Q3 2011 Earnings Call

Company Participants

- Clive Bannister, Group Chief Executive
- Jonathan Yates, Group Finance Director

Other Participants

- Duncan Russell, Analyst
- James Pearce, Analyst
- Jon Hocking, Analyst
- Kevin Ryan, Analyst
- Marcus Rivaldi, Analyst
- Oliver Steel, Analyst
- Toby Langley, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Phoenix Group Holdings 2011 quarter three interim management statement conference call. My name is Lloyd. And I will be the operator for your call this morning. I will now hand over to Clive Bannister, Group Chief Executive.

Clive Bannister {BIO 2183003 <GO>}

Thank you very much, Lloyd. Good morning, everybody. My name is Clive Bannister and I welcome you all to our Third Quarter interim management statement call.

I am the Group Chief Executive of the Phoenix Group. And I am joined here today by Jonathan Yates, our Group Finance Director; and Lorraine Rees, Head of Investor Relations.

Jonathan and I will be very happy to answer your questions in a few minutes. But first, I would like to take you through the highlights of our Third Quarter statement, which we released earlier this morning.

I'm very pleased to report the Group demonstrated real resilience in the Third Quarter and we expect to deliver on all of our 2011 financial targets; namely cash flow, MCEV uplift and organic deleveraging.

First, on cash generation. Cash generation at the Holding Company level. And the free surplus within the Life Company, are important metrics for the Phoenix Group. We recognize cash when it has been passed up from the operating companies to the holding companies. The free surplus within the Life Companies is consistent with the GBP750 million to GBP850 million full-year target for cash generation that we have published before.

Holding Company cash receipts totaled GBP503 million by the Third Quarter. The same number last year was at GBP364 million. This is an increment of over GBP139 million, or a 40% uplift.

As we speak today we have remitted a further GBP100 million from the Life Companies up to the Holding Companies, subsequent to September 30, taking the total year-to-date cash generation to GBP603 million.

This GBP100 million cash flow includes a further GBP89 million from cash flow acceleration from management actions, split equally between risk management activities and operational management activities. We continue to have a strong pipeline of cash flow acceleration management actions, which will emerge in the rest of quarter 4 and into 2012.

In total, closing cash in the Holding Companies was more than doubled to GBP691 million from the same period last year.

Second, I also want to take this opportunity to reiterate that we are on track to meet our GBP100 million target for MCEV enhancements through management actions by the year-end. Again, I am looking at a strong pipeline of actions, which gives me confidence on this point for the full year.

Third, de-gearing remains a key focus for us. We have already achieved our target of reducing our gearing ratio below 50% by year-end at the interim stage. And this position has been maintained.

The final tranche for 2012 mandatory payments on the bank facilities of GBP62.5 million was paid in October.

In the current environment I am particularly pleased at the resilience of our balance sheet. This has been proven again. Both our estimated IGD surplus and headroom were unchanged from the interims at GBP1.1 billion and GBP300 million respectively. This is a direct result of the de-risking we have done over the past few years and is absolutely in line with the IGD sensitivities that we have previously disclosed, which showed both these measures to be relatively insensitive to volatile markets.

Ignis, our fund management company, sustained its assets under management at just over GBP68 billion. The asset mix meant that there were no severe negative impacts for market movements in the period as increases in fixed income offset the fall in equities.

Net new money of GBP1.1 billion was up 10% over the same period last year and reflected strong inflows in the liquidity business in particular. And has largely offset the natural run-off in our Life book.

Over the period in question our exposure to peripheral European sovereign and financial institutions was down from GBP480 million to GBP189 million, a decrease of GBP282 million, or nearly 60%. We recently ran an Investor Day on Ignis which provided more details on each of the individual business units. And this is, of course, on our web site.

The Phoenix Group is more than a balance sheet, it's a business. The Group has continued to deliver operationally, bringing policy holder and shareholder benefits.

The systems transformation is progressing well with over 200 million life policies now transferred from legacy administration platforms to a modern bespoke platform we call BaNCS. All Pearl policies have now been transferred. The benefits of the IT transformation program were outlined in the Phoenix Life investor presentation, which we did in June. And, again, this is commented on in our web site.

We are pleased that our approach to estate distribution has meant that we are being able to increase payouts by around 3% to 10% for certain customers. TCF, treating customers fairly, is crucial to our modus operandi.

As we said at our full-year results for 2010. And we repeated at the interims, the Phoenix Group is on a journey. From private equity ownership, through our premium listing of a year ago, it is a progressive journey of normalization.

These Third Quarter interim results mark another important step on that road. A solid set of results, demonstrating the resilience of our balance sheet; Ignis' performance; and the continued operational delivery of our business. And we can say that we expect to meet all our financial targets in 2011.

At this point I'd like to finish. And if we may, Lloyd, can we move on to a question and answer session, where Jonathan and I stand by to answer all your enquiries.

Thank you very much.

Questions And Answers

Operator

Thank you, Clive. (Operator Instructions) Jon Hocking, Morgan Stanley.

Q - Jon Hocking {BIO 2163183 <GO>}

I've got three questions, if I may. Firstly, the cash flow target of GBP750 million to GBP850 million for this year. You obviously seem very on course to hit that. I wonder if you could talk a little bit about the range we might expect for 2012.

Secondly, you mentioned that there is a GBP62.5 million on the mandatory debt repayments that's paid in October. Are you going to make any voluntary payments on the debt in the remainder of 2011?

Then finally on the IGD you've got this -- obviously you've got a GBP0.3 billion of headroom. Given the environment, is there an opportunity to increase that headroom, or is that headroom likely to be stable? And is there anything underlying the IGD which looks a little bit more stressed than the stable headline number? Thank you.

A - Clive Bannister {BIO 2183003 <GO>}

Jon, thank you for those questions. Jonathan, I'll answer the first. And then will you take the debt one and deal with the IGD headroom. That would be very kind.

Listen, as we've said, we are on track to hit between our GBP750 million and GBP850 million. And I think, at this time, it's appropriate simply to give you that clear guidance and repeat it, because that is how we see the state of play.

So Jonathan, why don't you tackle the debt?

A - Jonathan Yates {BIO 15522084 <GO>}

In terms of discretionary debt payments, we're not expecting to make any further payments this year. Next year, maybe; it's quite possible that we will look to accelerate. But in terms of the -- what we're looking to pay this year, it will be the mandatory amounts.

In terms of the targets that we'll be setting for things like cash flow, MCEV, accretion and things like that, we'll probably come out with those early in the New Year as we did last year. I think that we actually announced them with our full-year results and we'd expect to carry on that pattern for next year.

And finally, on the issue of IGD headroom, obviously we are particularly pleased with the way in which our IGD headroom has actually held up over the last three months, or obviously, the period since the half year. Obviously these are very challenging times and other companies have found it very difficult.

But I think one thing about Phoenix is that we've spent the last 2.5 years or so really de-risking its balance sheet and I think we're really seeing the benefits of that now.

And that's very much what you're seeing here; IGD surplus and the headroom over our capital policy maintained at the levels that we had previously, in spite of the market conditions. It didn't happen just by chance. There were management actions that we were able to push through to keep it up at the existing levels. But I think, of course, management actions are part of what we use to manage our balance sheet through challenging circumstances.

So personally I was extremely satisfied with our performance in that regard.

Q - Jon Hocking {BIO 2163183 <GO>}

Okay. Thank you very much.

Operator

Toby Langley, Barclays Capital.

Q - Toby Langley {BIO 15924432 <GO>}

One question on refinancing; I'm wondering if you could give us some sense as to what your bankers have indicated to you would be the interest rate you would incur were you to refinance at the current time.

Then, separately, I was talking about this with Lorraine earlier, the disclosure is only on actual cash movements and I'm just wondering if you can give us some sense as to the free surplus generation that's been produced in the year. That would be really helpful, thank you.

A - Clive Bannister {BIO 2183003 <GO>}

Toby, thank you very much indeed. I'm going to tackle the first question and I'll ask Jonathan to tackle the second.

Our interest rates weighted at the moment are at about 195 basis points. No. We have not had any indication from our banks because we are not asking for a refinancing.

As you know well, Toby, it's not an issue in our mind of quantity of debt. It's a question of the terming of the debt and the obligations that we have for repayment in '14, '15 and '16. What I'm very happy to say is that we continue to have very cordial relationships with our banks who are immensely supportive.

We outline in our full annual report the nature of our future debt costs and charges and so that's what we expect and that's where we are at the moment.

Jonathan, do you want to talk about the surplus?

A - Jonathan Yates {BIO 15522084 <GO>}

Yes, I can't be hugely helpful in this regard, I'm afraid. But what I can say is that clearly we monitor our solvency continuously. So daily solvency monitoring for the surplus within the Life Company and, pretty much like I was saying on IGD, these have been very challenging times.

You've seen a combination of falling equity markets, rising credit spreads and falling yields. And that combination is just about the worst possible combination for Pillar 2 surplus. And so what we've seen is Pillar 2 surplus put under quite severe stress.

But having said that, I come back to the point I made before which, with the combination of previous de-risking that we've undertaken, plus the management actions that we've had at our disposal, we've actually been able to sustain the level of free surplus at a level which gives us the -- that means that we do still expect to be able to deliver cash generation out of the Life Companies from that free surplus, sufficient to meet the targets that we set for the year; in other words, GBP750 to GBP850 million.

Q - Toby Langley {BIO 15924432 <GO>}

Can I ask a follow-up question?

A - Jonathan Yates {BIO 15522084 <GO>}

Of course.

Q - Toby Langley {BIO 15924432 <GO>}

What kind of yield are you able to achieve on cash generated and then held in stock, if you like, at the moment?

A - Jonathan Yates {BIO 15522084 <GO>}

Good question. What we do is typically we -- the cash which we bring out, we put it into -- effectively it goes into long-term liquidity. But for a Holding Company, we broadly look to hold sufficient cash to meet our cash requirements, our outgoing requirements for another 18 months or so. So very strong cash buffers.

And what we do is we look to invest in the light of the term of our liabilities. So typically what we would be doing is we'd be looking to invest in liquidity funds, which are run by all the various banks. And of course, Ignis, Ignis has probably the UK's leading liquidity fund and we actually put a significant amount of our cash in there.

And typically the duration of that fund would be something like getting on for perhaps a month, maybe; something of that nature, at the most. Probably more likely less than a week in many cases. So very short dated. And typically yields on those are of the order of 85 basis points.

Q - Toby Langley {BIO 15924432 <GO>}

Thank you very much.

Operator

Kevin Ryan, Investec.

Q - Kevin Ryan {BIO 1814771 <GO>}

I was just wondering about the additional GBP100 million of cash which emerged since the quarter end. Is that a regular amount you would expect? And could you give us a feel for the dynamics of the cash emerging in the Group and whether this is likely to change going forward? Thanks.

A - Clive Bannister {BIO 2183003 <GO>}

Kevin, thank you very much for that question about the GBP100 million which emerged and I think I said how it would be GBP89 million, how it had emerged. But I'll let Jonathan answer it. Then you've asked about future cash and the timing thereof.

A - Jonathan Yates {BIO 15522084 <GO>}

Yes. It's a good question. The reason GBP100 million came up is because it was identified as being surplus. We had a Life Company Board meeting and then the Board was happy to approve the payment of that money up to the Holding Companies.

So that payment was made for that reason. It just happened to be the amount that was identified and the Board was comfortable to transfer at that time. It's not what we would expect to form part of a regular pattern of GBP100 million kicking [ph] up on us on a periodic basis. It just happened to be where we were.

In terms of looking forward, we can't really give predictions as to the precise timing of cash generation. But of course, we do look to set the cash generation targets for the calendar year. And the precise timing within the calendar year is really hard to pin down.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thanks.

Operator

James Pearce, UBS.

Q - James Pearce {BIO 16758460 <GO>}

Two questions; first of all, could you explain whether the fall in peripheral sovereign, etc., is because of sales, impairments, market movements or what?

Then second, on the debt restructuring, can you talk a little bit more about why we haven't seen more progress? It's been a couple of years now and I thought this was somewhat more urgent than it appears to be in that it would allow the full integration of the two silos of the Life business. Thanks.

A - Clive Bannister {BIO 2183003 <GO>}

James, thank you for those questions. The first point is that we have consciously -- this is Ignis, has managed these assets so it's not due to a write down. But these have been due to sales.

As I said a few minutes ago, our exposure here to financial institutions and sovereign debt on behalf of the shareholder and the non-profit funds has moved from GBP480 million to GBP189 million which is a decrease of just over 60%. So this is conscious and it's a way of managing our risk against the benchmarks that have been set within the Life Company.

Then, on your second question, which is regarding the debt restructuring, it's a very good question and it's a slightly moot point. We have very good value debt and the debt supports our capital structure well. It behooves us to work on behalf of the shareholders to re-term that debt on terms which are advantageous to us and, of course, fair to our banks who are a critical partner in our story going forward.

You've mentioned one of the concomitant benefits of such a re-terming, which would allow us to bring silos together. But that has to be balanced against the timing and the appropriateness of whatever re-terming we are discussing with our banks.

So it's not a question of if, it's more a question of when. And to do that at a time which is propitious for our shareholders; and so it is nothing untoward in this. So I go back to my earlier comments. But as you can see from our balance sheet, the value of this debt is obvious to our shareholders and retaining that is sensible until such time we get the right re-terming arrangements.

Q - James Pearce {BIO 16758460 <GO>}

Okay. Thank you.

Operator

Oliver Steel, Deutsche Bank.

Q - Oliver Steel {BIO 6068696 <GO>}

I've got three questions. The first, following up from James's question on peripheral sovereign deb. Where are you reinvesting this money and does that have any implication for future cash flows to shareholders?

The second question surrounds the furor over liquidity swaps and again, does this have any implication for future cash flows.

And the third question is whether you're seeing any greater scrutiny or greater intervention by the FSA in terms of your ability to dividend up cash from the Life Companies?

A - Clive Bannister {BIO 2183003 <GO>}

I'm going to answer those in the reverse order. We never comment on relationships with the FSA who continue, as always, to be our lead regulator and looks after us and we continue to have very good relationships with them.

Let me take your first question -- is that I can't tell you. And I don't think it would be right, to go -- what we've done by selling down on the peripherals, where that has been invested. We have a broad range; we are 85% fixed income; 15% in equities, these are in crude terms; 5%, 4.5% in property; and then we have some others.

So we would have to get back to you, Oliver, for more precise detail. But I think that might have to wait the year-end.

Then I think on your second question about liquidity swaps and how that affects cash flow, I'm looking at Jonathan.

A - Jonathan Yates {BIO 15522084 <GO>}

I think it's been fairly well-known that we have looked at liquidity swaps in quite some detail over the last 18 months. So it goes back quite some considerable time.

Now we consider it a very attractive form of investment for us. We would like to look to use the gilts that we hold and capture the liquidity premium that's available to us by doing transactions with banks. We think the security that the banks are capable of offering us is extremely good.

And the risk-return dynamic is very attractive, certainly when you compare it with the alternatives, such as investing in corporate bonds or indeed covered bonds. We think that, obviously, there's a lower return but the risk profile is very much better suited to our business.

So we'd be very keen to do this as soon as the FSA has completed its consultation and decides that it is prepared to actually countenance these transactions going ahead.

Q - Oliver Steel {BIO 6068696 <GO>}

So you still think that, potentially, there is some sort of deal that can be done here?

A - Jonathan Yates {BIO 15522084 <GO>}

Yes, very much so, yes. I don't want to quote -- I did actually have a quote from somebody fairly senior at the FSA who made the comment, well where else are the banks are going to get their funding from if not from the insurance companies and the pension schemes? And this is a very attractive form for us to actually provide that funding.

At the moment, we provide our funding in the form of unsecured corporate bonds. More than 50% of the iTraxx index is comprised of financials. I'd much rather lend in a secured form than in an unsecured form, which is historically what's been the case.

And I think the idea of actually doing it -- as I say, there is a lower return on secured funding in this way. But actually the risk profile is so much better and so much better suited to a Company like us, which is obviously here to meet -- we hold the money to meet policyholder guarantees.

Q - Oliver Steel {BIO 6068696 <GO>}

Okay.

A - Jonathan Yates {BIO 15522084 <GO>}

I think it's an extremely attractive opportunity for us, which is not to say we want to invest 100% of our assets in that form. But it certainly gives us a very interesting opportunity for diversification, away from unsecured funding.

Q - Oliver Steel {BIO 6068696 <GO>}

Thank you.

Operator

Marcus Rivaldi, Morgan Stanley.

Q - Marcus Rivaldi {BIO 5739374 <GO>}

I've got two questions please, first a follow-up from the liquidity swaps debate. And I guess we're slightly in the dark here, given no disclosure about maybe what security you might be looking at. But could you give some flavor about what banks are proposing for security here?

And can you give some sense about what skill set you have internally to be properly managing, from a risk perspective, that security?

Then second, just a second point on your fund merger program. You flag up NPI Limited today. Could you maybe just highlight what other funds might be available for you to carry on merging into Phoenix Life without resolution around the long-term resolution on your bank facilities?

A - Clive Bannister {BIO 2183003 <GO>}

Right, well I'm very happy to answer the first question, sorry, the second part of that question. But the first part, I think, hand back to Jonathan. Jonathan, do you want to deal with the banks and the liquidity?

A - Jonathan Yates {BIO 15522084 <GO>}

Yes, sure. In terms of what the banks offer by way of security, we've had conversations with a number of banks who approached us with a view to doing transactions of this type. And each was offering different types of security, reflecting the sort of assets that they had on their balance sheet. So without being specific in relation to individual banks, it's everything from residential mortgage bank securities to PFI-type assets.

And those kinds of assets, you're absolutely right. Obviously the bank is managing the asset up until the point at which the bank fails and all of a sudden your collateral becomes your asset. And in that situation, obviously, you do need the capacity to manage it, which is one of the highlights -- the things that the FSA has highlighted as part of its consultation.

And we're in a particularly strong position in that regard, in that, obviously, we have Ignis, our in-house asset management company. And that gives us the ability to actually manage these assets. And we have the confidence to do it, not least because we're already managing assets of this type. So this would just be more of the same.

So the quality of the collateral that we're getting would be exceptionally high in that situation.

A - Clive Bannister {BIO 2183003 <GO>}

Jonathan, thank you very much indeed. We talked about this, Marcus, at our June day. So happy to come back in greater detail. But as you know, we seek to get value from benefits in our Life business; risk management; restructuring; operational management; and outsourcing. And you've asked specifically about the restructuring.

So we are currently, we have five funds in the UK and five Life Companies in the UK and one in Ireland. It is our objective next year and probably in the second half, to bring two more together. Then that will bring additional benefits.

And of course, it is those structural things, not exclusively. But those structural things that allow us to drive what we call management actions, which are normal course of our business that allows us to drive forward and accelerate and release cash for that.

Q - Marcus Rivaldi {BIO 5739374 <GO>}

Just, sorry, what were those two funds? Sorry, I missed it in the middle of the year. But the two that you're targeting maybe for the second half of next year?

A - Clive Bannister {BIO 2183003 <GO>}

Pearl and PLF.

Q - Marcus Rivaldi {BIO 5739374 <GO>}

Thank you very much.

Operator

Duncan Russell, JPMorgan.

Q - Duncan Russell {BIO 15944951 <GO>}

Just one question really which is the free surplus generation phrase; just to be clear, is that the same basis as the GBP199 million you reported for the first half of 2011, i.e., includes investment variances?

A - Clive Bannister {BIO 2183003 <GO>}

Duncan. Good morning, thank you for your question. Investment variances included; we're just checking back on the GBP199 million, as you speak.

A - Jonathan Yates {BIO 15522084 <GO>}

Yes. Thanks Duncan. And in terms of the free surplus generation, you're absolutely right, that was the surplus generation within the Life funds.

And what we're saying is that the surplus which is within the Life funds and the surplus which continues to be generated should be sufficient to enable us to meet our target for cash generation for the whole year.

Q - Duncan Russell {BIO 15944951 <GO>}

Okay. So, obviously that includes -- that was defined as the total movement in the free surplus excluding the cash up streamed. That strikes me if that's the same definition, then that's quite positive.

A - Jonathan Yates {BIO 15522084 <GO>}

Yes.

Q - Duncan Russell {BIO 15944951 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Clive, it appears we have no further questions coming through. So I'll hand back to you for any closing comments you wish to make.

A - Clive Bannister {BIO 2183003 <GO>}

Okay, well listen, I'm going to wrap up in literally 20 seconds. But these are strong, solid results and we've delivered resilient financial and operational performance.

So as the UK's largest specialist closed life consolidator, we are happy at the generation of GBP603 million of cash from the operating companies. And despite the difficult market conditions, the Life Company free surplus generation is consistent with a full-year result of within the GBP750 million and GBP850 million of cash generation target that we've given before.

We're also proud that we have maintained our IGD surplus at GBP1.1 billion and that the assets under management for this business have remained stable at GBP68.3 billion.

And those are the sorts of results that make us happy to talk about strong and resilient. Thank you very much indeed.

Operator

This concludes today's call, ladies and gentlemen. Thank you for joining, you may now replace your handsets.