Q2 2015 Earnings Call

Company Participants

- Antoine Lissowski, Chief Financial Officer
- Jim Root, Director of Investor Relations

Other Participants

- Michael I. Huttner, Analyst
- Ralph Hebgen, Analyst
- Rötger Franz, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the CNP Half Year Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Antoine Lissowski, CFO. Please go ahead.

Antoine Lissowski {BIO 4384399 <GO>}

Hello, everybody. I'm glad to speak to you for this new interim results.

We are on the slideshow, and I'll make a short presentation of the first slides and after leave floor to you to invoke different questions. I am surrounded by different members of the team of CNP. That means that any technical question you may raise, should find someone here to speak to.

On page three, you have the main figures of our interim results. Starting with the premium income, which was this half year up 2.9% at €16.2 billion. The revenues of the company grew by 4.3%, at €1.666 billion, with administrative costs at €431 million. The EBIT stays at €1.235 billion, up by 3.9% to last year's.

The attributable net profit of the company for this half year is €615 million to be compared with €601 million last year. The new business margin is slightly higher than last year at 15.3%, and the return on equity is at 8.8% to be compared with 8.1% last year, for the whole year.

The economic coverage ratio, which is our calculation of Solvency ratio and the standard formula is at 170% up to last year's by 10 points. And the MCEV per share is at €26. The net book value per share being at €20.5.

Now I come to different information regarding the activity of the group. On page four, you have first a review on our French business, with the net insurance revenue up by 1.9% at €633 million. Here please notice that the growth comes from the business in savings and pensions which is up by 6.6% whereas the personal risk and protection business is down by 7.5% at €193 million. This includes as indicated a negative impact of statutory discount rates which we had to take into account in evaluating our liabilities. With technical reserves at the end of half year at €291 billion, and I let you take knowledge of the different compounding of these reserves.

On page five, you have a view on the product mix of the company and you see quickly that there is an important shift in our sales, with unit-linked contracts being up very dramatically. They represent now 17.8% total savings and pension premiums where they were at 11.6% last year. In fact, we are gaining market share in this area.

The inflows of unit-linked in net represented more than €1 billion and the outflows from traditional savings products slightly below €1 billion, €932 million, during the same period. That means that our business model clearly was shifted from completely or majority only, the business model in traditional products and it is now progressively gaining area of very much balanced business model where unit-linkeds are much higher.

The personal risk/protection business is on this side very stable. The APE margin was at 11.8%. It is slightly higher than last year and it is of course expressed explainable by level of unit-linked in our protection.

Now let's go to Latin American business on page six, with the net interest revenue at €501 million reported, is up by 10.7% to last year's. If you take like-for-like figures, the growth is at 15.2%. You see that, as usual, the major part of this net interest revenue is attributable to personal risk and protection, which grew by 11.2% reported. And the savings and pension business, which are of smaller magnitude in terms of revenue are up by 8.5%.

On page seven, you see how the premium income in this market behaved during the period. It's a very dramatic increase of the premium income. In like-for-like figures, the increase is by one-third, 33%, with very important growth in savings and pension business, which stays at €1 billion and with growth of 43% and personal risk and protection business at 22%. The new business margin, the APE margin, on the side are still around 32%, with 31.6%, which is relatively similar to last year's.

If we come now in page eight to Europe, out of France. The scope was significantly modified by strategic transaction among which the two main regarded transaction are the sale of our common subsidiary with Barclays in Southern Europe, which accounts for a reduction of net interest revenue of €16 million. And on the other side, the first time consolidation of CNP Santander Insurance, our loan insurance subsidiary in common with Santander, which accounts for €15 million plus the other contributors being the negative because of restructuration in our Spanish and Italian business which provoked reevaluation of some provisions.

On page nine, you have evolution of premium income. In this area, we're roughly stable as a whole, but when you look at different elements of this business, you see immediately the traditional savings are down by 50% and they are at €566 million. And it is mainly attributable to Italian subsidiary whereas unit-linked savings are up by 62%, represent now more than €1 billion. Here too it is a result of the very determinated management of the sales of Italian company, mainly.

The pension business being slightly at the same level as last year. And at the top of the slide you see that the personal risk and protection business was increased by 131% through the acquisition of CNP Santander Insurance. This acquisition is also one of the reasons for the growth of the APE margins which now stay at 16.5%, up 10.8 percents (sic) [percentage points] to last year's. The two moves explaining this level of margin are first the improvement of Italian pension savings business and also [majoritally] introduction of Santander CNP activities in the scope of the business.

All that results in page 10, in a very important growth of new business value across all the regions, the growth of 20.6%. If you take the reported figures, we come from €206 million to €248 million. We have growth in France by 11%. Growth in Latin America by 10.7% reported and would be 20% if you take into account like-for-like figures. And triple in Southern Europe with €28 million as previously reported.

Now we come on page 11 to administrative expenses. You can see that globally the change was slightly above the change in revenue, with 5.4% growth, at €431 million. The major part of these expenses are of course in France and growth there is very moderated at 1.8%, according to our budget. In Latin America, the growth of 14.4% is due to first to the inflation rate in Brazil, and second to the expense in development in Brazil, in particular for the creation of the digital company, which should start its activities in 2016.

A similar growth was registered in our Southern European activities in terms of expenses. And it is due to first, the changes in scope of consolidation. In fact that means that the part of the costs of Barclays Vida, which was the sold company were taken by our remaining company, which is called CNP Partners, which has different development finance during this half year. It was a sort of new start of the company there which explains specifically for this interim period growth of cost.

Globally, the cost to income ratio is at 35%. All that results in an EBIT – on page 12 – at €1.235 million. You see there that EBIT on savings and pension was up whereas it was slightly down in personal risk and protection. It is again due to our new provisioning attributable to the decrease of interest rates. And when you see the different countries: France and Latin America experienced an improvement of the EBIT whereas in Southern Europe, the EBIT was slightly lower than last year.

Now let's come for – a few moments to the investment policy of the company. We now operate in a low rate environment which needs a certain adaptation in our strategy. First, it is clear that the fixed income investments are mainly now in credit instruments, roughly 75% of investments in fixed income are now in credit. But in an environment of low interest rate, the maturities of these investments are short, less than 10 years. And a part of them are made at variable rates. The remaining investments in long-term government are clearly much lower than during the similar periods before due to very low interest rates. I remind you that the average interest rates in French govvies this half year was around 1%.

As a way, we have also intensified, our diversification of assets and turned over sorts of assets. In equities, we are still increasing the part of equities in our investment with €1.6 billion invested during the period. We have also invested massively in investment properties with €1.2 billion and in private equity with over €400 million of new capital commitments.

In this field, you may know that CNP Assurances was quoted as the one of the first 50 institution investors in the world. It is clearly the outcome of determinated policy which started 20 years ago. And now we consider to have sufficient knowledge of the markets to be able to support such volume of new investments. And the infrastructure sector is still at the starting level with €70 million of new investments during the period. We think that action put on this area by the new European Commission Juncker plan will lead us to increase substantially reinvestments in infrastructure in the next years.

On page 14, you have different configuration on the rules and constraints in the management of these investments and the Solvency II regulation. First, it encourages us to go on with protection against risk of rise in interest rates. Most of you are very familiar with CNP and know that this is a tradition of the company to protect our balance sheet against rising interest rates. Of course, from a very low level of these rates – that this now involves a very rigid increase of this protection.

Second, but I already mentioned that, the investment in credit was with shorter maturities. Third, we have started to hedged with options, long-term risk on equities. It is I would say one of the aspects of our decision to increase our equities exposure, which is that we must protect the result of the company against the risk of market difficulties when we are buying goods which are out of the money, which are not too expensive that which would be of very great use if there is an accident on the equities market now.

And we underline also that there is a significant portfolio of short-term fixed income instruments which represent of course a much lower cost in terms of risk and therefore of – in terms of economic capital to offset the relatively high risk level of capital involved by equities and over diversification assets which we have.

On page 15, we come back to the results of the company for the half year, starting at the level of EBIT which we explained before. You see that the finance cost of the company increased a little bit because of the issuing of subordinated bonds last year. The income tax expenses growth reflects the growth of the activity and our revenues globally. The noncontrolling interest is a part of revenue which is attributable to the minor shareholders of our partnerships and the major part of that goes to the Brazilian partners. All that together puts the recurring profit at €543 million which is slightly the same level as last year.

Below that you have different exceptional elements. The net realized gains on equities among which the gain realized on the sale of our subsidiary in Southern Europe with Barclays which by itself represented capital gain of €232 million and different other market movements which have an impact on the profits.

All of that was as usual with the company partly offset, but nonrecurring provisions which represents €216 million. You know that when we have an exceptional gain, we adopt this policy to keep part of this gain in provisions, whereas when we had in the past exceptional losses, for instance, when we had to impair some of our investments, this was also taken from these different provisions.

That allows us to have an attributable net profit which stays at 2.4% above last year's. It is €615 million, 75% of that is from the French activity, 28.7% coming from Latin American businesses – 23.7% coming from Latin America and the remaining 1.3% coming from Southern Europe.

If we come now to page 16, with equity and MCEV. The equity is roughly below €17 billion. I do not enter into the details. And the MCEV of the company is at €17.8 billion. You see that the our net asset value was up. It is due to the increase of different equity market, mainly. And the value of in-force is slightly below last year's. It is an effect of increased volatility between the end of last year and the end of this interim period.

And the last slide 17, shows for one of the last times, our Solvency I capital ratio, which is roughly at 400% with unrealized gains and at 120% without these unrealized gains. It is one of the highest level reached by the company in its recent history. And in page 18, you have one of the first ratio or the future history of the company which is the Solvency II ratio which is at 170% to be compared with 160% at the end of last year. This increase is attributable to the growth in the value of the assets, representing the wealth of the company and relative reduction in the cost of our activities this year being slightly down to last year's.

Now I finished the presentation of the main pages. We have of course different appendices to which we could refer business history longer where now conversation and I give the floor to you to answer to your different questions.

Q&A

Operator

[Operator Instruction] We take our first question from Rötger Franz of Société Générale. Please go ahead.

Q - Rötger Franz

Thanks for taking my questions. First of all, I have a question regarding your economic coverage ratio. Can you give us some more quantitative information what drove change in it? And in particular what was the impact of interest rates in terms of percent and the impact of the change and the scope of consolidation?

Also my question is how much capacity do you have under Solvency II for further Tier 2 issuance at least in theory? And also your equities are quite high, it's about 10% of your total investments, that's far above peers, why don't you reduce the equity banking ratio a bit to strengthen your solvency to bring it more in line with peers? And then finally you mentioned infrastructure investments. What would be the maximum exposure as a percent of total investments that you would target for infrastructure investments? Thank you.

A - Antoine Lissowski {BIO 4384399 <GO>}

Thank you. There were four questions. Jim, can you recall the different questions? The first one was about the coverage ratio.

A - Jim Root {BIO 2545921 <GO>}

The coverage ratio, if you could give a little more detail what it consists of and what the different factors that impacted it. Was that it, Rötger, basically?

Q - Rötger Franz

Yes.

A - Antoine Lissowski {BIO 4384399 <GO>}

We have here responsible of risk division of the company deputy, if she wants to add something to what is written.

A - Operator

Perhaps just to explain to you that increasing our coverage ratio is one of the two factors mainly equity markets and slight increase in future sales are really the two factors. And we can say that more or less half is coming from the first factor and the other half is coming from the other one. So for this half year, the valuation is quite simple. And there is no other specifics to mention.

A - Antoine Lissowski {BIO 4384399 <GO>}

And I would just add to that there was no specific restatement during the period to improve the ratio. The next question?

A - Jim Root {BIO 2545921 <GO>}

Under Solvency II, if there's a cap to the Tier 2 issuance.

A - Antoine Lissowski {BIO 4384399 <GO>}

Well, I'd just say that we have some room to Tier 2 issuance. And in fact, the element to which we pay more attention is not Solvency II limits but rather rating agencies' evaluations of what is risk, the limit at which we start to be at risk in terms of level of our rating. It is rather that the limit than the Solvency II elements.

A - Jim Root {BIO 2545921 <GO>}

Third question is why don't you sell your equities?

A - Antoine Lissowski {BIO 4384399 <GO>}

Because we want to have returns. It's very simple. And to enter in more detail, as we're trying to explain the policy of the company in a low interest rate environment is to increase the economic capital it devotes to relatively risky investment in terms of insurance, which are equities, which return is expected to be much higher than those of bonds. And to offset it – for remaining at a reasonable cost of capital to offset it by an important low capital charge investment part in short-term bonds. That means that we have one side, important investments which are burdensome in terms of capital cost. And on the other part, the light capital investments in bonds.

The next question was...

A - Jim Root {BIO 2545921 <GO>}

The last question what's the maximum of infrastructure you can do.

A - Antoine Lissowski {BIO 4384399 <GO>}

I don't know if that is the maximum. But we are far from it. Michel, would you perhaps say something about the difficulties you have to find investments?

A - Operator

Infrastructures represent almost 0.4% of our portfolio today. It's very low regarding our liability which some of them are – it consists of [joint] suspensions and long-term liabilities which are very well suited to infrastructure investment.

For the current year, we had targeted only €300 million investment infrastructures. And today we are far from this amount. So we are still looking for opportunities. We are contemplating some for the time to come. The difficulty today is to source interesting enough infrastructures within the competition in this field.

A - Antoine Lissowski {BIO 4384399 <GO>}

Okay. Further questions, please?

Operator

We take our next question now from Ralph Hebgen of KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yes, hi. Ralph Hebgen. Good afternoon.

A - Antoine Lissowski {BIO 4384399 <GO>}

Ralph...

Q - Ralph Hebgen {BIO 6297020 <GO>}

Can you hear me okay?

A - Antoine Lissowski {BIO 4384399 <GO>}

We can hear you okay. Sure.

Q - Ralph Hebgen {BIO 6297020 <GO>}

All right. Cool, cool excellent. So, I've got two things. One is the €200 million gain from BVP which you put into reserve. I'm just slightly confused how this worked technically. I just seem to remember that sometimes when you have a reserve increase or release from reserves, these amounts were reflected in net insurance revenue. So perhaps if you could just explain how this worked and confirm that this €200 million is indeed not reflected in the insurance revenue, or otherwise? That's question number one. Yeah, sorry.

A - Antoine Lissowski {BIO 4384399 <GO>}

Okay. And number two?

Q - Ralph Hebgen {BIO 6297020 <GO>}

Number two is on the economic solvency ratio again. So we've heard that the transition from 160% to 170% was basically generated by market movements entirely, but – so you can confirm that they were no modeling changes or no changes to the internal model...

A - Jim Root {BIO 2545921 <GO>}

Right. Yes.

Q - Ralph Hebgen {BIO 6297020 <GO>}

...in the first half. Does that generate an opportunity to make these changes in the progression towards Solvency II, or is your internal model basically already the fully loaded Solvency II model? That's question number two.

A - Antoine Lissowski {BIO 4384399 <GO>}

Yes. In fact, we have no internal model. We have purely standard formula. We are applying standard formula as precisely and conformingly to the regulation as possible. And there is no difference between what we do and the standard formula. There is no question of improving the model and so on. Obviously, you are analyzing accounts of many companies which are cooking their ratios. It is not possible where you are making a ratio without internal model. Then there is no clearly evolution in the model.

Q - Ralph Hebgen {BIO 6297020 <GO>}

So this is the standard formula you're using and that is not going to change?

A - Antoine Lissowski {BIO 4384399 <GO>}

Absolutely. Standard, and plain standard formula.

A - Jim Root {BIO 2545921 <GO>}

There is some scope from benefit from the transitionals.

A - Antoine Lissowski {BIO 4384399 <GO>}

No. So far there is nothing with transitional.

Q - Ralph Hebgen {BIO 6297020 <GO>}

No. Just to follow up to that. Will you – or at what, point will you disclose sensitivities to macro drivers of the economic solvency ratio or the Solvency II ratio?

A - Antoine Lissowski {BIO 4384399 <GO>}

We'll make first sort of inquiries among different analysts to see what is the least of indicators you will need to have next year with Solvency II. It is clear that there will be at the beginning a certain difficulty in communication because different competitors will produce figures and measures which will not be comparable. Then what we will do is first to analyze what all the other companies have given.

Second, to discuss with analysts which follow our equity to see what are their wishes. And after we'll settle sort of standard or CNP standard, what are the sensitivities which we will publish quarter after quarter in order to give you long-term series of not only of the ratio itself but of different positive elements to help you to analyze its evolution. But so far, we have no specific list of different publications which we will make. It is a work in progress.

Q - Ralph Hebgen {BIO 6297020 <GO>}

And do you have a target date by which you provide – by which you wish that work to be completed, like first quarter of 2016 for now?

A - Antoine Lissowski {BIO 4384399 <GO>}

I think that we will work on that at first at the end of the year to be ready to say something in February and of course complete this with a view on the publications of the market during the first quarter of next year in order to be fully complete in July next year.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay.

A - Antoine Lissowski {BIO 4384399 <GO>}

I come back to your first question. There is no specific point with this sort of capital gain. I think I referred to Barclays Vida capital gain. There was no relation with net interest revenue in the past of them. You know sufficiently well the structure of the company. You know that all our own accounts investments are in specific part of the balance sheet and the subsidiary are there. And when we impair or when we make capital gain on the subsidiary, it is out of net insurance revenue.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Outside?

A - Antoine Lissowski {BIO 4384399 <GO>}

Outside, I am sorry.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yeah, okay. Okay, perfect. Thank you very much. Very clear.

Operator

Thank you. We now move on to a question from Michael Huttner of JPMorgan. Please go ahead.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Fantastic. Thank you very much. My only question actually is on the PPE which I discovered this morning was €6 billion which is a lovely number. Is there a limit – when will you stop adding to it? It seems you're growing it at the moment just about €1 billion a year and what is the benefit to shareholders of growing it on a stand that eventually it all goes to policyholders? Is there a benefit because it's part of some fee or it's a buffer or – just understand a little bit, because the way I look at it as I think, well, when you stop adding to it, then the earnings will go up and the dividend will go up, maybe up? That's my question.

A - Antoine Lissowski {BIO 4384399 <GO>}

And the restructure orders will also go up as well. Do you have, Michael, a suggestion on the target on the PPE to the provisions. At roughly 3% when we look figures published by our French competitors, we see that to be just below 3% is not exotic, okay? It is not exceptional. There are many very important actors which are at this level. And when you are at very low rate environment to have reserves in order to be able to, if necessary, pay some policyholders – dividend to policyholders to keep these customers in case of interest rate surge is necessary, then the benefits to the shareholders is clearly that it protects their own risk against an increasing interest rate. It is sort of buffer at the benefit, indirect but at the benefit of shareholders. And it allows us to have a very regular and predictable net revenue all of the time.

If not, there would be probably very high volatility in terms of net revenue and perhaps sometimes also necessity to make emergent capital raising which is clearly not the style of the company.

Q - Michael I. Huttner {BIO 1556863 <GO>}

And is it included in solvency?

A - Antoine Lissowski {BIO 4384399 <GO>}

The status of that in solvency, Mike, the status of the PPE of solvency, you can say few words of how if looks?

A - Operator

So the PPE is I know that would be using the Solvency II model because it's a return that protects the eligible of funds because when you have a stress, a market stress, in the standard formula, you can use this figure to reduce the impact of the stress.

A - Antoine Lissowski {BIO 4384399 <GO>}

It is clearly a status of being a buffer against capital being dented in case of market events.

Q - Michael I. Huttner {BIO 1556863 <GO>}

So it's a bit like available capital?

A - Antoine Lissowski {BIO 4384399 <GO>}

You can call it like that. But I don't know if there is a word in English for the PPE. It's not available capital. It's not capital. It is a buffer. It is a sum which is available in case of, but is not capital.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Okay.

A - Antoine Lissowski {BIO 4384399 <GO>}

It's not capital.

Q - Michael I. Huttner {BIO 1556863 <GO>}

It's not capital.

A - Antoine Lissowski {BIO 4384399 <GO>}

It is a protection for the capital.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Yeah. Okay, lovely. Thank you very much.

Operator

Thank you. We have no further questions at this stage.

A - Antoine Lissowski {BIO 4384399 <GO>}

Okay. Then thank you very much everybody. Have a good holidays. Bye-bye.

Operator

Thank you. That would conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect. Thanks.