7 billion. Property & Casualty showed a 2.3% increase, reversing the negative performance of the first quarter. The segment Holding and Other businesses increased 7.9% to €71 million profits, driven again by very strong result of Banca Generali.

Let them see the journey from operating result to the bottom line. Non-operating investment income reached €351 million, thanks to higher net realized gains and lower impairments, again, reflecting the impairment of Ingosstrakh last year. Non-operating holding expenses decreased by 10.3% to €367 million, thanks to €41 million lower interest costs. Other known operating expenses increased by €298 million versus the same period last year.

Let me explain this movement, which is mainly one-off. Firstly, we have €134 million higher restructuring costs. This item is exceptionally high in the second quarter, mainly due to the specific issue in Germany where the restructuring program is moving ahead and, in fact, we have booked the full restructuring charges there much earlier than originally expected.

In addition, in Germany and in Italy, we have strengthened some other provisions against specific items, explaining their remaining delta. These will also not be recurring. Therefore, I would expect the other non-operating expenses to be very much lower in the second half of the year compared to the exceptionally high levels seen in the first half. Despite these, net of taxes at a similar rate last year, the overall net result increased by 21.6%.

Let's now turn to look at the balance sheet. Shareholders' equity remained broadly stable at the year-end level. The €1.3 billion positive contribution on net profits has been almost entirely counterbalanced by the negative evolution of the available-for-sale assets, and in particular, of bond investments in the second quarter. The dividend payment in May has reduced shareholders' equity for further €934 million, while other items were €932 million positive, mainly as a positive effect on the pension liabilities deriving from increased interest rates and the positive currency movement, in particular due to the appreciation of the Swiss franc towards the euro.

Our Solvency I ratio remain overall stable at 156% or 164% pro forma for the sale of BSI. On the positive side, the net result contributed for 8 percentage points. On the negative one, we had an increase of our required margin, driven by the underlying growth of our Life business and by exchange rate effects, with 6 percentage points negative impact on the ratio.

Financial markets and other had an additional 1 percentage points negative impact with negative effect from higher interest rates offsetting the associated positive impact in our available capital from the aforementioned reduced pension liability and foreign exchange movements.

The pro-forma view of economic solvency using our new internal model further increased in the first half to 200% from 186% at year-end 2014. In addition to the organic creation of capital, financial market effects and especially the improved level of reference rates contributed to both an increase in own funds and a reduction in the SCR.

Let me focus now on our business segments starting with Life. Overall, Life premiums increased strongly by 10.6% to €26.9 billion driven by positive trend of all business lines. Worth mentioning is the continuing growth of unit-linked production that posted a 25.7% increase with a particularly strong contribution of Italy and France.

Life net inflows also continued their strongly positive trend, growing 38.5% year-on-year and reaching €8.2 billion. The Life operating result went up 13.2%. New business value was down 29.2% at €474 million due to a 8.5 percentage points margin contraction. This is the consequence of the rather extreme economic scenarios at the end of March as I will explain to you in a moment.

Let me first dive into the single drivers of the Life operating result. The technical margin posted a robust 6.1% increase, thanks to higher risk results in Germany and increased unit-linked fees in Italy and France. The investment result increased by €284 million, partially due to the growth of the invested asset base, but also thanks to higher net realized gains.

I would add that part of these profits have been used to increase our policyholders' reserves, such as the strengthening of the PPE (20:47) in France by €170 million or the ZZR in Germany by €58 million net of policyholders' participation. Expenses increased by 11% mainly due to increased acquisition costs as a consequence of the growth in volumes, but the overall Life expense ratio declined 0.2 percentage points to 9.4%.

Life net inflows started with a very positive trend reaching €8.2 billion in the first half of the year. Our continuing focus on increasing the share of more capital-efficient products enabled us to have, once again, the majority coming from unit-linked business, which accounted for 52% of total net inflows.

Looking on a country basis, in Italy, we have a particularly strong increase of net inflows at €3.9 billion, up 78% year-on-year. The growth has once again been driven by unit-linked business, thanks to the success of our hybrid products. In France, we see an acceleration of the recovery trend starting in the second half of 2014 with the €721 million positive net inflows driven by strong unit-linked premium up 46% and also reduced surrenders.

Also in Germany, after the planned reduction of single premium saving business in 2014, net inflows continued their recovery showing a 23% increase driven by the unit-linked component. Lastly, the decrease in EMEA is mainly explained by contraction in the sale of wealth protection products in Europe through our platform in Ireland and by increased maturities in Austria.

These strong net inflows contributed to an overall 5.2% increase of Life technical reserves over the first six months to €365 billion. It is worth highlighting the particular positive development of unit-linked reserves, up 13.4% to €76.5 billion. Life general account investments remain overall flat at €322 billion compared to the end of 2014. Total Life current returns are down 10 basis points to 170 basis points for the first half. As always, this is not an annualized figure.

In absolute terms, current income increased 2.6% reaching €5.5 billion. Fixed income current returns in particular had the same development as total Life ones. Also here, current income increased by €233 million or 5%. In the first half of the year, we invested pre-existing cash, net inflows, bond redemption and coupons at an average yield of 2.4% in the Life segment, mainly in financial and non-financial corporate bonds and government bonds.

Turning to new business, APE is up 5.4%, like-for-like to €2.7 billion, driven by strong performances of unit-linked and protection, up 35% and 21% respectively while saving business posted an almost 8% decline. Unit-linked production weighted for 26.7% on APE versus 20.7% in the first half of 2014. Protection business increased its share to 16.6% from 14.1% year-on-year. As you can see, the relentless effort to redirect our production towards more capital-efficient products is continuing.

Looking at our main countries. In Italy, APEs decreased by 1.6% due to positive group business one-off during the first half of last year. Net of this one-off, APE would have increased by 13.9% (24:44). In terms of business mix, we see a continuing strong performance of unit-linked production with weight on APE strongly increased from 8.7% to 22%, thanks again to the continuing success of hybrid products. At the same time, guaranteed saving business declined by 16.3%. We saw a strong development in France where APEs increased 27%. The biggest contribution came from unit-linked, up 54%, and protection business, up 46%.

Germany grew by 5.1%, driven by 38% increase of unit-linked production. Traditional savings business decreased on the other hand by 8%, in line with our strategic decision to continuously decrease the weight of fewer guaranteed savings products. The new business margin experienced a sharp decrease down 8.5% points to 17.5%.

The positive impact on the margin of the change in business mix as well as reduced minimum guarantees was much more than offset by worsened financial scenarios. I remind you that the new business value of the second quarter of the year is calculated using financial assumptions as at the end of March, which were characterized by reference rates at the lowest level ever and by very high volatilities.

At the end of June, these assumptions have improved substantially, this assumption which will be relevant for the new business value calculation in the third quarter. All other things being equal, you should, therefore, expect to see a significant recovery when we report our nine months results. As a consequence of this profitability contraction, the new business value decreased by 29% on a like-for-like basis to €474 million.

Now let's turn to look at the P&C. Gross written premium are overall stable on a like-for-like basis at €11.3 billion. Looking at business line, Primary Motor posted a 1.7% decline mainly driven by Italy and France, as I will explain later, but with an improving trend in the second quarter of the year. Primary Non-Motor increased by 0.9%. The combined ratio improved by 0.2 percentage points notwithstanding a slightly increased nat cat burden. The operating result improved by 2.3%.

Looking at the components of this operating profit increase, we can see a technical result at €644 million, down 0.7%, a positive development of the investment result as a result of slightly decreasing current income more than compensated by reduced interest expenses on operational debt and investment-related expenses and an improving residual other items line that increased by €7 million.

Let's look now at gross written premium developments within our core countries. Italy is down 3.5% at €2.9 billion, still driven by the highly competitive environment of Motor. Primary Motor decreased by 9%, consistent with the trend observed in the first quarter, mainly due to reduced average premiums. Primary Non-Motor is slightly positive with a slightly declining health business compensated by growing personal lines.

France declined by 2.5% to €1.380 billion due to the competitive market environment and the continuation of strict underwriting guidelines and pruning activities. Primary Motor continue its negative trend with a 5.5% decrease driven by an ongoing pruning of unprofitable fleet and garage-related contracts, and by a still soft retail market but will continue positive signs in terms of number of contracts in the retail segment.

Non-Motor is down 1.5%, mainly due to contract cancelations in the commercial construction and general liability businesses. It is worth pointing out that the rate of decline of both lines has moderated since the first quarter, which is an encouraging sign for the future.

In Germany, premiums went up 0.6%. The reason for this slow growth rate is that the Motor business, up 0.7%, is also this year affected by the ongoing shift from the main renewal date from January to other months of the year, that in June affect policies with the semiannual payments. As in 2014, we expect that this effect will be leveled during the rest of the year benefiting also from relatively good market condition, with average portfolio premiums still rising. Non-Motor went up 0.6%.

Moving to the profitability analysis. The combined ratio improved by 0.2 percentage points year-on-year to 92.6%, in presence of a 0.1 percentage points higher nat cats. The main nat cat events were storm Mike and Niklas affecting mainly Germany and also winter storm Anton, which caused losses in Italy. Looking at the single drivers, the loss ratio improved by 0.7 percentage points, thanks to the improving currency result, down 0.3 percentage points and higher prior years releases. The expense ratio increased by 0.5 percentage points, mainly driven by higher acquisition costs.

Looking at the combined ratio in our main countries, in Italy, our combined ratio deteriorated slightly, but still at a net solid 88.7%. That should be seen in the light of the nat cat losses that were worse by 1.6 percentage points. In France, the combined ratio improved significantly by 5.9 percentage point to 99.2%, thanks to a 6.4 percentage points lower loss ratio helped by the absence of nat cats that last year weighted for 3.6 percentage point, as well as by better current year results, reflecting the first signs of success of our turnaround efforts. In Germany, the combined ratio decreased by 1.2 percentage point despite the 0.7 percentage points higher nat cats. CEE confirms its outstanding profitability levels with an 85.4% combined ratio.

Overall, P&C investment remained stable at €39 billion with respect to year-end 2014. In terms of investment returns, total P&C not annualized current returns declined by 10 basis points to 170 basis points. Also fixed-income current returns decreased by 10 basis points partially compensated by increased current returns on real estate and equity investments. The average of investment rating P&C during the first half of the year has been 2.1%.

Let me finally turn to our Holding and Other businesses segment whose overall contribution to the group operating result increased from €66 million to €71 million. This improvement has been entirely driven by the positive contribution of financial businesses that posted a €45 million improvement. And in particular, Banca Generali which yet again posted an excellent performance.

Operating holding expenses increased from €197 million to €251 million year-on-year. This is reflecting the reinforcement of the Group Head Office structures starting 2013 and further developed in 2014, including the transition to the new Solvency II regime as well as the development of Regional Offices aimed at leading, coordinating and controlling the key business areas for growth prospects, as in the case of Asia. Other businesses have increased their positive contribution from €62 million to €77 million.

Overall, we are very pleased with the progress made in the first semester of the year in challenging market conditions. We have seen profitability improvements across the business lines backed up by strong volumes and improving mix in the Life segment. And our underwriting fork (33:12) is leading to the best-ever combined ratio for the semester in P&C. We are well placed for the transition to Solvency II with a pro-forma internal model economic capital ratio, which has further strength to 200%. Overall, as Mario said, this is an excellent foundation from which to execute our new strategy. Thank you very much for your attention.