

Q4 2016 Earnings Call

Company Participants

- Christian Sagild, Chief Executive Officer
- Lars Thykier, Chief Financial Officer

Other Participants

- Anna Hui, Analyst
- Asbjørn Nicholas Mørk, Analyst
- In-Yong Hwang, Analyst
- Janet Demir, Analyst
- Kim Bergøe, Analyst
- Per Grønborg, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Topdanmark Annual Report 2016 Conference Call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. I must advise you that this conference is being recorded today on Thursday, the 23rd of February 2017.

I would now like to hand the conference over to your speaker today, Christian Sagild. Please go ahead.

Christian Sagild {BIO 15093649 <GO>}

Thank you very much. Good afternoon, everybody, and good morning to the USA, and thank you for joining us in this conference call. With me, our CFO, Lars Thykier; and Steffen Heegaard, who is Head of Investor Relations and Group Communications. We're holding this conference because earlier today we published our annual results 2016. And we are now ready to answer your questions. Please ask them one at a time.

Operator, could we have the first question, please?

Q&A

Operator

Thank you very much. And the first question comes from the line of Asbjørn Mørk from the Danske Bank. Please ask your question.

Q - Asbjørn Nicholas Mørk

Yes, good afternoon. This is Asbjørn from Danske here. A couple of questions. First, on your operations, if you look at the underlying claims ratio for Q4, it's rather high and you're also talking about claims inflation. Still if I adjust for the IT investments or the digital investments you make, you're guiding unchanged combined ratio for 2017 of 90% to 91%, that is underlying. Why is that, what is that that you're seeing that should improve this trend in 2017? And if I can add a question on that on motor insurance where we've seen claims inflation. Do you expect re-pricing on the back of this more than just what indexation brings to the table? Thanks.

A - Lars Thykier {BIO 16427122 <GO>}

We do not expect the expense ratio to increase in spite of the initiatives we are making, that is due to the fact that we already have made savings and due to the fact that external expenses will be capitalized. And then - okay.

Q - Asbjørn Nicholas Mørk

What I just mean that you're saying that the combined ratio now is guided for 2017 of 91% to 92%, right...

A - Lars Thykier {BIO 16427122 <GO>}

Yes.

Q - Asbjørn Nicholas Mørk

...which if I re-correct this because of the investments that you're making.

A - Lars Thykier {BIO 16427122 <GO>}

That is changes because of the investments we make and the extra expenses we'll have in this context, but it will probably rather the claims handling expenses than the expense ratio.

Q - Asbjørn Nicholas Mørk

Okay. But my question was more related to the actual combined ratio level relative to the underwriting that we've seen in Q4 on the claims inflation and the general weaker underwriting. So, are you seeing trends in 2017 that make you believe that underwriting hasn't been impacted? I guess that all things equal, Q4 has been softer than you would have expected on the underlying part.

A - Christian Sagild {BIO 15093649 <GO>}

But, Asbjørn, the Q4 underlying technical results is not a very good guideline for the full year 2017. We still have to regard a full year with, of course, everything we normally do with a normalized weather and everything. And in that context, we still look at 90% to 91% underlying, but because of these extra investments (03:50).

Q - Asbjørn Nicholas Mørk

Okay. Fair enough. Then, considering the claims inflation, you previously said that you didn't want to raise prices within motor because you didn't want to lose market shares, is that still the case?

A - Christian Sagild {BIO 15093649 <GO>}

Well, yes, we don't have any general price increases in the draw and we have - we see the automatic indexation and without this being rocket science, we think that claims inflation will be more or less in line with the price indexation.

Q - Asbjørn Nicholas Mørk

Okay. Fair enough. Then, on your investments that you're making now, the benefit, you're saying that's going to be more or less neutral in 2018 and 2019, I just have two questions on that. First of all, does that include all the costs, including the external costs that you will capitalize or is that - does that come on chop, meaning that this will be an hidden sort of negative effect? And looking further ahead, do you expect that the benefit that you get, that you will be able to retain that or should we expect competition to sort of erode that going forward?

A - Lars Thykier {BIO 16427122 <GO>}

We expect to be able to absorb the extra expenses at least in 2019. Whether this will disappear in competition or not, we can't really tell now.

A - Christian Sagild {BIO 15093649 <GO>}

At some point in time in the future, it's difficult to say what was part of your profitability stems from which investments and you're just looking at the market conditions and set prices according to that. It's extremely difficult to say anything very stable forth going about how much of these benefits will actually materialize for the shareholders and how much will be competed away in the competition that we don't know anything about.

Q - Asbjørn Nicholas Mørk

Okay. But, is it fair to say that the investments that you make now are quite similar to what your peers are making these days?

A - Lars Thykier {BIO 16427122 <GO>}

Probably.

A - Christian Sagild {BIO 15093649 <GO>}

Yeah, most probably.

Q - Asbjørn Nicholas Mørk

Okay. Then a final question on online sales, as far as I understand, that's part of your - the investments that you want to expand within online sales has that never really been successful in the Danish market. Why do you think that will change going forward?

A - Christian Sagild {BIO 15093649 <GO>}

At some point in time, if nothing else, then generations will change that pattern because younger people tend to use online selling. So we think that with some unknown pace, we will see a transition towards much more online selling. But our investment is as much if not more in self-servicing, that means that our customers that we already have on the book can service themselves over the Internet, hence save the back-office a lot of resources.

Q - Asbjørn Nicholas Mørk

Okay. Thanks a lot. That's all from my side.

Operator

Thank you. And the next question comes from the line of Per Grønborg from SEB. Please ask your question.

Q - Per Grønborg

Yes. Good afternoon. Two questions from my side. First of all, on your prognosis for 2017 on the investment side, the DKK 180 million to DKK 230 million. I assume that you have delivered materially more than your normalized run rate, the first 1.5 month. Can you break it down to how much is what you have earned the 1.5 month and how much is the expected investment return that maintained the half month? That was my first question.

The second one relates to Asbjørn's question, you said that you will take some cost charges for the IT projects on the claims handling if I understood it correctly in 2017, then you will activate some costs that will come back and hit the cost ratio from 2019 going forward. Was that correctly understood? And if that is the case, how last - why should we expect to see in the intangibles during 2017?

A - Christian Sagild {BIO 15093649 <GO>}

Lars, there are questions for you.

A - Lars Thykier {BIO 16427122 <GO>}

First 45 day or 40 days of the 2017 on the investment side, but I don't want to speak on these exact numbers.

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Q - Per Grønberg

We have previously discussed the run rate on your investment income.

A - Lars Thykier {BIO 16427122 <GO>}

Yeah.

Q - Per Grønberg

Have that changed? As far as I remember, we were somewhere between 100 to 150 normal run rate without - with your base assumption.

A - Lars Thykier {BIO 16427122 <GO>}

It has increased somewhat. I think we discussed this in Q4 and that was on the basis of the very low interest rates we had at the beginning of Q4 and we're seeing such rates a little higher now, but not substantially higher. If that was an answer to your question.

Q - Per Grønberg

So can you give us a number what is - as far as I remember, that time we discussed 100 to 150, so now we are more at the 150 level. Is that...?

A - Lars Thykier {BIO 16427122 <GO>}

That's true.

Q - Per Grønberg

That's true. Okay. Perfect.

A - Lars Thykier {BIO 16427122 <GO>}

And then, it was the investments we're going to make. If we make investments that are Inter Systems (09:29) that were worked in the claims handling, then the depreciation of these expenses will be on claims as well.

Q - Per Grønberg

Yeah. Of course.

A - Lars Thykier {BIO 16427122 <GO>}

And that means that this will not hit the expense ratio if it is this kind of an investment. But on the other hand of course, we're going to make some investments on the sales side as well and that part of the investments will hit the expense ratio in a couple of years. And again, when this is going away because we will continue to do more investments and we'll continue to (10:08) more benefits.

Q - Per Grønberg

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But 1% to 1.5% (10:13) in digitalization investment you will take in 2017 - actually we'll take similar amount in 2018, is that only what is the P&L or is there another amount that will be activated and if it's intangibles there?

A - Lars Thykier {BIO 16427122 <GO>}

Yes.

Q - Per Grønborg

Can you give you any indications about the amount of the excepted total investment in 2017?

A - Lars Thykier {BIO 16427122 <GO>}

No, but the increasing intangibles in 2017 were definitely bigger than in 2016.

Q - Per Grønborg

Okay.

A - Lars Thykier {BIO 16427122 <GO>}

I could give you a guesstimate, but we really don't know which pace we are able to make this in.

Q - Per Grønborg

Fair enough, fair enough. When I look at the rise in 2016, I of course have an impression of where we're. Thank you.

A - Lars Thykier {BIO 16427122 <GO>}

Yes, we are working on this. It is not that thing is going to start in 2017.

Q - Per Grønborg

Okay, perfect.

Operator

Thank you very much. And the next question comes from the line of Janet Demir from Morgan Stanley. Please ask your question.

Q - Janet Demir {BIO 19462264 <GO>}

Hi, I have a couple of questions, please. I was just wondering, first of all, and I'm curious on this proposed changes to the board, I'm wondering from a regulatory point of view whether there is any concern over possibly having the management of one of your competitors as Chairman of the board, if you could comment on that?

And then secondly and the motor insurance, I'm just wondering why you have said that you've seen a decline in volumes as well as rates, is that perhaps due to increased competition or is there lower volume of cars in general on the road in Denmark? And sorry this my last one is just on the run-off for the year. I noticed that it's more elevated than in the past. I'm wondering whether you're giving any guidance on that going forward when we can expect it to fall near to the long-term average?

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A - Christian Sagild {BIO 15093649 <GO>}

Regarding the management board, already when (12:18) it was appointed to the board. This has been dealt with through the legislation and also through the confidentiality agreement that has been made between the board members and between the board members in Topdanmark, and therefore, the fact that Sampo moves from one to three participants, all members of the board does not change the legislative foundation of their presence on the board. There has been no change and this is not an issue with the Danish supervisory authorities.

Q - Janet Demir {BIO 19462264 <GO>}

Okay. Thanks.

A - Lars Thykier {BIO 16427122 <GO>}

Then, we had the question whether there are fewer cars in Denmark. No, that's not the case. The fact of the matter is that we are losing market share in motor in 2016.

Q - Janet Demir {BIO 19462264 <GO>}

Okay.

A - Christian Sagild {BIO 15093649 <GO>}

Regarding the run-off, it has in 2016 and also in 2015 been higher than you should normally expect. We don't guide for run-off going forward, but just sort of our experience tells us through the conservatism in our provisioning that you could probably expect somewhere between 1.5 percentage point and 2 percentage point on the combined ratios, but we're not guiding for that. It could be more, it could probably also be less.

Q - Janet Demir {BIO 19462264 <GO>}

Okay. Thank you.

A - Lars Thykier {BIO 16427122 <GO>}

I would just add to that, in our opinion, we are more or less as conservatively reserved now as we expected to be a year though.

Q - Janet Demir {BIO 19462264 <GO>}

Okay.

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Operator

Thank you. And the next question comes from the line of Anna Hui from RBC. Please ask your question.

Q - Anna Hui {BIO 19762795 <GO>}

Hello. Thanks for taking my question. It's just one on the earnings distribution. Would you be able to give any guidance indication on the mix between share buyback and dividend if the Sampo's proposal was rejected at AGM?

A - Christian Sagild {BIO 15093649 <GO>}

I would say that the odds for this proposal not being approved by the AGM is very small. Therefore I think it's probably theoretical to discuss that, that would also be something that the board would have to decide at that point in time.

Q - Anna Hui {BIO 19762795 <GO>}

Okay. Thank you.

Operator

The next question comes from the line of Vinit Malhotra from Mediobanca. Please ask your question.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi, thank you. Good afternoon. Some of my questions have been addressed, but if I can seek clarification, just on the run-off being elevated in this last year and last quarter in particular, is it just driven by body injury if you could just comment? And then secondly, just on the investment side, obviously the discounting is confusing us a bit, but if you could clarify the very large negative print in the government and mortgage bond, which is probably offset by the technical rate, but it's quite a large number and if you could comment on that. And also related to that the CDOs continue to do very well. What do you think we should think about the CDOs going forward? What are the factors which suggest the mortgage market in Denmark or the economy? How would you think of that base? Thank you.

A - Lars Thykier {BIO 16427122 <GO>}

In the first place, the one-offs are on partly entry (16:14), yes. A very steep decrease in expectations for this wider (16:23) liability for physical things hasn't changed very much. Then when we're talking about the loss on the government bonds, you asked the question correctly, that this is due to the match between the liabilities and the assets. The gains on liabilities are almost the same or they're somewhat smaller than the - somewhat (16:52) bigger than the losses on the asset side.

CDOs that is mainly CLOs that means, that it is an investment in leveraged loans. It has nothing to do with the Danish mortgages, it is the loans that are typically issued in relation

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to takeovers.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay.

A - Lars Thykier {BIO 16427122 <GO>}

And looking forward, it is my expectation that we've seen the best part of the return on the CDOs now. It has been many very good years and we see a somewhat lower run rate going forward, probably below two digits.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you very much.

Operator

The next question comes from the line of In-Yong Hwang from Goldman Sachs. Please ask your question.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Hello. Thank you very much. I've got two. Just the first one, when you commissioned your bridges to the 2016 combined ratio to what you're expecting for 2017 on your presentation, just got a kind of 1% expected on the line improvement. Is that just part and parcel of your reselection in portfolio management or is there any kind of specific areas you're targeting there for their improvement?

A - Lars Thykier {BIO 16427122 <GO>}

Let us - the major part of this is the increased efficiency, we have gained already.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Okay. Okay. And the second one is on the - in the report you mentioned the higher workers' comp rates and from the labor market insurance body that's kind of impacting your claims ratio for the quarter. Did you expect any kind of changes to the competition or the market dynamics on there or your back book or any kind of FX other than what we saw in the quarter?

A - Christian Sagild {BIO 15093649 <GO>}

The increase in this workers' comp is relating to the price that we had to pay for this government body to handle these claims. It is a market condition and therefore, it's competition competitive-neutral. Whether it will affect prices, we'll have to see. But, at the same time, we're actually working on maybe having some of these tasks being dealt by the insurance companies rather than this government body. But, as of now, we have seen this increase in the price from the government body of 80% just to cover their expenses to do this, and they're doing quite a poor job because the number of decisions that

comes out of this government body is very, very few. So, we hope that we can change that, but as I said, this is competitive neutral as we see right now.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Okay. Thank you very much.

Operator

The next question comes from the line of Kim Bergøe from Nordea. Please ask your question.

Q - Kim Bergøe

Hi. Actually, my questions have been asked - answered, but if I can just maybe add one, and as you mentioned losing market share in motor. But also when I look at your guidance for next year for premiums in non-life, I mean you're losing some now. So actually just to keep it flat, it's indicating some sort of growth, could you just walk us through maybe sort of the bigger areas, where are you losing? But are there also areas where you're gaining market share, and just sort of maybe quickly touch on the dynamics in some of the bigger items?

A - Christian Sagild {BIO 15093649 <GO>}

The guidance that - in the presentation in that we say that the motor insurance would probably have a negative impact of 1 percentage point on the top-line 2017. That is just prolonging the effects that we've seen in 2016, where we've experienced a drop in the average motor premium of 2.9%.

If we see the similar development in 2017, we should expect this 1% effect on the top-lines stemming from that. And if you mean by other business lines in terms of the price pressure, what we see is the development, I mean, we are losing some of these large industrial clients and we lost some at the end of 2016 and that will have an impact on the growth in 2017 of - negative impact of 0.7%.

So underlying looking at the markets where we are actually growing or where we are focusing, we're experiencing a growth with the price index, and also underlying a growth in private lines and in the agricultural sector. So we are still seeing growth potential, but have to offset these effects, which is also in my opinion competitive neutral because the fact that average premiums in motor is coming down, is the market condition basically because the risk is coming down, but also because people tend to drive small and safer cars.

Q - Kim Bergøe

Okay, thank you.

Operator

The next question comes from the line of Per Grønborg from SEB. Please ask your question.

Q - Per Grønborg

Yeah, Sagild, I have a single follow-up question. When I look at your solvency requirement, can you - I know it's difficult to give a number, but can you give us any indication of how much of that is coming from life and where would group have been without the life company, I assume it's a pretty small part that is coming from life?

A - Christian Sagild {BIO 15093649 <GO>}

Basically, the life portion share of the solvency requirement, it changes pretty much from quarter-to-quarter. And in some quarters, it will be close to half, which was after Q3 and sometimes it will be closer to a third, which is what it was at the beginning of the year.

Q - Per Grønborg

You are saying, at sometimes it will be half of the total solvency requirements and sometimes it will be one-third of the total solvency requirement?

A - Christian Sagild {BIO 15093649 <GO>}

Yeah.

Q - Per Grønborg

Is that rightly understood? Okay. Thank you.

A - Christian Sagild {BIO 15093649 <GO>}

And that means that - this is due to the total capital requirement changing with the demand from life.

Q - Per Grønborg

Yeah. Of course, of course. Thank you.

A - Lars Thykier {BIO 16427122 <GO>}

But, if I can add just one thing here, Per, that is that, this requirement is, of course, subject to management actions because you can change - it is to some extent, at chosen level because if you can - if you have guaranteed products in the life company that deals quite nicely with the - on the bottom line, you are willing to carry some extra capital requirements in order to maintain that profit.

But on the other hand, you could chose as other pension providers are, you could chose to sort of invite pension savers to switch from guaranteed products to more unit-linked market interest products and which carry less capital requirements, but which also probably carries a little less yielding. So we feel that, we don't mind having this capital requirements relating to life because the portfolio is yielding quite nicely.

Q - Per Grønborg

Okay. That will be it (25:13).

Operator

The next call comes from the line of Asbjørn Mørk from Danske Bank. Please ask your question.

Q - Asbjørn Nicholas Mørk

Yes, I just had actually two follow-up questions. One on motor, if I understood you correctly, you said that indexation would be in your view enough to offset claims inflation in 2017, so I guess all things equal 1.8% or something like that should be enough to offset claims inflation, was that what you meant?

A - Christian Sagild {BIO 15093649 <GO>}

That is what we intended to mean or intended to say, it is different from product to product, of course, and we have discussed this before that on the motor comparison (26:05) that we do see some claims inflation. On the other hand, we see risk falling on the third-party liability.

Q - Asbjørn Nicholas Mørk

Okay. And then on a completely different topic, the investments that you make now on the digitalization, does that - will that have an impact going forward in an M&A scenario where you also merged with some Nordic - say non-life insurance company that owns a big part of you?

A - Christian Sagild {BIO 15093649 <GO>}

In which way?

Q - Asbjørn Nicholas Mørk

Well, that - I guess the newer systems saw that things even could maybe have an advantage in terms of combining and combining that in the future?

A - Christian Sagild {BIO 15093649 <GO>}

That is beyond our knowledge, we don't know, everything we do, we do just to optimize the operation for Topdanmark and Topdanmark alone with disregarding any shareholder individual interests.

Q - Asbjørn Nicholas Mørk

Okay. Thank you.

Operator

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There are no further questions on the phone. Thank you.

A - Christian Sagild {BIO 15093649 <GO>}

Okay. Well, thank you for taking the time to attending this conference. As you know, you're always welcome to call one of us if you have any further questions. We'll be happy to answer them. Thank you, and good bye.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may now disconnect. Speakers, please stand by.

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