10 Months 2018 Sanlam Ltd Corporate Corporate Sales Call

Company Participants

- Heinie Carl Werth, Financial Director & Executive Director
- Ian Maxwell Kirk, Group CEO & Executive Director
- Wikus Olivier, Group Executive Finance

Other Participants

- Francois Du Toit, Director
- Johny Lambridis, Analyst
- Larissa Van Deventer, Analyst
- Michael Christelis, Director and Insurance Analyst
- Musa Malwandla, Research Analyst

Presentation

Operator

Good day, ladies and gentlemen. Welcome to the Sanlam 10 Months Operational Update. (Operator Instructions) Please also note that this call is being recorded.

I would now like to turn the conference over to Mr. Ian Kirk. Please go ahead, sir.

Ian Maxwell Kirk {BIO 1778703 <GO>}

Good afternoon, ladies and gentlemen. Thank you for joining us in this conference call. I'm joined on the call by my finance and actuarial colleagues, Heinie Werth, Wikus Olivier and Patrick Hartnic.

Let me first deal with the overview of results. We released details of the results for the 10-month period earlier this afternoon. I would like to make a couple of comments before we proceed to questions.

From a strategic perspective, I'm pleased with our progress in 2018, which is our centenary year. A particular highlight is our conclusion of the SAHAM Finances acquisition, the 53% deal, which is the largest transaction in our history. This transaction gives us unique footprint and competitive advantage across the African continent, which will be a key driver of future growth. The need to raise capital as partial funding for the transaction simultaneously gave us the opportunity to propose an integrated package of Broad-based Black Economic Empowerment transactions to shareholders. This was aimed at strengthening our competitive position in those areas where we do not yet have a fair market share. We've been working on this package for a period of time. And we consider that the package will position us well in those areas. The areas include third-party asset management, employee benefit, health and the entry-level life insurance market segment. These transactions are still subject to shareholder approval at a meeting which is scheduled for 12 December.

From an operational perspective, the group's clusters delivered an overall resilient performance for the 10 months ended 31 October, in a challenging environment which is characterized by weak economic conditions in a number of territory, including South Africa, which is our largest territory. And also significant volatility in global investment and currency markets. The South African equity market also had volatile trends and a particularly weak performance in the month of October, with the JSE All Share Index deteriorating from a minus 6% year-to-date decline up until the end of September to a minus 12% at the end of October 2018. This had a negative impact on investment returns and commensurately normalized headline earnings, particularly at the end of October. The hedging strategies, which we've had in place in our capital portfolio for a while, however, provided significant protection. And that limited the downside to an extent.

Some of the salient features of our performance for the period up to end October are as follows. New business volumes of ZAR 188 billion were up 3% on the first 10 months of the 2017 financial year. And the major trends here remained in line with how we reported for the first half at the end of June, first half of 2018. Net value of new life business or VNB increased by 7% or 12% up excluding structural activity and on a constant economic and currency basis. This is a good overall performance under the difficult conditions. Sanlam Sky and SEB achieved strong growth, which offset disappointing performances in Kenya and in Malawi.

Overall, net fund inflows of ZAR 36,2 billion were 5% higher than the ZAR 34,6 billion achieved in the comparable 10-month period in 2017. The 2018 net flows include an ZAR 8,5 billion withdrawal of passive mandates managed on behalf of an institutional client.

Persistency experience trends remained in line with the first half of 2018. Net result from financial services increased by 2% of the first 10 months of the 2017 financial year, impacted by increased new business strain and investment in future growth initiatives which included BrightRock, MiWay Life and Indie. Normalized headline earnings declined by 10% as a result of the significantly weaker investment market performance in the first 10 months of 2018 compared to the same period in 2017.

So overall, we are satisfied with the performance for the 10 months to October, which reflect our resilience and our ability to maintain value creation in the difficult times that we're in.

In conclusion, we expect that the economic and operating environment will remain challenging in our key markets certainly for the remainder of 2018. Investment market and currency volatility are also expected to persist. We, therefore, do not expect any significant improvement in the operational trends experienced in the first 10 months of

2018. Investment markets have recovered to some extent. And the economy may well slowly recover into 2019.

The SAHAM Finances integration is progressing well. The Sanlam Emerging Markets management structure is being aligned to create a dedicated focus on Africa as well as a new line of business structure, which will support the expanded cluster in Africa and will deliver in time the returns we expect from this investment.

On the capital side, we incurred internal and external debt of some ZAR 3,2 billion during the settlement of the SAHAM Finances acquisition. Our plan is to repay this, should shareholders approve that proposed empowerment share issues next week.

Over the medium to long term, we remain confident of the growth potential in all our markets, including South Africa. And we'll seek to deliver value to our shareholders and other stakeholders.

Thank you. I will now open the call for questions from the audience.

Questions And Answers

Operator

(Operator Instructions) Our first question is from Francois Du Toit of Citi.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

Francois?

Operator

We're going to move on to the next question then from Michael Christelis of UBS. My apologies, sir. We're just waiting for Michael to rejoin the call. (Operator Instructions) Our first question then is from Michael Christelis of UBS.

Q - Michael Christelis {BIO 15233664 <GO>}

Can you hear me?

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

Yes, Michael, we can hear.

Q - Michael Christelis {BIO 15233664 <GO>}

Just a couple of questions. Just for some clarification. I appreciate you can't give me detail. But a few comments. Firstly, you mentioned the Capitec funeral policies have got strong demand. I mean, I wonder if you can just talk about what sort of proportion of your 80% growth you're seeing in Sky related specifically to funeral alone. Just trying to understand the quantum there. And if that's the reason for the beat on my numbers? The second question around your value of new business. You commented about VNB being up 7%. And I'm just -- I'm trying to understand how that reconciled with the margin at half year that was severely lower than it was at full year. So I'm trying to see is that VNB margin differential between 10 months '17 and full year '17 a sharp spike up and therefore we should expect that to come back down? The numbers just don't seem to add up to what was reported, if that makes sense. The third comment, you made a point about EB claims experience. And we've gone through this repricing cycle across the industry. Can you maybe just comment as to whether we now need to go through another repricing cycle? I think you guys mentioned increases typically in the order of 30% or 40% over the last two years. Then lastly, on the investment result, I'm struggling to understand how the investment result can be down 55% for the 10 months when for the first six months you were actually up. And if I understand that your hedging protects you to basically a 0 return in any particular month. So at worst, I can see a 4% odd differential, even if here was spectacular for the performance in half 2. So I just don't understand where is the investment results that far down on last year? So if you can maybe just give some clarity on that?

A - Wikus Olivier {BIO 20074722 <GO>}

Okay. Yes. If we start with the investment results, from a relative performance perspective last year up to the end of October, this week's index was up by about 16%. And this year it was actually down about 15% in total.

Q - Michael Christelis {BIO 15233664 <GO>}

All right. But when you really maintain hedges, you only get -- either get 0 or at most 1, right?

A - Wikus Olivier {BIO 20074722 <GO>}

Yes. But you did move from a positive returns last year to effectively almost 0 this year. And that's where the minus 55% comes from.

Q - Michael Christelis {BIO 15233664 <GO>}

Even though you're up in half 1?

A - Wikus Olivier {BIO 20074722 <GO>}

Yes. But you must have look at relative. So 10 months, 10 months if we look at what the market did last year kind of June to June relative and October to October relative is a completely different picture.

Q - Michael Christelis {BIO 15233664 <GO>}

And maybe we'll take that off-line. I don't see how it can be that different, okay. Yes. VNB?

A - Wikus Olivier {BIO 20074722 <GO>}

On the VNB margins compared to what was reported in June, in particular, what you need to take into account is this increase in interest rates. So we moved from about 9.3% to 10% at the end of October, which had quite a significant impact on the VNB. Then also the turnaround on the EB, which is much lower than the average for the rest of the group.

Q - Michael Christelis {BIO 15233664 <GO>}

Right. But you still got rising VNB about 7% whereas your margin at June was much lower than it was in December, right?

A - Heinie Carl Werth {BIO 7529974 <GO>}

Margin is still lower than last year December, yes.

A - Wikus Olivier {BIO 20074722 <GO>}

Margin can be quite misleading to look at. But you can have VNB growth at lower margins.

Q - Michael Christelis {BIO 15233664 <GO>}

No, of course.

A - Wikus Olivier {BIO 20074722 <GO>}

Mix of business.

A - Heinie Carl Werth {BIO 7529974 <GO>}

Michael, you're not getting answer on Capitec. Because Michael, perhaps the easiest is, yes, Capitec did had a nice contribution in the first few months or now until October. But it's really not the main driver. There's a lot of good just organic growth and expansion of advisers in the what you call in the entry-level space. Then also Safrican are trying some good deals, again, during these last few months. But Capitec is starting to come through nicely as a nice contributor to this growth.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

Okay. On the EB claims, yes, it's -- we had actually thought that the experience would be a little bit better. So to answer your question, we will need to do some repricing to get back to where we need to be.

Q - Michael Christelis {BIO 15233664 <GO>}

So the industry widening, because we saw the similar commentary out of MMI couple of weeks ago as well.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

I think -- yes, there's only, I think, maybe for a shorter period. Otherwise, I read their comments. Ours is for a bit of a longer period. So -- yes, I think what's happening really is that the experience on the disability is not behaving properly. And I mean, it's understandable with people under pressure and employers under pressure. So that's really where the pain has been taken a bit. And we'll have to do some selective repricing. We have been doing some repricing. But it hasn't had the effect that is necessary.

Operator

Our next question is from Francois Du Toit of Citi.

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

Question may have been asked, I had to redial. Just quickly on the new business strain, can you give the percentage increase in new business strain over the period? Is it directly related to the volume increase as well on the more regular premium side? Then just on your dividend policy. Given that the weakness in earnings is in your cash earnings businesses rather than in Santam and given that there's been obviously an increase in shares as well as your per share numbers look worse than in terms of operating earnings, can we expect any growth in dividends? I think the last time operating profits were down back in 2008 at least you still gave dividend increases. So just the implications to dividends really, if we can discuss that from cash operating profit growth in this period? Yes. So those 2. And maybe also bit more color on the volumes. So if you could maybe express the life volumes on -- in APE terms, please?

A - Heinie Carl Werth {BIO 7529974 <GO>}

Okay. If I can, Francois, start on the dividend side, yes, the new business initiatives. And so you are right. In the traditional businesses that will contribute nicely to the dividend, like Sanlam Investments and SPF, you're right, the profits are a bit under pressure. But I mean, in terms of our dividend policy, we do say we look on a 1 to 1.2x cash cover ratio. And we also say we try to grow the dividend with 2%-plus real terms. And as we said here with the information today and notwithstanding the dividend issue -- of the share issue earlier this year. And I want to say even the possible issue on the BEE side, we are comfortable that we will be able to maintain our dividend policy. And yes, we may for a while or for the next year or so be a bit on the lower end of the range of 1 to 1.2x cover. And we may be a bit on the lower end of the 2% to 4% dividend growth. But there's no indication to just think that we will not able to maintain our policy. Wikus, on the new business strain, it wasn't so dramatic this time around. It is actually in certain countries outside of Africa, Namibia, there was a lot of new business strain.

A - Wikus Olivier {BIO 20074722 <GO>}

And maybe and also on Sanlam Sky, the middle-income market with the flat recurring premiums, of course, the new business strain was essentially flat. But then BrightRock also had quite a significant strain. But from a new business strain perspective, the normal new business strain perspective. But also, as you know, they're still running at J curve. And we've also taken the reinsurance in-house with -- in Sanlam Life, which increases the strain because we effectively carry the minorities share in the short term.

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

Volumes?

A - Wikus Olivier {BIO 20074722 <GO>}

On the volumes side, I don't have in APE because we use present value of new business premium as our basis. And that's up just north of 20%.

Operator

The next question then is from Larissa Van Deventer of Mazi Macquarie.

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

Two quick questions, please. The first one splits into 2. It's about the volume growth that we saw in Botswana and in the rest of Africa. In Botswana, volumes were down 20%. But you mentioned VNB being similar. The question is, is the current change in mix sustainable? Or were the -- was there particular demand that we should consider nonrecurring? On the rest of Africa, if you can please give us the sense of the 46% growth, how much of that was driven by life, nonlife and then asset management? Then the second question is on SPF's operational earnings growth. You mentioned that the profit growth of 5%, if you exclude the one-off items. Should we consider mid; to -- mid-single digit a sustainable growth going forward? Or is it something else that is pulling that number down?

A - Heinie Carl Werth {BIO 7529974 <GO>}

I can go on the first part along. Then, Wikus, you must please come in. Larissa, Botswana, we have seen a mix. In other words, last year, it was quite a bit of asset management volumes. This year, we are seeing a recovery on the annuity business. We said previously that one competitor went past end of last year. And the annuities, which is more profitable. And so it's returning to us. The rest of Africa, it was quite a bit of flows now, obviously, also coming from the acquisition of SAHAM, the general insurance flows, where we included our stake then one year ago. Then also following the acquisition of PineBridge, there's also volumes coming in from that side. On SPF's profit growth in the mid-5s, I think with all the new business initiatives for the next year or so, it's possibly a type of level to look at. But we, again, in terms of our own projections 2 to three years from now, we see the profit going higher -- to higher levels again as these initiatives contribute.

Operator

Our next question is from Musa Malwandla of Standard Bank.

Q - Musa Malwandla {BIO 20221131 <GO>}

Just a quick question from me. There's the new business experience, the 7% increase in VNB was likely supported by employee benefits or at least in part. Now given that disability experience was particularly bad for the flat period. And we saw in the first half strong growth from SEB. If you were to adjust for the assumptions that used to value new business, what growth would be reflected in VNB? In other words, given that there's clearly a deterioration in experience from SEB, if you had to revalue the VNB, what kind of? Then maybe just a subquestion is, the poor experiences, on which kinds of business is it? Is it on older business? Or the business that you wrote recently?

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

Okay. Just before I hand over to Heinie, on the EB, we also wrote investment business in this -- in the 4-month period. But it's not just all risk business.

Q - Musa Malwandla {BIO 20221131 <GO>}

Okay.

A - Heinie Carl Werth {BIO 7529974 <GO>}

On the assumptions, at this stage even though we've got, let's call it, high claims and so, our assumptions are not yet really under pressure. And that's why there's more proactiveness on doing further price increases in the EB side. There was -- also, we did a comprehensive exercise to look for the possibility of fraud and all of that. And if I take -- and I mean, we said to have people like AndrÃ© Zeeman, Chris Swanepoel on our Actuarial Committee. And the general view is that for whatever reason the trend this time is the longest that I've seen it carrying on. So we will have to continue the repricing. But at this stage, Wikus, we don't have reason to believe the VNB in insurance. We will monitor of the year-end and then make a call.

A - Wikus Olivier {BIO 20074722 <GO>}

And I think Ian might add a point. If you look at the VNB for the 10 months, most of that is actually coming from annuity and the investment business. So adjusting the assumptions on the risk side, we'll really have a small impact.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

The other thing is just in terms of the VNB the 12%, as you say, when we adjust for it -- the adjusted 12%, Sky had a very good period over the whole 10-month period. So it's not just all EB.

A - Heinie Carl Werth {BIO 7529974 <GO>}

Now the bulk is full coming from Sky.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

Yes. The improvement in Sky is actually more significant to the total improvement than the EB. We said it to you that the VNB was weak in EB. And the business was written thereafter. And now you've seen that now.

Q - Musa Malwandla {BIO 20221131 <GO>}

Okay. All right.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

The Sky has the bigger impact.

Q - Musa Malwandla {BIO 20221131 <GO>}

Yes. But I guess, what it almost seems like, I mean, we started -- we saw this first in Old Mutual and then MMI and then Liberty. And now it seems to be you. And in all the instances it's first you see high growth and then you see a deterioration in experience. It's almost as though it's the one book of business or it's tranche of business that's sort of looking around and being mispriced. When we saw the strong growth at the beginning of the year, we almost had the sense that it could be a similar instance because it's almost as though you are now in sort of late cycle compared to the peers. And the only thing that makes sense is that it might be that kind of -- but maybe I'm misreading the situation.

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

I don't think -- I don't think it's 1 or 2 bad schemes getting rebroked around the market. I think

your point about the cycle is perhaps a valid comment in that we didn't have the experience of the others. And therefore, the extent of our repricing was perhaps a little bit lower than the others. And the others reprice quite quickly. And now we're having to do a bit of catch up. That point, I might accept. That -- you might be in a better position to assess that. That point as opposed to the point that's a few rotten schemes running around the market, that we're not aware of.

Operator

(Operator Instructions) We have a question from Johny Lambridis of Prudential.

Q - Johny Lambridis {BIO 1887932 <GO>}

Sanlam always sort of pardoned itself into very high ROEVs and ROEs but pretty simply raising ZAR 7 billion that's going to effectively be used to repay debt, presumably that to paying 8% debt and the other half is going to be put into a loan back into EB also earning around 8%, 8.5%. So as 10% of your capital base is now earning 8%, 8.5% makes the rest of the business have to run pretty hard to generate historic ROEs of sort of 17%, 18%. Just thoughts on the ROE dilution?

A - Heinie Carl Werth {BIO 7529974 <GO>}

Yes, I reckon I have to go with that. I think, Johny, we -- obviously, when we came out with a circular, we showed financial impacts. And we -- as we did not show the potential impacts on RoGEV. But in term -- what we did, my apologies, in -- but overall, I mean, the impact of all of this is negligent. And we again did 3-, 4-year forecasts. And there was no significant deterioration. Part of the funding whatever we use from the transactions, yes, we raised capital. But then on top of that, we also put back-to-back loans in place using the strength of our own balance sheet. And that is all contributing to the picture. So I don't think it is. But really on the own projections, this is not a burden. If we invest it in the right investments, this will be value accretive. And that's what we -- why we are comfortable to go this route.

Operator

We have a follow-up question from Michael Christelis.

Q - Michael Christelis {BIO 15233664 <GO>}

Just again for clarity. Your comment around strong organic growth in SAHAM, at the half year, I think, your organic growth was in the low 40s. I mean, is that sort of the level being sustained in the following four months? Or is it much higher or much lower?

A - Heinie Carl Werth {BIO 7529974 <GO>}

No. We've seen the Third Quarter trends mostly continue. And I mean, it's not so there is a bit of lumpy stuff here and there. I can't recall the 40% now specifically. But I mean I know it sounds very boring. We always say it's all attracts the business plan. And the first nine months of this year is slightly better than what we have hoped for. Wikus?

A - Wikus Olivier {BIO 20074722 <GO>}

Yes, I agree with that.

Operator

(Operator Instructions) So we have no further questions in the queue. Do you have any closing comments?

A - Ian Maxwell Kirk {BIO 1778703 <GO>}

No, no. Thanks for listening in on the call. Thanks for your support to Sanlam. Have a good break. And we look forward to catching up with you in the new year and, obviously, our next supporting cycle earlier in March. Thank you very much.

Operator

Thank you very much. Ladies and gentlemen, that concludes this conference call. And you may now disconnect your lines.