Legal & General Group PLC at Deutsche Bank Virtual Investor Conference

Company Participants

- Stuart Jeffrey Davies, Group CFO & Director

Other Participants

- Zafar Aziz, Analyst

Presentation

Zafar Aziz {BIO 16099027 <GO>}

Hello. Welcome to the Deutsche Bank Depositary Receipts Virtual Investor Conference, dbVIC. My name is Zafar Aziz from the depositary receipts team at Deutsche Bank. I'm pleased to announce our next presentation will be from Legal & General Group from the U.K. Before I introduce our speaker, a few points to note. During the presentation, please submit questions in the Ask a Question box along the bottom of your screen. There is no need to wait until the end of the presentation to type in your questions. Please remember that after the presentation and the Q&A session lasting around 30 minutes in total, don't log out. You'd automatically be transferred to Legal & General booth. We can continue the conversation via the chat screen and access additional investor material. On a final note, all of today's presentation will be recorded and can be accessed by the Deutsche Bank website, adr.db.com.

At this point, I'm very pleased to welcome Jeff Davies, Chief Financial Officer from Legal & General. Over to you, Jeff.

Stuart Jeffrey Davies {BIO 20023574 <GO>}

Thanks a lot. Good afternoon, everyone. We'll run through the presentation. Thanks for taking the time for joining. Obviously, we can't ignore what's going on in the news at the moment. And I think we're definitely into buying opportunity territory today. So hopefully, I will explain why that is the case in the next 30 minutes. So yes, thank you very much for joining. We'll run through a little bit of how we're positioned and also a little bit of update on the activity we've had and leave you with some of the figures around the half year, how that's looking and repeating some of the stuff of the outlook going forward and hopefully then we can have some good questions.

So we have the usual forward-looking statements that came up and then the overall picture is what we show here on the first slide. I think we are -- I'll never like to say we're uniquely placed. But we're extremely well-placed and our values and what we stand for come through in what we're trying to achieve and you have that down the left-hand side. It is genuinely true throughout our business that we are not only looking to create value for shareholders. But we are looking to do things that improve customer lives and build a better society, whilst therefore making money along the way for our shareholders and you see that in the number of areas that we focus on.

We've tried to -- as you move across the slide, we've tried to simplify the business. We think of our business as reasonably simple though obviously, there's many complex angles to it and varying forms of regulation. But we've simplified it down from the divisions into the areas that we operate, the investor management being the simplest in the middle because it is just the asset manager. The insurance at the bottom there, which is our life term book generally and the hyphen contents. Then at the top, the one that's really been making the news this year and is driving a large portion of our profits, the annuity business, which also combines to create or deliver capital which we can use for investing in our LGC division as really we just invest our shareholder capital to optimize returns. The big advantage we have there is that we have very long-term liabilities, which are illiquid by nature and they therefore need long-term capital sitting alongside that. We can be very patient investors both on equity where we need to be. And also in the long-term debt in which we have been able to create and generate that gives us a competitive advantage in that market. And we'll go through some of those individually as we go through. But all of that we add together to deliver our ambition that we've put out in the market, which remains the same, which is to deliver the 10% EPS growth or in line with what we've done in the previous five years, which was that sort of magnitude out to 2020.

And so move on, why is that -- why do we think that growth is there, why do we think it's achievable? Well we have that on the next slide, which is the growth drivers. Our strategy is very much aligned with the macro growth drivers that we see in the economy and these continue on a global level and are not really influenced by bumps in the road if you like. Things like age and demographics are a fact and we are -- we show on the right-hand side where our businesses are aligned with it and things like age and demographics take many forms. We've all seen the pension schemes that are now running off. That is leading to defined benefit pension schemes looking to buy out. We're at record levels for that. We'll have more on that later. And we've seen record amounts of activity this year in both the U.K. and the U.S. And at the same time, we're looking to invest alongside that age and demographic, where we move into later living and provision of accommodation, lifetime mortgages as people look to access the equity in their house and the changes we're seeing around there. So we will look further out around broader ecosystems and what that means.

Then in Investment Management, you get overlap in a number of these areas, both welfare reform and age and demographics and the DC market. And what does that mean? You've got the 401(k), for example, in the U.S. where these are now coming up to end of accumulation and people are starting to think about the accumulation. What does that mean? And the big growth in DC market in the U.K. And you can see the other drivers which align very naturally with what we're looking to do. So creating real assets. There is, as you all know, a lot of demand for infrastructure, for housing. These are factual. The question is, how do we optimize the margin delivered from this, do it in an efficient way and where do we have competitive advantages. All really starting from our brand, our access to capital, our access to partnerships and applying that and the fact that we can bring both equity and debt to work on these arrangements.

The final one and probably worth highlighting is the technical innovation because we can only deliver all of this if we continue to be extremely efficient and in our retail markets such as the DC market and the term insurance market where we have to deliver hundreds of thousands of applications, transaction policies in each year. Those need to be driving ever lower unit costs through technology and of course, the digital front-end that customers expect as part of their interaction. And we're even seeing that now when we pitch for DC business, the corporates are expecting a far higher level of interaction for their employees with a pension provider and the ability to switch between funds, to get information. And of course, that plays perfectly to us. We want to be looking at a paperless world where we can deliver statements electronically. We get to interact. And you'll have seen maybe in our Capital Markets Day around LGIM asset manager, where we showed an example of a video that we used with one of our biggest DC clients that are individually tailored videos which lead to them -- advice or guidance around optimizing their pension part and their contributions from their employee and where they are looking -- what it would look like at maturity for them. And so we're looking to constantly invest in that side of the business as well and then have add-ons. It would disrupt this such as salary, finance and what could we do around the workplace and how they interact as well with employees as well as the employer, given the breadth we have across all of our businesses. We probably have relations with every single corporate just about in the U.K. of a meaningful size, for example.

So we should move on, otherwise, I'm going to talk through the whole thing before we get to questions. So this goes back to something we showed at the half year. It's a coincidence, quite a nice coincidence that all 3 of these metrics have grown by 10% over that period. There was nothing funny going on with that. But that shows that we have been constantly delivering over this period. And these time frames are not chosen for any particular reason. They sort of go back to a financial crisis and show the development of the dividend over the period and, in particular, around the earnings, et cetera, obviously relate very closely to the period of the year as being in that role as well. And so we continue to have this as an ambition. We are committed to that and feel there are a huge amount of growth opportunities across our business to continue to deliver this. And in our core markets around annuities, et cetera, we obviously see a huge demand that can continue to show growth.

The only other thing probably to bring out on that slide is the slightly dotted bars in 2017, which represent the longevity release. We also have benefited of course from the tax changes that were brought in by Mr. Trump. And to some extent, we've normalized for those. We tried to exclude the longevity release from what we are claiming as our core metrics, otherwise, we'll already have achieved our target for 2020. It's, however, obviously, a very nice buffer to have in terms of earnings. We've talked about a number in the GBP 350 million to GBP 400 million type range for this coming year. Then we look forward to other tables that are still saying there is potentially more to come there. As I said, it's very nice to have as an insurance. But we don't claim that as part of our core earnings per share. But it does mean that we are free to use that to invest in the business, invest in capital strain or invest in smaller acquisitions as we wish on top of the earnings growth that we're delivering. The other one to remind people of is that we have over 400 million of accounting profits that also come in 2018 at the point that the court process is completed around the sale of our Mature Savings business. And that will also then lead to cash being moved up from our insurance entity to group. So there's a cash and accounting profit that will also flow through. Again, we won't be claiming as part of our core earnings per share.

Just moving to the next slide was a bit of an update on the numbers. I mean, you'll all have seen this from the half year. Then relating it to where is the growth, what's the drivers in the second half, the great thing in the half year and what we continue to see is nice operating profit growth across our businesses. You can see the 5%, 8%-plus growth, of course, in Legal & General Capital, the influence of the CALA acquisition is coming through there, which is an increase on the previous period and we continue to see good activity in the housing business. We are in a very strong position to defend the margin, if you like, within that -- in a slightly different setup to your more or traditional house builder in that we are long-term capital not reliant on short-term working capital. We can invest in land on an opportunistic basis, et cetera. And we will continue to do that. Whilst we're on Legal & General Capital, we also see huge opportunities in the, what we're now starting to call more feature cities around the urban regeneration, combining clean energy strategies, mobility strategies with Later Living and built to rent and the requirement for these accommodations in city center, which is allowing us to offer a real sort of multipurpose solutions, a bit like IKEA. I was talking about it in the FT yesterday is something we're working very closely with councils, universities on this and we have good examples but we would love to do this in 10 more cities across the U.K. And we have a number of these that are in progress and continue to do that. Obviously, the big one at the top, we're now at sort of record pipeline levels. We have a slide on this both for the annuity business, we'll come onto that. Lifetime mortgage market continues to move forward strongly. We're confident in that and the individual annuity market of continued to increase either market share or the total size of market. And we are well placed to continue to be good investments for the annuity business and individual annuities. We are increasingly improving the offering around enhanced annuities and looking to create more partnerships where we are taking more share of back books from other maturing business, et cetera.

The asset management business, there are big global trends here. We've acknowledge -- we see the DB index business running off in the U.K. but are seeing increases in the DC market. U.S. as it's highlighted here, a big growth driver. U.S. LDI fixed income continues to see excellent inflows and we see the positive trends continue in there. Then the U.K., U.S. DC is really a strong performer for us. So even in the short term of '18, '19, we see that continuing to drive a lot of flows for us. And obviously that will counter some of the natural DB runoff over time as pension schemes mature, many of which we will capture in our pension risk transfer business, of course. And we continue to see upticks in our insurance business. So U.K. and U.S. premiums are growing and continue to grow. We monitor closely U.S. mortality experience. But overall, we've seen good growth in both of those businesses given that we're at #1, #2 in our chosen markets there and we've seen excellent turnaround in our group protection business.

So we'll just move on, make sure I can get to the number of questions that are coming in. So this is the overview around the annuity business. And so we've already completed -- well, at this point, this was year-to-date more than let's call it GBP 8.5 billion of pension buyout transactions. The U.K. has gone extremely well. We, of course, have the record-breaking 4 -- GBP 4.4 billion, GBP 4.5 billion with British Airways. And these are transactions where we believe we have a real competitive advantage, whether these are through long-term relationships or complexity or our rating covenant or simply our operational and certainty of execution. So we will continue to look for those. But equally, we'll operate across the whole piece around the smaller transactions and the GBP 1 billion-type level. Even having completed these, there was a GBP 4.4 billion, a GBP 2.4 billion. We have an extremely strong pipeline and this gives some breakdown of when we've been talking about numbers where we left and we're still actively quoting of the order of GBP 25 billion, have a good line of sight to Q1 next year and what may be executing there, whilst at the same time being on. Overall for our annuity business, potential to go over the 10 billion for one year in our annuity business, which is phenomenal compared to where we were 4, five years ago.

And one of the questions that comes up is well, the assets, et cetera, what does that do to the balance sheet? We generally have the assets required to write that business. We're not anticipating any particular reporting strain if you like in our figures as a result of that. Then we have opportunity to optimize it going forward as we source other assets. And we feel well placed to source the assets required for the business in 2019.

So the big growth drivers, one of the questions was what is the growth drivers for '19? Clearly, a big growth driver is the continued level of activity in the U.K. PRT market, where we are market leader. What will be very interesting on that is where pricing lands. We were very comfortable with the deals we've completed this year. It would be the case. But on our own value metric and based on our feedback in the market, we believe we -- the deals we completed in the second half were advantageous pricing compared to the ones we turned down in the first half and it will be instantly where that lands. It may be that companies are still aggressive in the First Quarter looking to get some deals done and we will continue to be measured and disciplined and if the pricing is not where we want it to be we will not participate in the market and we will save up our assets and our execution for later in the year to get the margins that we require. So we'll continue to be disciplined on that but see huge potential.

And as I say, I already have line of sight to significant pipeline throughout 2019 and have tasked the team to continue to create the assets required to dealing with those. Of course, if we don't think the pricing is there, we will simply apply those assets to the back book and actually make more overall accounting profit because we won't be giving any of the spread away to our customers and we are very happy to do that for a period of time if we don't agree with the pricing in the market. So great position and also some good deals done in the U.S. We continue to look to build that market. We would love to write more in the U.S. and as I say continue to push in there and optimize it and look to source more efficient assets that allow us to compete even more in that market, grow our balance sheet. And we'll continue again in a measured way in the U.S. but we'd like to start participating in the bigger transactions there.

Just one slide that we like to show because it's very relevant in a world where people worry about credit and Brexit and everything else. In particular, people say, what are these direct investments, what are these illiquid. And there's some misconception around this. These are a sample of our top 10, 11 direct investments that are back in our annuity portfolio. And it's important to realize that the quality of these, they are many, many -- tax authority build in revenue and customs. This is actually now a bigger number and you add that with a couple that we have that are backed by the Secretary of State and it's well over 1 billion of government exposure we have. And no matter what you think about the government currently and what's going on, the tax authorities tend to pay their bills. And our real exposure there is HMRC being able to speak and be able to afford their rent on an ongoing basis and they tend to do that. So we feel very comfortable with that. Things like an Amazon distribution warehouse, we've rotated away from retail and into where we think the future is, even if in the case of an Amazon default, we would, in that case, end up with a highly technologically full distribution warehouse which will be a very attractive proposition for others that are in that market and you see they transport for London BBC. These are very strong counterparties with the double trigger of not only if they -- should they fail only then do we look at the property. So it is not that we are exposed to a huge amount of U.K. property exposure and property evaluation on our balance sheet. The vast majority of these are really about the counterparty that is simply paying us the lease and we have very little to no value for the property held in our balance sheet. And those -- there is no expectation that we would ever get hold of those properties. The expectation is that rentals are renewed or they simply go back to the underlying leaseholder.

So just before we get to some questions, the last slide I think is just a recap of where we were in the half year. We continue to feel extremely well placed, operating profit continues to grow over GBP 1 billion there. Earnings per share continues to grow. We have over GDP 4 billion of cash which also leaves us feeling we are very defensively placed. It's very important at this point in time whatever you think about global macro or Brexit or anything else, we want to be very well placed to capitalize on this whether that's buying land cheap or entering into financing agreements or simply transacting around PRT, which is what we did in the last financial crisis, which allowed us to improve dramatically. And we continue to provide strong return on equity and our solvency coverage ratio improves all of the time. And one of the things we've -- that will have improved as interest rates increase, we have other drivers that are within that. But we do a large number of stress tests around many multitude of Brexit scenarios and Jeremy Corbyn governments and everything else, feel very well placed in our balance sheet and what that looks like in the different scenarios and would love the flexibility around management actions. So we'd just answer some questions. And we're just going to flick through some.

Let's have a look. We got -- our first question here is what is the #1 priority for management team -- said new management team. I guess it's relatively new, though Nigel has been here a long time and some others have moved around. I mean, it's always hard to pin down to #1 priority. One answer to that is the opposite of what's your #1 risk. Our #1 priority, I would say, is focused execution. And so it's almost as I say the opposite of our biggest risk would be management stretch, lack of focus. So we ensure that we are investing wisely. We're looking at the most material opportunities. But it isn't the case of a single opportunity because it does vary by divisions. If you think really big picture what's going to drive our value is ensuring that we are disciplined in our pricing in the pension buyout market and that we are continuing to source the correct assets with the right risk/reward profile for that. The advantage we have there and the competitive advantage is the interaction of the annuity business, the asset manager and LGC being able to create those assets and look more broadly ourselves. But there isn't a single one because the DC market is also huge opportunity and investing wisely in technology around that is also another very large driver. But I think more and more what we are seeing and management are aligned around this is the new exec team is around collaboration across the business. There's are a lot more interaction between the various businesses because of the nature of the offerings that are out there now, single workplace offerings, the overlap between group provision, SalaryFinance, DC pensions, for example. And starting to develop more how those would look in an ecosystem. And so that really is the priority is continue to improve that collaboration across the business which is something we've always stood for.

Let's see if we can find another question. There's a few sort of Brexit-related. One I can guess as much as any of you why are we down so much when the FTSE is down. Well obviously the FTSE 100 as we've known has all sorts of random correlations that are normally quite strong with sterling. And obviously, with the sterling weakening today, we can see why the FTSE 100 has gone in one direction. Whereas probably us, Barclays and others, though we are seen as a bit more of a U.K.-specific play we wouldn't benefit so much from sterling though we actually do in our balance sheet. As sterling falls, our balance sheet NIMS do improve a little. So I suspect that's why we are down in comparison to the overall FTSE being much more reliant on the FTSE 250. But of course -- and then the question is around best worst-case scenario in Brexit negotiations. Yes, I mean, I would say we've done lots of balance sheet work on this and earnings and resilience. I mean, in terms of where could it go, well, I mean, you all know yourselves. I mean, I think, even today, our central case and a number of the banks' central case is that we will get through. There are enough conflicting priorities of all the different politicians and enough fear of what may happen that eventually this will get through with some sort of solution. So we do put a reasonably low probability on a worst-case scenario of a no deal dropout. Though, even in that scenario, we're pretty positive in terms of our own outlook. People will continue to buy our pension schemes and continue to put their money in their DC pension. And we don't expect to see wide-scale corporate bond defaults as a result, which is really that thing that would economically harm us. And so we're not too concerned about that. I mean, it's the tail risk of a tail risk of a Corbyn government and extremes impact on the sovereign downgrade and capital controls that would play out over a medium term that we would plan differently for. But even within those, a lot of those are in line with our Affordable Housing development for example and also within that, we're not particularly exposed to sterling downgrades. We've looked at our portfolio and it wouldn't necessarily flow through. And things like the HMRC debt, we hold very little capital against that as you had seen the government debt. And you don't hold capital against your own government debt.

There's a nice one here, possibly needs to be last one. Can you speak to the growth trends in the U.S. of your businesses? Yes, sure. We have 3 different businesses. We have the term life business, where we're #2 in the broker market. That one, we are already a significant player. And difficult to grow beyond the sort of 5% type level from that pure business. But we do see a lot of opportunity to grow more direct, put more technology through there and also improve efficiency on there. So we would look to potentially increase a bit of market share and then look for more direct business through partners, et cetera. So we continue to grow there and some of the areas that are closely related to that Protection business. The U.S. pension annuity business -- buyout business, we see very large opportunities. The market is over -- is basically the same size as the U.K. You're talking over $20 billion market this year and we -- the demand is increasing all the time. There are a number of players. But not that many that compete in larger transactions. So as I say, we want to get more involved in the 500 million, billion-type transactions. We have some technology in place to do that, making use of our balance sheet and then we need to source the assets and we're growing -- continue to grow our Real Asset capability and look for partners that can provide those assets in the U.S. that we see significant growth opportunity there from where we are at the moment. And that brings us to LGIMA, which the asset manager we've talked about DB pensions, both private and public, were $190 billion and 350 clients, which is a tiny number in the U.S. They've done extremely well. But that means there's just a long way to go. We have now strong track record on active fixed income and we're seeing a lot of flows into that. And obviously, the LDI continues to grow in the U.S. market and we're investing in teams as well as looking at acquisitions around real assets, whether that's real estate, equity, debt and infrastructure equity and debt. And that then has knock-on implications for our annuity business, which means we can then be more efficient, create more profit in that and compete more in that market. So that would be a big growth driver in the U.S. and we don't see that slowing at any time.

So thank you very much. We've got through a few of your questions. Hopefully that was interesting, useful. Obviously, IR are always here. Feel free to fire a question through or if any of you would like to speak to me or the team, then we're always welcome. Thank you very much. Enjoy the rest of your day.