Q3 2014 Earnings Call

Company Participants

- Jarmo Salonen
- Kari Henrik Stadigh
- Peter Kristian Johansson
- Ricard Wennerklint

Other Participants

- Blair T. Stewart
- Daniel A. Do-Thoi
- Gianandrea Roberti
- Matti Ahokas
- Mika Koskinen

MANAGEMENT DISCUSSION SECTION

Jarmo Salonen {BIO 1860650 <GO>}

Ladies and gentlemen, welcome to this Conference Call on Sampo Group's Third Quarter 2014 Results. I'm Jarmo Salonen, Head of Investor Relations at Sampo. With me here in the studio, I have our Group CEO and President, Kari Stadigh; Group CFO, Peter Johansson; and Deputy Head of P&C Insurance, Ricard Wennerklint.

I'll hand over to Kari for his presentation, but let me first remind you that you can follow this transmission live at sampo.com/result. A recorded version of the call will later be available at the same address. Thank you. Kari, please.

Kari Henrik Stadigh {BIO 1504152 <GO>}

Thank you, Jarmo. Welcome to the conference call on my behalf as well. Given the sluggish economic environment in Europe, I'm happy to report a strong result. All area of our operations improved the results during the first nine months compared to last year.

I would like to start off with my list of best ever results. If combined ratio at 87.8% was the best ever result. If solvency ratio at 94% was also highest ever. Nordea's contribution to Sampo's result exceeded €500 million for the first time ever for the first nine months.

Also, Nordea's capital base is very strong and its total capital ratio exceeded first time ever at 20%. And it was very impressive to seeing Nordea's assets under management climb to a record-high at €255 billion, very impressive numbers all the way. Concerning

Mandatum Life, its technical provisions exceeded for the first time €9 billion and its unit-linked reserves peaked at €5.2 billion.

Turning to the standalone Q3, it is worth noting that even if we are facing slow general economic growth, the operating profit grew in all areas. If by 1% burdened by currency fluctuations, Nordea by 22% and Mandatum Life by 15%. Our Q3 EPS grew by 15% to €0.71.

Given these solid numbers, If will distribute in December as usual an internal dividend of SEK 5.5 billion, i.e., almost €600 million, up 20% from last year. Also, Mandatum Life with a solvency ratio of 29.8% is well positioned to distribute in the first quarter of 2015 an internal dividend at the same level as this year, i.e., €100 million. All this is fine and dandy, strong numbers and stable performance.

However, there are the same old issues that keep us awake at night, namely the sad general economic development in Europe and slow growth consequently leading to low interest rates, actually lower than we thought and apparently staying lower for a longer time than we thought. So, our running yields in our fixed income portfolios are continuing to come down. In If, the decline was after nine months on a year-to-year basis down from 3% to 2.5% and the Mandatum Life from 4.1% to 3.5%. Sadly enough, we will see this downward trend continuing in the coming months.

Our investment stance remains the same, cash is king until we see a steepening in yield curve, and equity should be bought on dips. There is not much left of this year, but as you have all seen, we have changed our combined ratio guidance from 88% to 90% for the full year. And even if we saw cloud burst in Denmark/Sweden, and forest fires in Sweden accompanied with flooding now in Norway, we see no reason to change this. All in all, confidence prevails.

Jarmo Salonen {BIO 1860650 <GO>}

Thank you, Kari. Ladies and gentlemen, we are now ready for your questions.

Q&A

Operator

And we have our first question from Mr. Matti Ahokas from Danske Bank Markets. Please go ahead, sir.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Good afternoon. It's Matti here from Danske Bank. Two questions if I may. Firstly, regarding the dividend payout, you're increasing it by 20% even though the result is flat. We interpret this as an indication of basically you willing to increase the leverage more in If.

And the second question is regarding – even though, Kari, you mentioned that you've seen a record result overall an 88% combined ratio compared to peers, even though it's not directly comparable, isn't that great? So, I'm just thinking, as a kind of benchmarking act, would you consider cost cuttings or further kind of efficiency improvements in If to get the profitability maybe closer to some of very aggressive recent targets presented by our competitors. Thanks.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

We are not really benchmarking us to our competitors. I think that we feel that we are the market leader in this business segment and we run our own show here. So, whatever our colleagues are producing, that doesn't really guide us at all. And I don't even want to comment on our colleagues' performance because it's not relevant for us.

We run this company based on return on equity targets, and we are performing extremely well there. And the present level of combined ratio is actually very much to my liking and satisfaction. I don't know if Ricard wants to add anything. But this is my strong belief that this is the way we see. This is an excellent result.

A - Ricard Wennerklint

I can add that cost-cutting has always been a big part of our strategy and we'll continue to push down cost ratio the same way we've done on the previous years.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Yes. Our cost ratio has been going down more or less every quarter on a level of 0.1%, 0.2% per year for the last 12 years. Dividend, I don't feel that we increased leverage at all. Our solvency at 94% is all-time high. So by distributing this dividend, we are still in the upper part of an A rating. So, I feel very comfortable with this and it's by no means an indication of an increase in leverage.

Q - Matti Ahokas {BIO 2037723 <GO>}

If I may follow up on that as well regarding the subordinated capital potential in Solvency II. So you don't see this as a kind of indication to that front. I'm just here as well pointing out to some of your competitors which have given fairly detailed estimates on how the subordinated capital shares if you look at in the Solvency II world?

A - Peter Kristian Johansson {BIO 20728335 <GO>}

Yes, and on your previous question, Matti, I could add that actually, when we paid out the SEK 5.5 billion dividend now, it's actually coming from the 2013 profits. So, when we made the full-year numbers for 2013, so in spring basically, If in Sweden and If in Finland paid the dividends up to the holding. So basically, we're taking out now 2013 profits. So this year's profit will not be distributable before we take the full-year numbers.

On hybrids basically, the hybrid capacities, I don't remember the exact numbers but I think we're pretty close on the present regime, we're pretty close to the maximum hybrid capacity, so we will have to wait until Solvency II and see how much we want to increase potentially, hybrids in and if maybe Mandatum Life.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks.

Operator

We have a next question from Mr. Blair Stewart from Bank of America. Please go ahead, sir.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Thanks very much. Good afternoon. Lovely to hear there were phrases fine and dandy being used in the presentation. A couple of questions, firstly on the P&C side, we know that the net reserve releases were very low. We know that large claims were broadly in line with expectations across the piece. I just wonder, has claims frequency been friendly or otherwise over the piece? That's the first question.

The second question is on the life side, where I think you saw about a 22% reduction in premium income in Q3, I know Q3, looking at life businesses on any one quarter is not useful, but was there anything going on in particular in life that led to that reduction in premium income? Thank you.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Well, I can start off with the life. The fluctuation comes purely from Danske. What I quote, our own distribution performed really well. Danske decreased to the level of the previous year to 2012 levels. That's fluctuation and that was, in my view, mainly based on the fact that Danske was cutting their distribution capacity.

I suppose that their intention is to – after cutting capacity to start to grow again. So we'll have to see how they perform but this was the source for the fluctuation.

Q - Blair T. Stewart {BIO 4191309 <GO>}

How significant is that as a distribution channel for you now please, Kari?

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Is that – sorry, I couldn't hear you now.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Sorry. How significant is Danske as a distribution channel for the life business compared to your own distribution?

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

It's, at this moment, a little bit smaller but it's very important to ask because bank distribution has become more and more important as we are selling less and less pension products and more and more wrappers, capital redemption policies, for instance.

So it's more close to asset management nowadays in life than it used to be. And Danske is the number three bank and we have an exclusive distribution agreement with them. So, of course, it's very important for us. And therefore, their performance is influencing our volume.

A - Peter Kristian Johansson {BIO 20728335 <GO>}

Normally, the third quarter numbers are quite volatile and the comparable number in 2013, we had an exceptionally good September. July is always very quiet. And then activity picking up in August and September 2013 was, for some reason, very good month and 2014 wasn't that good.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

When you distribute insurance products especially if they are from a subcontractor or a partner, it's very dependent on how you'll compensate your distribution, what kind of campaigns you have and things like that. And those issues, the timing of those are, of course, not in our hands. So, I think we will see fluctuation in the banking distribution also in the future. It depends on their appetite for more mortgages and other issues.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Very clear. Thank you. And on the P&C side?

A - Ricard Wennerklint

Yes, on the P&C side, the claims frequencies has continued to surprise a bit on the positive side. But then I have to sort of take away the fact that we've had a few events during this year, smaller events, below our net retention of SEK 250 million. But still, they impact the results. And, again, the same as we have said before, there's nothing to be read into the prior year result. There are some volatility in prior year's result. Reserve strength and solvency is still on very high levels, so really nothing to be read from this quarter or the first nine months prior year gains.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Very good. Thank you very much.

Operator

We have the next question from Mr. Mika Koskinen from SEB. Please go ahead, sir.

Q - Mika Koskinen {BIO 1557965 <GO>}

Yes. Hi. It's Mika from SEB. Just two questions regarding to the investment portfolio. You mentioned that the running yields on the portfolios are likely to trend down in the coming quarters, which is very understandable. Still, you were able to maintain fairly stable running yields. Now, in this quarter against the previous quarter, is there something special that has happened whereby you could fight against the trend a bit?

And then second question, relating also to investments, you mentioned that equity should be bought in dips. We had a fairly up significant dip in the markets over the last few weeks and did you increase your equity exposures in that period?

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Yes. We work exactly as we communicate. So in the dip, we were buying shares. Unfortunately, the dip was lasted for a very short time. We increased to roughly SEK 1.1 billion in equities during the dip. In the summer, there was some turbulence in the high yield market and I think it was in July...

A - Peter Kristian Johansson {BIO 20728335 <GO>}

In July, yes.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

...so we were able to increase high yielders at very good value for roughly €100 million in the summer. And that's – I would treat that as a one-off. And therefore, the running yield didn't trend downwards this quarter. But I still expect it to do so going forward.

Q - Mika Koskinen {BIO 1557965 <GO>}

Okay. That's very clear. Thanks very much.

Operator

We have our next question from Mr. Gianandrea Roberti from Carnegie. Please go ahead, sir.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yes. Good afternoon from me as well. I have three question. Ricard, can you give me some comments on the outlook for Norway. You continued to produce extremely strong numbers in Norway and some of your key competitors are doing so as well. But at the same time, Gjensidige is telling us that as an example in the price increases of 3%, 4% that they announced at the beginning of the year, basically particularly in motor, they're not pushing that through to customers anymore, signaling that, well, I guess, there's some sort of limits of how much they can do. Just a few words on the Norwegian market would be really appreciated.

And the second question is more of a discussion on your rating in the non-life. We'd touched upon this before but I'm just wondering, there is a substantial difference from your economic capital model and the (16:05) And clearly, the difference is the fact that you need – I mean, I guess so far, you have been needing a credit rating. And I'm just trying to understand now how far ago your discussion with S&P in terms of trying to convince them that your internal model is probably better and more sophisticated that their capital model and so on.

The final question is on life. I just want to check is it still correct the assumption that by year-end, you will have everything in place to take in the Suomi Mutual portfolio? That's a €1.3 billion of traditional reserve. And I think we mentioned previously, if I remember correctly, probably an improvement of €5 million, €10 million or something around that level on an annual basis in terms of the operating result. Thanks a lot.

A - Ricard Wennerklint

Well, on the Norwegian market, we are not looking to push through premium increases in the Norwegian market. Generally speaking, we do claims inflation or expect the claims inflation no more than that. So, if you want an outlook for the Norwegian market, you will have to give me the number for Norwegian claims inflation next year.

Secondly, rating. Yes, a dialogue with S&P continue. We get a SEK 1 billion reduction of the economic requirement for an A rating, i.e., they take part of our internal economic model into account when they give us the A rating. Having said that, €1 billion is, of course, not very much, but the dialogue continues and I expect to be given more credit for our model going forward.

A - Peter Kristian Johansson {BIO 20728335 <GO>}

And then, Gianandrea, you have to remember that when you look at our economic capital model, it scaled at 99.5 confidence level which is close to a BBB, so you have to scale it up to become A. And that means add on roughly 30% of capital requirement.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Then on the Suomi deal, it's still I think an excellent deal both the seller and the buyer are benefiting. I wouldn't expect anything else but good takeover. The life company is very busy working on this, for us, very big transfer. On the profitability, I think that we have also communicated that the impact will be very limited in the two first years because then we have agreed on a fixed bonus level for the two first years. Of course, we will get the management, asset management fee of 0.2% from day one, but the carry or the profit sharing will not really pop in with full impact until year three.

It's a segregated portfolio and the takeover issue is the main issue that we get everything running in the back office and that we take over the investments. In the investment side, they have outsourced a big part of it to outside fund managers and we are, of course, bringing the team as soon as we can.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay. Thank you very much. I guess I will have to make up my glimpse inflation estimate to have an idea of your top line in Norway at this point.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Good.

Operator

We have our next question from Mr. Daniel Do-Thoi from JPMorgan. Please go ahead sir.

Q - Daniel A. Do-Thoi {BIO 17019775 <GO>}

Hi. Good afternoon. I just have one question and it's sort of on your ROE. And if I have done my math right, should I send the ROE against the 10 basis point decline in the running yield, you'd have to improve your combined ratio by about 20 basis points?

And so given your sort of current run rate of 10 basis points decline per quarter, that to me implies that you need to make up about 80 basis points on your combined ratio next year and which I guess 10 to 20 basis points that you just mentioned comes from or can come from cost savings.

So my question is how do you make up the remaining 60 or so basis points? I mean, does the current competitive environment allow you to re-price sufficiently? And feeling that, would you consider scaling back on growth and perhaps returning more capital? Thank you.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

I don't think that you can calculate the way you do because if running yields go down, that shouldn't affect our risk and underwriting philosophy as such. It is quite natural that we are more pressured with running yields but partly that will decrease our investment return and it has to be compensated also from an expected higher return on equities. If this wouldn't happen, I would expect the investment income to be lower than this year. So it will not be fully mitigated by underwriting changes.

It's very dangerous to change anything on underwriting in a company which is based on underwriting excellence. So I don't expect that to happen. Then of course, on costs, I think that you don't do it that quickly based on quarter by quarter. We have a tradition of making this company more competitive year-over-year and that's a much longer term job. So unfortunately, we are not in that type of culture that you describe that if the running yields slowly deteriorates, it wouldn't affect us. Unless the equities perform, the lower running yield will impact our results.

Ricard, what would you like to add on this?

A - Ricard Wennerklint

Well, I have nothing to add. When we do the planning for If, we look at the two-year horizon. To change prices now means changing the results between 12 to 24 months from now. So this is far from a quarter-on-quarter business.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

And then also, maybe the last remark is that when we look at our ROE, you must remember that our ROE target is 17.5% and we are significantly above that. So we are not pushing any panic button if the ROE fluctuates with a big margin to our target.

A - Peter Kristian Johansson {BIO 20728335 <GO>}

Yes. The long-term average on ROE has been over 25%, and even in January, September this year, ROE was over 22% and that's what the significant amount of excess capital and now we're partly distributing that out with the €600 million dividend.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

That's a good comment, that the quickest way to have improve the ROE is to distribute big dividends. Much simpler than cost cutting or new underwriting guidelines. Good, Peter.

Q - Daniel A. Do-Thoi {BIO 17019775 <GO>}

Okay. So we should think of the €600 million as sort of a sustainable level going forward or a base to grow from?

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Wow. You are worse than my board. Let's take one dividend per year.

Q - Daniel A. Do-Thoi {BIO 17019775 <GO>}

Okay. And that's very clear. Thank you very much.

Operator

And there are no further questions at this time. Please go ahead speakers.

A - Jarmo Salonen {BIO 1860650 <GO>}

Thank you. Thank you all for your attention and have a very nice evening.