Q2 2019 Earnings Call

Company Participants

- Cristiano Borean, Group CFO
- FrÃ©dÃ©ric Marie de Courtois D'ArcolliÃ¨res, General Manager

Presentation

FrÃ©dÃ©ric Marie de Courtois D'ArcolliÃ¨res

Good morning, everyone. Welcome to the presentation of Generali's first half 2019 results. I'm pleased to take you through the main business results before our CFO Cristiano provides you with a detailed P&L and balance sheet review.

As you know, we presented our new strategic plan Generali 2021 last November. The Generali 2021 strategy is built upon 3 pillars: first, profitable growth in our Insurance business as well as in Asset Management; second, capital management and financial optimization, increasing capital generation and cash remittance and reducing both the amount of debt and cost; and third, innovation and digital transformation of the distribution and operating model to ensure we become lifetime partners to our customers. Empowered people, a strong brand and commitment to sustainability serve as the 3 enablers of Generali 2021.

Generali set 3 new high-level financial targets that it aims to achieve by 2021: first, earnings per share will increase by 6% to 8% per year on average; second, dividend will increase while preserving 55% to 65% payout ratio and ensuring its sustainability in the long term; third, higher returns for shareholders with a target return on equity above 11.5% on average. Since November 2018, the management team has spent a considerable amount of time implementing this strategy with our employees, agents and partners. Everyone is fully dedicated to the execution of Generali 2021. We aim to become a lifetime partner to our customers, offering innovative, personalized solutions, thanks to our unmatched distribution network.

Our results during the first half of 2019 marked a good start to our Generali 2021 strategy with the group making progress on all its 3 key pillars of profitable growth, capital management and financial optimization and innovation and digital transformation.

Our technical excellence is reaffirmed by this set of results with a Property & Casualty combined ratio at best-in-class levels and Life new business margins well above 4%. This is against the backdrop of more challenging market conditions impacting the Life business mix and financial assumptions.

Our effort on cost reductions has been effective. And we are on track with our efficiency targets. The growth of our Insurance business with strong technical margins, coupled with the expansion of our Asset Management footprint and other activities, led to normalized net result growth of 6.4%, on track with our plan. Last. But not least, in spite of the pressure from lower rates across the world, our capital position remains strong with a Solvency II regulatory ratio at 209%. This is also thanks to an operating capital generation at the high end of the industry range. Lower interest rates compared to six months ago are obviously a challenge for all insurance companies. But we consider their impact as manageable and confirm our Generali 2021 objectives.

In the first half of 2019, Generali posted further improvements across most financial indicators. I would like to focus on a few high-level KPIs that highlight the group's profitability in the first six months. Cristiano will then give you a more detailed overview of our financials.

The operating result increased by 7.6% to over EUR 2.7 billion. The group's normalized net result, adjusted for the impact of gains and losses from disposals, came at EUR 1.3 billion, a 6.4% increase compared to one year earlier. Our technical performance remains excellent. Our Property & Casualty combined ratio improved by 0.2percentage points to 91.8% with strong progress on the accident year attritional loss ratio and a very satisfactory top line growth of nearly 4%. In the Life segment, our new business margins remained broadly stable at 4.4%.

Let me now explain to you how our businesses performed in the semester, starting with Life. But before doing this, I would like to inform you that within our Life premiums, net inflows and new business figures, a restatement between lines of business has been applied to provide a more accurate representation of some products sold in Germany and Asia. Comparative figures have been reclassified accordingly. The overall picture remains nevertheless unchanged.

Net inflows grew strongly during the first half 2019, totaling EUR 7.4 billion, up 29.5% year-on-year. This performance has been mainly driven by our Asian business, thanks to reduced surrenders, which were particularly high last year. And due to higher volumes of new sales. In terms of business mix, a dominant contribution of capital-light products, such as unit-linked and protection, has been confirmed. This is in spite of an increased weight of the savings component that increased from 11% to 34% and a decreased weight of unit-linked, down from 53% to 34%.

But the quality of our net inflows remain at satisfactory levels. New business is represented by almost 90% capital-light premiums with the traditional part having very low guarantees, largely at 0% or even lower in some European countries. In addition, a large part of the traditional new business has a guarantee at maturity only, in particular in Italy.

In Italy, net inflows increased from EUR 2.3 billion to EUR 2.7 billion driven by an increased capital-light traditional savings contribution. This more than compensated for the contraction of unit-linked production mainly caused by increased client risk aversion. This aversion is a response to financial markets volatility witnessed at -- in the last quarter of

2018, which translated into a more conservative initial allocation for hybrid products that will automatically revert over time.

France saw strong growth of net inflows, up 46%, reaching EUR 1.45 billion. Also here, the main driver was capital-light traditional savings business. In Germany, there was a 5.5% increase entirely due to a strong performance of unit-linked net inflows. In Austria, CEE and Russia, lower net inflows were mainly due to higher surrenders of unit-linked policies in Poland and of savings in Austria.

The International business experienced strong growth, up EUR 800 million, driven by Asia. This was primarily thanks to China's performance as positive new business momentum was combined with a significantly lower level of surrenders versus last year.

Moving on to new business. We saw increasing volumes, up by 5.4% in PVNBP terms and still very sound margins at 4.4%, down by 18 basis points on a like-for-like basis. The main driver of the slight decline in margins has been negative economic variances due to lower reference rates. A negative impact also stemmed from a slightly changed country mix with the lower weight of Italy and increased weight of Germany and France. Better product features, such as lower minimum guarantees, had a positive counterbalancing effect.

Overall, a positive volume development, coupled with a solid margin, notwithstanding lower interest rates. This led to 1.3% new business value increase on a like-for-like basis, which comes to EUR 942 million.

Germany and the Austria, CEE and Russia region have been driving this positive new business value trend. In Germany, the integration of our agency sales force into DVAG has now been fully implemented, contributing positively to strong new business sales that increased by almost 26% in terms of PVNBP. This, combined with the 33 basis point improved margins also driven by lower minimum guarantees, lead to a 41.6% NBV increase. In the Austria, CEE and Russia region, margin expansion, thanks to a higher weight of protection products, coupled with overall stable new business volumes, led to 8% growth in new business values.

Italy experienced a modest NBV decrease, down 0.5% due to 1.5% volume decrease entirely driven by the reduced unit-linked component. In spite of the unit-linked drop, Italy was able to preserve its very good level of profitability.

In France, new business sales grew by 3.6%, thanks to the development in capital-light savings products. In spite of the good volumes, the NBV declined by almost 22% due to 71 basis point contraction of the margins. This margin movement is explained by worsened economic and operating assumptions as well as by a lower weight of unit-linked products, albeit with a mild recovery in Q2.

Finally, in the International region, we saw strong volumes growth, coupled with the 91 basis points margin contraction, thus driving a 4.3% NBV decline. The margin contraction was mainly caused by reduced profitability of the Chinese savings business linked to worsened financial assumptions.

In P&C, the group confirms robust profitable growth with premiums up 3.9%. The positive trend was seen in both motor and non-motor.

Italy's top line was up 2% at EUR 2.66 billion. The main driver of this performance has been primary non-motor, which increased by 3.3%, thanks to positive development of most business lines and, in particular, accident and health. Motor posted a positive development as well with the premiums up 0.3%.

In terms of profitability, Italy experienced a 1.6percentage point combined ratio deterioration mainly due to higher incidence of nat cats. Also, acquisition cost increased slightly due to the continuous effort of developing profitable non-motor business lines. The combined ratio still reached a comfortable 91.8% level.

In France, the top line grew significantly with premiums up 3.5% to almost EUR 1.5 billion. Motor grew 4.2%, thanks to the development of new commercial initiatives. Non-motor performed positively with premiums up 2.6%. The overall combined ratio improved by 2.2percentage points, reaching 96.7%. The result was mainly driven by a better current year loss ratio and by a reduced nat cat burden.

In Germany, premium increased by 0.6%. This development was the result of a robust growth in non-motor, up 2.2%, while motor was down 1.5%, impacted by pruning activity of some nonprofitable segments. The combined ratio experienced a 1.6percentage points improvement, reaching an excellent 89.8%, thanks to a better current year loss ratio and to lower nat cats. The expense ratio increased due to higher acquisition costs following the integration of the Generali network into DVAG.

Austria, CEE and Russia delivered a strong growth -- a strong performance once again, showing a 5.7% premium increase driven by CEE countries. The combined ratio was outstanding at 86.9%, 1.3percentage points lower than previous year.

The International region delivered strong growth at 6.4% to EUR 2 billion of premiums, mainly thanks to inflationary-driven prices increases in Argentina and the growth in non-motor, predominantly in Spain and Asia. The overall combined ratio stood at 95.5%, down by 0.3percentage points.

In November 2018, we have presented 3 goals for our global ambition in Asset Management: contribution to revenues from external clients, operating margin and net result after taxes. Let me provide an update on the 3 KPIs and on our revenues mix and third-party asset under management development. And Cristiano will add more details later on focusing on our enhanced disclosure based on a reclassified P&L.

The Asset Management net result before minorities reached EUR 133 million, up from EUR 109 million in the same period of 2018. This growth trajectory is in line with our EUR

400 million target at the end of 2021, EUR 350 million of which organic.

The share of external clients' revenues increased from 13% to 30% year-on-year. This strong improvement has been driven by the recapturing via external mandates of the Asset Management of the technical reserves sold with our Belgian activities and with Generali Leben as well as the acquisitions carried out during 2018, namely Lumyna, KD Skladi and Sycomore. I take this opportunity to remind you that the 2021 target is to reach 35% of revenues from external clients. The operating margin remained healthy at 52%, down 3percentage points year-on-year, which is above our 45% target for 2021.

Our Asset Management revenues are fairly balanced across the different management styles. 36% of the operating revenues are generated by the insurance liability-driven business while 37% are generated by high-conviction strategies, both for insurance clients and third-party retail and institutional clients. Real assets business, including real estate, private debt and private equity, accounts for the remaining 26% of the revenues.

On the right side of the chart, we show the development of our third-party asset under management business that increased from EUR 27.2 billion at the end of 2018 to EUR 101.9 billion. The main contributors have been EUR 20.5 billion of new assets coming from acquisitions and EUR 51.9 billion coming after our partnership after the sale of Generali Belgium and Generali Leben. Finally, net inflows during the first half 2019 totaled about EUR 1.1 billion. And market effects had a positive EUR 1.2 billion impact. We are in line with our strategy of building the top 5 multi-boutique asset management platform and on achieving our 2021 targets on external client revenues, operating margin and net results.

Finally, I would like to spend few words on our recently announced acquisition in Portugal. These transactions represent an important step in the execution of the group's 3-year strategy which aims to strengthen Generali's leadership in Europe and confirms our disciplined and focused approach towards M&A. This was a unique opportunity to optimize our strategic positioning in Portugal, a market where we lacked scale, to become the second-largest non-life group in the country with a market share of 18.7% and the third-largest player in the whole market. The transaction will enable us to capture future growth opportunities, to achieve significant cost synergies through the integration of Generali Portugal and Seguradoras Unidas and to ensure the operational solidity of Europ Assistance in the Portuguese market.

The acquisition of AdvanceCare, a service platform leader in the management of medical service outsourcing which has a diversified institutional customer base, will also help the group to acquire a strong know-how and a scalable platform to develop in other countries.

The total consideration for the 2 businesses stands at EUR 600 million. For 2021, we anticipate a net income contribution in the range of EUR 60 million with greater benefits in years to come as we fully realize synergies and develop the business forward. Today's financials show that our performance trajectory is healthy and robust and that we are making good progress on the execution of our plan.

Thank you for your attention. Cristiano will now provide more details on our financials and a capital review.

Cristiano Borean {BIO 15246531 <GO>}

Good morning, to all. FrÃ©dÃ©ric has already provided you with our key strategic and industrial achievements. I will now present our first half 2019 financial results, both from a P&L and capital perspective. I will begin with an overview of our performance so far in 2019. Without repeating what FrÃ©dÃ©ric has already explained to you from an industrial perspective, I will make a few remarks.

Our top line is growing at a very satisfactory pace. P&C posted a strong 3.9% growth. In Life, premiums are up 0.9%. However, removing a positive 2018 one-off stemming from an in-force management exercise executed in Italy last year, the growth would've been of 6.2%. More importantly, Life net inflows and technical reserves are developing positively, growing 29.5% and 4.3%, respectively.

We are also maintaining our disciplined underwriting approach with a continuous focus on technical results as demonstrated by our excellent combined ratio and Life new business margin. All of this led to an operating result that increased by 7.6% to EUR 2.7 billion. I would like to remind you that the redeployment of disposal-related proceeds into higher-yielding investments has just started and will progressively contribute to the growth in the group's results going forward. Our recent acquisitions in Portugal, just discussed by FrÃ©dÃ©ric, have been a further step on this journey.

The net result of EUR 1.8 billion was up 34.6% on the previous year, reflecting the continuous enhancement of our operating machine and the gains from the disposal of Belgium and Generali Leben. The adjusted net result net of the gains related to these 2 disposals stood at EUR 1.3 billion, up 6.4% from the previous year.

Our regulatory solvency ratio reached a solid 209% at the end of June, down 8percentage points from the year-end 2018 mainly because of regulatory changes, recovering 2percentage points during the Second Quarter of 2019. I will explain later on the related drivers. The operating result was above EUR 2.7 billion with a 7.6% increase delivered thanks to positive performances across all business lines as you can see in the chart.

We will now look at divisional performance in greater details. Let us look first at the performance on the Life business segment. On this slide, I would like to guide you through the development in premiums, which went up by 0.9%. In terms of business mix, protection performed very well, posting a 9.3% growth, while savings was stable and unit-linked decreased by 8.7%. This reduction in unit-linked volumes has been mainly driven by the development of our Italian business.

Here, the financial market volatility during the last quarter of 2018 translated into a temporary increased client risk aversion. This impacted the initial allocation of inflows to new hybrid products. The growth rate on overall Life premiums was affected, as I mentioned earlier, by in-force management actions on group business in Italy that inflated the first half 2018 comparative base. The underlying trend would have been a 6.2% increase primarily driven by France, Germany and Asia.

Our Life operating result increased by 4% to EUR 1.6 billion. This was mostly driven by a good technical result performance, up by EUR 208 million. This increase can be mostly explained by a good performance of Germany on the back of growth in unit-linked and protection as well as higher technical margins in France and growing protection in Italy. The investment result increased by EUR 40 million, thanks to higher realized gains and lower impairments net of policyholder participation. The expense result worsened by EUR 186 million due to increased acquisition cost, mainly in Germany and France, to support our new production.

Moving to Life new business. Let me first remind you that the new business figures include the contribution of entities disposed until the moment of sale coherently with the Solvency II framework. Year-on-year changes have, however, been normalized, thereby neutralizing the impacts of the entities sold until first half 2019. Please also note that as we did for Life premiums and net inflows, a restatement between lines of business has also been applied for new business. This, in order to provide a more accurate representation of some products in Germany and in Asia coherently with their characteristics.

Within this framework, the overall present value of new business premiums increased by 5.4% to EUR 21.4 billion. In terms of business mix, savings business increased by 12.1% driven by Germany, France and Italy. Almost 85% of first half 2019 savings new business premiums are considered capital-light, given their product features, in line with our strategy compared with 75% at first half 2018. Protection had a good performance, growing 17.7%, mainly in Italy, Germany and International.

The unit-linked new business decline was driven primarily by Italy, down 27% in this business line, affected by the financial markets volatility during the last quarter of 2018, consistently with what I explained for the Life gross written premium development. France also experienced a 9% drop. But with a recovery trend in the Second Quarter of the year. In contrast, Germany was able to grow also unit-linked with an increase of 16%. This is a proof of the effectiveness of the new distribution setup.

The new business margin stood at an excellent 4.4%, experiencing only an 18 basis points drop year-on-year on a like-for-like basis. As already explained by FrÃ©dÃ©ric, lower reference rates led to negative economic variances that explain a good part of this drop, together with a different country and product mix. In terms of business lines, margins of savings and protection remained fairly stable. This was due also to continuous product enhancement, such as lower minimum guarantees decreasing by 6 basis points on the savings part. The margin on unit-linked new business experienced a decline to 3.4%. This was mainly due to higher expenses and lower premiums. Overall, new business premiums growth, combined with a solid margin, led to a 1.3% new business value increase.

Thanks to a combination of financial market development and strong positive net inflows, our Life technical reserves increased by 4.3% to over EUR 358 billion. We continue to steer the mix of liabilities in line with our strategy. Capital-light business has increased its proportion of total reserves by 1.8percentage points since the end of 2018, reaching 58.8%.

Let's now look at the Life investment portfolio. General account investments reached EUR 327 billion, up 8.6% from year-end 2018. In terms of asset mix, the allocation remained substantially in line with year-end. Our exposure to Italian government bonds amounted to EUR 61 billion, slightly increasing compared to year-end '18 only due to market value movements. Current investment returns marginally decreased to 1.5% on a not annualized basis with the current income in absolute terms declining by EUR 88 million gross of policyholder share. The new money reinvestment rate in fixed income in Life amounted to 2.1%, compared to 2% for the whole 2018.

Let us now turn to P&C. On this slide, I would like to focus on gross written premiums, which increased by 3.9% to EUR 11.4 billion. Trends were positive in both motor and non-motor insurance with the main drivers being Austria, Central/Eastern Europe and Russia, France and the Europ Assistance. We have continued to achieve profitable growth without sacrificing sound underwriting.

The operating results showed a 1.4% increase entirely driven by an improving technical result, up by EUR 59 million. The investment result decreased by EUR 29 million due to lower net current returns. Lastly, the result from other decreased by EUR 14 million mainly due to costs linked to the reorganization of German operations. The combined ratio improved slightly by 0.2percentage points, reaching an outstanding 91.8%.

Looking at the components, we can see that this reduction derived from an improving loss ratio, down 0.9percentage points to 63.2%. The driver of this has been a 1.5percentage points better current year loss ratio. Excluding a 0.3percentage points higher impact from man-made losses, the attritional current year ratio would have improved by 1.8percentage points. The nat cat burden remained stable at 1.4percentage points with the positive contribution from prior year's development decreasing from 4.8 to 4.1percentage points. The expense ratio worsened by 0.7percentage points mainly linked to higher acquisition costs supporting the profitable growth of our non-motor business.

P&C investments increased 9.7% to EUR 41.5 billion compared to the end of 2018. In terms of asset mix, there has been a 3.5percentage points reduction in the weight of corporate bonds and 1.4percentage points reduction for government bonds. This was counterbalanced by increasing weight of other fixed income, up 1.9percentage points, mainly driven by loans, together with the higher weight of equity and cash instruments. Total P&C current returns remained broadly stable at around 1.6%. I remind you that this is not an annualized number. The average reinvestment rate in P&C was 1.8% during the first half of 2019 compared to 1.7% during the whole 2018.

Moving to Asset Management. We are presenting to you a new disclosure based on our reclassified P&L. As you can see, during the first half of 2019 operating revenues increased by 25% to EUR 360 million driven by growing management fees. Around 60% of this increase is linked to acquisitions while around 40% is organic growth.

Operating expenses increased by 35%. This was driven by M&A activities and by investments into startup boutiques, like Aperture, Generali Global Infrastructure and Axis Retail Partners. An additional contribution to cost came from the strengthening of central control functions. Consequently, the operating result grew by 17% to EUR 186 million. The net result after nonoperating items and taxes increased by 22%, also thanks to a one-off effect decreasing tax rate.

In terms of geographical breakdown of the net result, Europe has grown from EUR 89 million to EUR 123 million, which is in line with the European strategy presented in May 2017. The rest of the world, which includes China and United States, shows decreasing profits driven by lower results achieved by our Chinese JVs and by the setup cost of Aperture, our first boutique in the U.S. The cost/income ratio stands at a healthy 48%, even if this is 3percentage points higher, year-on-year. Asset under management increased by 12%, reaching EUR 519 billion caused around 1/3 by acquisitions and the remaining 2/3 by market movements and net inflows. As FrÃ©dÃ©ric mentioned before, it was overall a good first half for our Asset Management.

Let me now turn to our new Holding and Other Business segment, which, from the end of last year, no longer includes the Asset Management business. The overall contribution to the group operating result improved from an operating loss of EUR 56 million last year to a positive contribution of EUR 21 million. This positive development came from the good operating performance of Banca Generali, up 30.8%, thanks to higher performance fees and from the line other businesses. The latter was a result of good proceeds from the growth of our private equity investments and also of our pension fund business in Chile. Operating holding expenses increased by 7.4% mainly due to higher costs in our German subholding.

To move from operating results to net result, we start with the nonoperating investment income, which made a EUR 66 million negative contribution compared with the EUR 20 million positive contribution last year. This was mainly due to lower realized gains that, in the first half of 2018, included a EUR 113 million gain on the disposal of the stake in Italo; Nuovo Trasporto Viaggiatori. Nonoperating holding expenses decreased by EUR 17 million to EUR 371 million, thanks to lower interest expenses on our financial debt, in line with our strategic goal and actions to reduce both the amount and cost of our debt.

Net other nonoperating expenses decreased by EUR 19 million to EUR 152 million, benefiting from lower restructuring costs, now EUR 14 million compared to EUR 68 million at the first half 2018. Among the negative items, there is the recurrent amortization of intangible asset equal to EUR 56 million, slightly increasing due to the recent acquisitions of Sycomore, Lumyna and Adriatic Slovenica and the other net nonoperating items. In the latter, there are other nonrecurrent items such as expenses linked to the disposal of Generali Leben in Germany, local IT investments and the cost related to the application of IAS 29 hyperinflationary accounting to our Argentinian business, which was not triggered in first half 2018. Let me remind you that the comparative first half 2018 amount included a realized gain from the disposal of our Panama operations.

The overall effective tax rate of the group was 31.5%, slightly below the previous year on the back of higher deductible costs in China. In the discontinued operations line, we have a EUR 475 million profit, which includes a EUR 352 million gain from the sale of Generali Leben in Germany and EUR 128 million gain on the disposal of our operations in Belgium. Minority interest increased by EUR 27 million, thanks to the good performances of Banca Generali and of our Asian operations. This takes us to a net result for the first half 2019 of EUR 1.789 billion, up 34.6% year-on-year.

Let us now turn the attention to the balance sheet. Shareholders' equity increased compared to year-end 2018 by 14.7% to EUR 27.1 billion. Main positive drivers have been the mark to market of fixed income investment and the contribution from the net result. On the negative side, we have the EUR 1.4 billion dividend paid in May and EUR 423 million of other, mainly represented by a negative effect on defined benefit plans in Germany linked to the reduced interest rates used to discount these liabilities.

Our regulatory solvency position was confirmed as very robust, reaching 209% at the end of June 2019, 2percentage points up compared to the closing at the end of March and 8 points down compared to the year-end 2018. Let me now explain the movement of our solvency ratio during 2019. I remind you that the implementation of regulatory changes, namely the EIOPA changes on the ultimate forward rate and reference portfolio as well as the treatment of the IORP business in France, accounted for 7 negative percentage points and, together with some opening adjustments, had a total 8percentage points negative impact from year-end 2018. Both own funds and solvency capital requirements were impacted.

Normalized capital generation was once again strong at EUR 1.8 billion. This was mainly supported by our Life business and the profitable new business written during the first half of 2019, adding 9 points to the regulatory ratio. We also had a relative large impact from negative variances, totaling EUR 0.9 billion, affecting both own funds and solvency capital requirement. Economic variances were the main cause, largely driven by the major drop in reference rates.

M&A activity had an overall 3percentage points positive impact. This is the result of the positive effect from the disposals of our activities in Belgium, Guernsey and Generali Leben and of the negative impact of our acquisitions in Central/Eastern Europe and of multi-boutiques. The redemption of EUR 250 million of subordinated bonds had a 1percentage point negative impact on our solvency. Lastly, we deduct the foreseeable accrued dividend worth 4percentage points of solvency.

In conclusion, we have had a good start to our Generali 2021 strategy with the group delivering profitable growth at excellent technical margins. Our balance sheet has proven its resilience despite the challenge coming from the lower rates environment. Our focus on managing the Life business through liabilities, shifting towards more profitable and less capital-intensive business, is demonstrated by these numbers and will accelerate going forward. And on P&C and Asset Management, we will continue to pursue our actions in line with the strategy.

With this in mind, I am confident that we will deliver on our commitments within this Generali 2021 strategic plan. Thank you for your attention.