Q1 2020 Earnings Call

Company Participants

- Guido Maria Nola, Chief Financial Officer
- Massimiliano R Riggi, Head of Investor Relations
- Massimo Rosini, Head of the Mail Communications & Logistics Department
- Matteo Del Fante, Chief Executive Officer, General Manager & Director

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Poste Italiane Q1 2020 Results Conference Call. At this time, all participants are in a listen-only mode. I must advise you that this conference is being recorded today.

And I would now like to hand the conference over to your first speaker today, Massimo Riggi. Please go ahead, sir.

Massimiliano R Riggi {BIO 20490987 <GO>}

Good afternoon, ladies and gentlemen. Apologize for this short delay. Welcome to Poste Italiane first quarter 2020 results presented by our CEO, Matteo Del Fante; and our Group CFO, Guido Nola.

Starting from now, participants can submit questions, which will be gathered in writing via the webcast platform only. During the Q&A session at the end of the presentation, we will read and answer your questions based on the order we receive them.

Now, let me pass it over to Matteo.

Matteo Del Fante {BIO 6237992 <GO>}

Thank you, Massimiliano. Good afternoon, ladies and gentlemen. Thank you for joining us today. I hope you and your families are well and safe. Let me send our thoughts to those affected by COVID-19 in Italy, and all over the world.

In the last few months, we had to face an unforeseen environment on very tough operating challenges. I'm very proud of all people at Poste Italiane for their continuous commitment to provide uninterrupted service to the whole country, special to those who lost their lives because of COVID-19.

Our efforts and continuity in operations in the last 10 weeks had been recognized by all our clients, which were almost surprised by our resilience and presence in such a difficult environment. I'm confident that our reputation has been strengthened and this will benefit our future commercial initiatives.

Let's now move to Slide number 3 please. This quarter has been characterized by diverging trends in the first two months versus March. We will therefore present results highlighting the trend for January and February on one side and on a separate basis for March. We can cautiously say that in April and May with a gradual relaxation of emergency related restrictions. We are seeing a slow resumption of economic activities across Italy and at Poste. And where possible, today, we will try to give you some highlights.

Nevertheless, there is still not enough visibility on what the new normal will be and when it will actually begin. We have therefore decided not to update our on 2020 guidance, fully aware that COVID-19 pandemic and lockdown have affected our 2020 financial performance making our original targets not achievable.

Poste Italiane has a diversified business with a sound financial profile. We only distribute loans and mortgages, so with no underwriting credit risk. Therefore, we're not exposed to downside related to credit deterioration. We do have a high cash flow generation capability with wide liquidity buffers. Limited outstanding debt, significant undrawn credit lines and our insurance and financial businesses are strongly capitalized both in terms of Solvency II and CET 1 ratios.

At the same time, thinking about our Deliver 2022, there is nothing that today I would change in the strategy. As a matter of fact, all the underlying trends at the macro level had been accelerated, making our strategic decisions of Deliver 2022 even more compelling. Our mindset is basically not to lose a good crisis, seeking cost cutting and operating efficiency initiatives that today are easier to implement. We will also put in place certain organizational changes to benefit from emerging trends and accelerate the implementation of the plan.

Our goal is to continue to be a pillar for our communities. This strategy has increased general client penetration over the last three years, and I'm confident that it will support our future growth. We therefore need to change and adapt, and in this presentation we will give you some sense of such an evolution, which is already underway.

On Slide 4. We summarize our efforts to face the health emergency. With timely actions to take care of our employees, safeguard our customers and support our communities. I want to thank again all our employees, and especially those in the frontline for remaining strong, ensuring the continuity our services. I'm very proud of the strong commitment to do their jobs, supporting the whole company initiatives.

To protect our colleagues' health and safety, we choose to voluntarily reduce our services in, Mail and Parcel and Distribution partially and to cut physical presence in post office and sorting centers also reducing the efforts of our Postina and Postini. We immediately appointed an internal emergency committee and a contingency task force with over 500 people for crisis management to coordinate initiatives across the country.

Throughout the crisis and especially during the peak of the outbreak, our presence was guaranteed across the country with over 9,000 post offices open, one for each municipality at least once per week. We agreed with the government with large utilities and banks to postpone mass mailings allowing us to dedicate all our efforts to more essential client needs. And for our people working on the frontline, we acted quickly to assure extra protection for their safety.

As a matter of fact, we delivered over 5.2 million sanitary masks over 12 million disposable gloves and sanitizing kits. We installed 14,000 protective plexiglass screens, thermal imaging cameras. We run extraordinary clinics and sanitize our logistics fleet and 20,000 buildings all over the country. 15,000 people work at home with a positive impact on productivity.

In order to comply with social distancing measures and restrictions on movement of people, we decided to reduce our marketing efforts, limiting customer footfall in our offices to essential needs. At the same time, we promoted the use of our digital channels.

During lockdown, we prioritized parcel delivery, despite the reduced workforce as part of our response to rising client needs with e-commerce obviously strongly accelerating. In coordination with the government and the relevant institutions in March, we distributed over EUR5 billion in pensions to five million seniors on a pre-agreed schedule over six days with a new operational model. We supported our communities in a number of ways.

Let me mention a few. In cooperation with the government, we are service provided of the emergency income to financially support most vulnerable citizens. For those eligible customers whose salaries credited with Poste, we took immediate action to provide them with advances on State wage support. In close cooperation with local municipalities and thanks to our distribution network, we supported local communities to ensure a timely distribution of financial aid measures and PPEs to citizens.

We also signed an agreement with the Carabinieri Corp to home-deliver pensions to most vulnerable seniors over 75 years. We run a sustainable business and promote initiatives to support all our stakeholders. We have always been a beacon for the country and we contribute to set new standards in the new normal.

In this emergency, Poste felt the responsibility to live up to its role as social and economic backbone of the country. We have once again strengthened our reputation in the eyes of our customers, our colleagues, central and local institutions and stakeholders in general.

Let me conclude with two achievements regarding our brand and reputation. First, in April our corporate reputation measured by Reptrack increased by 5.4 percentage points with an average reputation of companies around Italy remaining broadly stable, since the COVID-19 outbreak of February 2020. The significant increase in the reputation of Poste is based mainly on growing performance on the perception of the workplace, leadership and product and services. Second achievement, we're very proud that last Monday, Brand Finance awarded Poste Italiane the first ranking within the Top 100 most valuable insurance brands worldwide.

On Slide 5, we highlight the solidity of our financial profile. Poste Italiane has a strong capital position. Our Solvency II ratio in insurance has been reinforced over the past two years significantly reducing volatility. Our CET 1 ratio for BancoPosta is high and predictable. Our financial services business is capital-light as we only distribute loan and mortgages without any credit risk.

We're aware that 2020 financial will be impacted by lower fees, while we do not underwrite loans and only distribute products on behalf of third parties. Besides our CET 1 ratio is not exposed to the volatility of BTP swap spread that has the related portion of the fair value reserve is filtered out.

Overall, we have a large liquidity buffer with up to EUR5.2 billion liquidity resources potentially available. In particular, in March, we took immediate action to activate around 1 billion credit lines retaining maximum flexibility for extreme scenarios. In a nutshell, our position when entering the crisis was extremely safe and remain so.

Moving to Slide 6. We have a high cash flow generation capability with sound funds from operation, while the schedule of repayment of our low outstanding debt is extremely manageable and smooth over time. Hence, not only we do have a strong balance sheet, but it's sustainable over time as we have the capability to generate cash. Thanks to our profitable business and diversification across segments.

Moving to Slide 7. To effectively react to the emergency and be ready for the new normal we put in place a specific actions capitalizing upon new emerging trends. Business wise most of the initiatives were embedded in our Deliver 2022 strategy, and this crisis is projecting us into the future at an accelerated speed. In fact, in logistics, we are observing around 18 month acceleration in Mail and Parcel trends. Specifically, B2C volumes increased significantly confirming the validity of our strategy focusing on e-commerce to offset the mail decline.

In April and May, we saw peak volumes comparable to Black Friday and Christmas periods, driven by inbound flows from China. Just to give you an idea, in late April volumes from China were comparable in size to our larger customers and sometimes even higher. We're also noticing an improvement in the shift from low margin products to higher value-added delivery solutions. Thanks to targeted proactive initiatives on the commercial side in the Chinese market.

As already mentioned during our innovation workshop back in January in London, we entered into a partnership with Milkman for premium delivery services and with Sennder for long-haul transportation. We are accelerating the pace, as this strategy proved to be a winner in the current environment. In financial and insurance, the increased use of our digital channels as well as higher liquidity on current accounts and postal passbooks created a condition for business growth going forward.

We have already launched a new remote advisory model to offer our customer investment and protection products. And we will gradually upgrade this model reaching from remote our customer across the country has a natural complement to the face-to-face interactions. We are ready to resume our modular P&C offer, which was starting to perform before the lockdown, when it was just launched in February. On life insurance, we will focus on our multi-class accumulation product with a gradual exposure to risk launch back in January, which proved right when we choose to effectively protect our customers from the impact of strong and sudden market corrections.

In payment and mobile, Poste's web and app presence has been greatly appreciated by customer, confirmed by an acceleration in the usage of our digital platform with a significant increase in online transaction. The in-app use of Postepay was up by 34% and BancoPosta by 20%. Also, our third-party network played an important role, contributing with a 92% increase in transaction.

Our QR code product shows how we are already preparing for a cashless word, an example of new digital payment solutions avoiding touch point, like pulse, systems and pin buds and easily available in neighborhood shops for home delivery services. Our digital strategy is clear and is a competitive advantage in the implementation of Deliver 2022. Beyond payments and across all segments capturing new key trends through our physical, digital and third-party networks.

Just to give you an idea of our impressively widespread reach. In the first 10 days of May, we reached 2.8 million daily online users on top of the 1 million daily visits in post offices and 400,000 transaction across our third-party networks. Finally, thanks to our state-of-the-art platform during lockdown. Our fully digital customer assistance managed to record inflow of customer services and inquiries, responding automatically to nearly 170,000 questions per day on average via Chatbot and Voicebot, leveraging on our accelerated cloudification and AI developments. This is quite an achievement for us, and it was also recognized by major tech players.

Our focus on innovation and enhanced digital experience is also confirmed by the partnership with Microsoft announced last Friday, aim at accelerating Poste digital transformation and the joint delivery of advanced cloud services to private and public clients.

Moving to financial results at a group level on Slide 8, please. As anticipated this quarter has shown divergent trends with January and February on one side and March on the other. Overall, the underlying trends in January and February were in line with 2020 guidance. Lockdown impact was on the other hand, mainly visible in March and April across segments. Group revenues amounted to EUR2.76 billion, down 3% year-on-year or 4.4% adjusted for capital gains.

The eported EBIT for the quarter is down to EUR441 million, down 29% and down 40% on adjusted basis impacted by one-off costs to face the emergence. Lockdown had a major impact on Mail, Parcel & Distribution and financial services through the quarter which has

-- which was mitigated by the positive performance in insurance services as well as payment and mobile. Reported net profit reached EUR306 million, down 30%.

Let me now hand over to Guido, who will take you through a more detailed business review. I will then provide, as usual, some final comments before we answer to your questions.

Over to you, Guido, please.

Guido Maria Nola {BIO 20719012 <GO>}

Good morning, everyone. Thank you, Matteo, and good afternoon. It has been an eventful quarter and I hope all of you and your families are well and safe.

Moving to quick overview of segment revenue on Slide 10. As mentioned before, we have split the quarter to highlight the results of January and February when underlying revenue trends across all segments were in line with the drivers of our 2020 guidance, and then separately March results which are impacted by a slowdown in the lockdown.

Following the slowdown in business activity due to the measures taken by the government to face the COVID-19 health emergency, we quickly adapted to the changes occurred in the macro-environment.

Starting with Mail, Parcel & Distribution which is segment most impacted by lockdown. Revenues were down in the first quarter, as we voluntarily reduced specific activities in March, while parcel revenues held up. Thanks to accelerated B2C volumes. Financial service adjustment -- adjusted revenues were slightly down in the quarter to EUR1.17 billion, excluding capital gains as sales of financial and insurance products were suspended in March. Both payments and mobile as well as insurance grew in the quarter up respectively 18.4% and 5.1%.

Payments and mobile capitalize on synergies between card payments and telecom and of the increased online activity during lockdown. Life insurance services grew, thanks to high volumes realized over 2019, fully offsetting the reduction of new business in March 2020. The negative trend continued in April, and fewer than planned gross written premiums are therefore expected in 2020. Resulting in lower segment revenues over the next quarters for insurance and lower upfront distribution fees for the network, as we will see within the Mail, Parcel & Distribution results. The non-life business was also impacted, despite positive early results from the distribution of our new modular product for just one week before lockdown.

Let me now take you through each segment. Starting with Mail, Parcel & Distribution on Slide 11. Overall, segment revenues were down 12.4% in the quarter. An inevitable mail decline was already embedded in our plan, but lockdown has accelerated it and long-term effects will be assessed in the coming quarters. Mail revenues were down 19%, also impacted by the voluntary reduction of our operations.

Indeed, as Matteo mentioned, since the beginning of lockdown, our priority has been to continue providing our services while safeguarding customers and employees. For this reason, we promptly suspended delivery of direct marketing products and we reduced delivery of some unrecorded mail, such as bills and ordinary banking bulk mail with a partial recovery at the beginning of the second quarter, although it remains away from budget. On the other side, to meet client needs in this critical situation, we focus on home delivery and e-commerce goods, despite a reduced workforce.

On the Parcel side, revenues increased by 5% with lower B2B transactions affected by the economic downturn offset by the speed up in B2C during lockdown. Notwithstanding, pandemic was already affecting Asian markets in the first two months of the year, parcels were up 8% in line with our expectations for the first two months of the year. March was instead fully hit by reduced activity related to lockdown in Italy, while volumes from China rapidly recovered, a trend which we believe will remain steady and contribute to diversify our customer base. Distribution revenues decreased by 5% impacted by lower fees paid to the network due to a decline in the sale of financial and insurance products.

On Slide 12, we look at the core volume and pricing trends for Mail. Overall Mail volumes fell 14.4% in the first quarter mainly due to lower sales of higher margin products. Non-marketing material was distributed -- no marketing materials distributed and delivery of utility bills and bank statement was suspended. Higher margin recorded mail, such as finesand judicial documents declined 22% in Q1 with volume postponed in part to the coming quarters.

Let me remind you that within the Mail line we also include packets from China sent with deferred delivery services. This business slowed down in January and February due to Asian lockdown. Average prices for mail were down 5% in the quarter due to the described mix of products.

On Slide 13. Although Mail volumes were affected by lockdown and self-imposed reduction of activities from early April, they started to recover. Recent trends show an acceleration of this substitution whose development, we will monitor closely in the upcoming months.

On Slide 14. We show Parcel volumes in the quarter, which increased 9.7% boosted by over 22% increase in B2C. As said, B2C volumes were supported by increasing e-commerce activity with inbound flows from China growing strongly from early March. The partnership we launched last year to strengthen our logistics chain have proved key Sennder in long-haul transportation and Milkman in last mile delivery. Both enabled parcel volume growth.

Senders successfully managed workloads so far recorded only in specific short peak periods, while Milkman supported a housebound community with premium delivery services. Our third-party network is also expected to continue to an accelerated B2C volume growth, leveraging on 7,300 alternative delivery points, which we expect to expand going forward. On the other side, the economic downturn resulted in a decrease of B2B and C2X in March versus January and February. The average price index for parcels was down 5% in the year reflecting the change in volume mix with a greater contribution from B2C.

Slide 15, shows the weekly evolution of parcel volumes until April. We've already seen over the past months volumes from China have grown very rapidly outpacing the market and we are targeting further increase of our market share, leveraging on our cooperation with Chinese partners to boost volumes as well as specific higher margin products. Also, thanks to inbound flows from China, in April we reached record high peaks comparable to those normally registered by the main market place during Black Friday and Christmas.

To give you a sense of scale, our Bologna Hub increased the average number of items managed daily compared to 230,000 items dealt with before lockdown, we reached peak up to 400,000 parcels daily. At segment level, early May, we managed a one day peak of over 1.1 million items. This confirms the success of our logistic transformation also in automating sorting, which will position us better within the sector also in the new normal.

Moving to Slide 16 on Payment, Mobile. Card payments and Telecom activities continue to increase with quarterly revenues up 18.4% in a challenging environment. Card stock remained stable, and the gradual shift from Postepay towards higher margin evolution cards further supports revenue as a result of increased recurring fees and higher usage.

Lockdown caused reduced sales of both mobile and payment cards in March, but we recorded an average higher customer base year-on-year and high volumes, which resulted in a strong increase in card payments. Although we lost some relative ground during lockdown, we saw a significant increase in volumes from sale of Postepay evolution cards since early April.

As Matteo said, we're now able to sell online Postepay Connect with home delivery of the cards and soon we'll be selling fully digital plastic free Postepay Cards automatically on-boarded in our e-wallet. Our integrated strategy for Telco and payments paid off with telecom revenues up by a strong 33%, outpacing a competitive market leveraging on a loyal customer base.

We gained momentum, thanks to a product offer widen to meet the needs of a housebound community. Traffic volumes both on mobile and fixed line increased, especially during March and even further in early April both for voice and data. Intercompany revenues from financial services were down more than 6%, due to a slight decrease in bill payments, partially compensated by increased transactions through our digital channels and third-party network. For payments and mobile as well our third-party network proved to be a resourceful channel during lockdown.

On Slide 17, we focus on the emerging trends in payment with specific attention on our flagship Postepay prepaid card, leader in e-commerce transactions. During lockdown, the increase in digital payments has been confirmed and reinforced with a significant growth of transactions on our apps, both year-on-year and year-to-date. Although from a different mix of purchases. Before lockdown, the use of Postepay was mainly concentrated on services, such as transportation and leisure.

In March, we registered a broader scope of transactions with a strong increase in food and pharma. In March for the first time, a 145,000 of our customers finalized e-commerce transactions, 83,000 bought food online and 99,000 recharge a Postepay card online, while 70,000 used Postepay to pay a bollettino. This confirms the validity of our digital infrastructure for payments, and we expect an acceleration of the trends already envisaged in Deliver 2022.

Moving to Slide 18, on financial services. Segment revenues were down 6.2% in the quarter to EUR1.6 billion. The halt of commercial activities during lockdown of both financial and insurance product heavily impacted the performance in payment. Interest income remained broadly stable year-on-year. Thanks to average higher volumes of setting yield compression. So far, we've been experiencing higher inflows of deposits which we invested in BTP for about EUR4 billion, EUR2 billion of which in Q1. Postal savings fees were down 4% due to fewer campaign bonds distributed in March. New products are, however, in pipeline, which we will resume, promote and distribute also remotely.

Asset management fees were resilient year-on-year, thanks to recurring management fees. Loan and mortgage distribution upfront fees were impacted by significantly reduced commercial activity in March. Although we are not exposed to credit risk deterioration. For the rest of the year, we will focus on distribution of salary-backed loans, which are suitable for our customers and less risky.

Transaction banking fees were down 7%, mainly due to a strong reduction in payment slips. This item is broadly neutral on EBIT as these revenues are paid back to Payment and Mobile for this service and Mai, Parcel & Distribution for network remuneration.

Net capital gains realized in the quarter amount to EUR234 million, mainly related to forward contracts signed over the past months. Intersegment distribution revenues were down, mainly due to lower sales of insurance products in March, these upfront fees are paid back to the network. Most of the negative impact was borne by advisory driven products.

As you can see on Page 40, in the appendix, growth inflows related to insurance, neutral funds and postal bonds, significantly reduced during lockdown. Looking forward, our aim is to resume the dialogue with our customers who are becoming more familiar with digital channels, complementing in-person interactions with remote advisory services.

Just to mention a few initiatives, we are strengthening remote advisory via web and phone to sell P&C insurance and investment products. We will use data to maximize hit ratio. During the time of reduced presence in post offices, we provided specific training to our sales force. We will also resume our P&C modular offer, which is well appreciated to meet increased protection needs. Finally, in our commercial efforts, we will leverage our large liquidity on carried accounts and postal passbook as well as on significant expiries of products in the upcoming months.

Moving to Slide 19. TFAs are up by EUR2.6 billion, reaching EUR539 billion with EUR6.4 billion positive net inflows, more than offsetting market impact which negatively affected TFAs for EUR3.8 billion. Customers confirm their trust in our brand and showed a higher preference for liquidity products such as deposits and postal savings.

Deposits increased by EUR4.2 billion, EUR2 billion of which coming from early pension payments in March. Postal savings registered new flows for EUR1.3 billion. Thanks to postal saving books. Insurance volumes are much lower than expected, due to the hold of activities in March, recording EUR1 billion net inflows in the quarter. Thanks to the new multi-class product with gradual risk exposure launched in February. Lapse rate was down 2.5%, confirming the loyalty of our customers. In mutual funds, new inflows offset outflows in a volatile market.

Looking forward, we expect our mix of new flows for 2020 to be different than planned, with clients increasing their balances sheets on accounts and postal saving books rather than investing in insurance product and postal savings bonds, with an obvious impact on revenues, partially mitigating -- mitigated by interest income. Nevertheless, as mentioned earlier, we're working on accelerating the evolution of our service model, leveraging on available liquidity to offer investment solutions, such as multi-class accumulation insurance products.

Moving to Slide 20 on insurance services, where life insurance contribute to increased segment revenue by 5.1%. Life revenues up 6% as a result of higher margin higher financial margin. With volumes and product margin increased year-on-year, despite lower distribution activity put on hold in March. This was due to positive inflows and higher profitability products sold over 2019, such as multiclass insurance products. The above mentioned effect more than compensated lower upfront fees from new policies sold. This decrease in fees is neutral on EBIT as upfront commissions are paid to the network.

In non-life premiums increased across all business lines, despite heavily reduced activity in March. Net revenues were down as 2019 benefited from a EUR9 million release of on-claim reserves.

As said, in the first week of March, just before lockdown, we launched our new modular offer receiving positive feedback from customers and increasing daily sales. We expect a gradual recovery after the end of lockdown with a proposition of a wide range of products to respond to customers' needs in the new normal, and we are working to enlarge even further the P&C segment.

Let's move to Slide 21 now. PosteVita groups Solvency II ratio was 226% above the managerial ambition of 200% through the cycle. Since December, we registered a negative impact on the ratio from higher BTP-swap spread, lower risk free rates and negative performance of all asset classes corporate bonds overall. The reduction of the ratio was mitigated by the positive impact of the currency volatility adjustment, which was up 39 basis points allowing to withstand liabilities at a higher rate and providing a benefit of about 24 percentage points.

Let me comment on the Core Solvency II, which was down 10 percent points to 149%. This component contributes to the resilience of the overall ratio to market shocks. In fact, market volatility impacted valuation reserves, while shareholders' equity including retained earnings and subordinated liabilities contributed significantly to stabilize the ratio. Including traditional measures Solvency II ratio is up 259%, and they provide a benefit of 33 percentage points and represent an additional buffer to address market volatility. Since the end of the first quarter, markets continue to be volatile particularly regarding the widening of BTP-swap spread.

Moving to Slide 22, where we present sensitivities on the Solvency II ratio, even excluding transitional measures, Solvency II is above our risk tolerance threshold in all scenarios we assumed. A sudden increase of Italian government spread by 100 basis point would result in a ratio of 144% as country volatility adjustment would not be triggered. Nevertheless, this corresponds to a BTP-Bund spread of about 300 basis points. In order to test an extreme scenario, we ran a simulation combining a shock on interest rates down further 25 basis points, equities down 30% and corporate and government bond spreads up a 100 basis points.

In this case, the outcome will still be in line with our risk tolerance, as the currency volatility adjustment would rise to 77 basis points, mitigating market volatility. Finally, let me remind you that PosteVita has already started the process to develop an internal model, which we expect will further contribute to reduce the volatility of Solvency II ratio in the future.

On slide 23, we look at Poste's continuing workforce evolution. Our average headcount decreased from 129,000 in December 2019 to 126,000 FTEs at the end of March. This is the result of an average decrease of more than 6,000 FTEs for turnover and subsidized exits leading to 12,000 FTE reduction since December 2017, out of an overall target of 15,000 by 2022. This confirms our ability to actively manage headcount in a flexible way to adapt to the evolution of business needs and create efficiencies for long-term growth.

The key emerging trends confirm the validity of the strategy and we will continue to right-size our workforce. We will keep targeting early retirements taking into account organizational sites and skills required in specific geographical and business areas. Our average cost per FTE has increased since year- end as a result of conservative accruals in the first quarter. The value-added per FTE held out despite lower revenues.

Moving to Group Costs on Slide 24. Ordinary HR costs are down 2% year-on-year. Thanks to lower FTEs. The salary component is up year-on-year as the one-off paid in 2019 was entirely booked in the last quarter of the year. COGS increased EUR26 million in January and February due to volume driven items, while the slowdown in activity of March resulted in lower COGS for EUR10 million. Non-HR cost overall are down, excluding the EUR23 million one-off costs incurred so far to face the emergency.

Let me highlight that our cost base is flexible as we can leverage on both HR and non-HR cost initiatives to mitigate the impact of lockdown, still our approach is not focused on short-term results only but rather making sure that the cost base is the most efficient to support our growth in a sustainable way going forward. So we are reassessing the size of our workforce in light of recent developments, such as accelerated e-substitution to effectively balance FTE reduction and the quality of our services.

Now let's move to Slide 25, to summarize the effect of revenues and costs at operating level segment-by-segment. Quarterly operating profitability was down almost 29% year-on-year with all segments impacted by lockdown. Please note that this quarter does not take into account nor benefit from cost-cutting initiatives currently under assessment.

As anticipated, the most relevant impact of lockdown is borne by Mail, Parcel & Distribution. This is because the emergency compromised all activities entailing interpersonal relations, sorting and distribution of mail and parcel as well as the sale of financial and insurance products, whose distribution fees are ultimately paid back to the network and shown with this segment.

Turning on Slide 26. We present some of the levers it is in our hands to activate to reduce costs and mitigate the impact of lockdown depending on the severity and length of this crisis. Please bear in mind that our objective here is not cutting cost in 2020 to mitigate the impact on this year's EBIT, but to take the opportunity to rethink and act on our cost base in a structural way, while preserving the long-term sustainability of our business. We have a flexible cost-base and significant potential levers to activate, but our goal is to intervene in a targeted manner preserving profitability for 2021 and onwards with the rightsize of FTEs, skills and tools. Hence in this slide, we show the cost base and the review and our propensity to trigger the related measures in 2020.

Let's start from HR costs. We are reviewing performance-related incentives. As a first step, a few weeks ago we cut 2020 MBOs based by 50% for over 1,300 managers. The payment of commercial niche incentives will depend on the achievement of targets and salary increase for white collars are under assessment.

Moving to headcount flexibility. As you see, over the past two years-and-a-half, we have demonstrated to adapt the size of our workforce to the evolution of the business. Aside from natural turnover at present, we have -- we are a green subsidized exit at a lower average cost than budgeted and leverage on fixed term workers to manage business peaks. As said, our target is to reduce costs in the long-term. So we intend to confirm our early retirement plan because it will allow us to achieve a lean organization that maximizes business growth and adapt to new trends.

Other cost savings within HR will be reached with ongoing initiatives such as smart working as well as state wage support to our people during the crisis. On non-HR cost, we are putting in place both tactical and strategic actions. In the short-term, we are reviewing discretionary expenses to make sure that planned costs are in line with our changing business needs. As a result of a thorough evaluation, we are canceling or rescheduling some costs to address new priorities within benefits expected already in 2020.

We launched a dedicated project of in-sourcing to save costs on those services which can be managed internally by our people following specific reskilling programs. From a strategic point of view, we are reviewing processes across all segments to maximize efficiencies across the company, while sustaining our services in the long run. Of course, this needs more time to bear fruit, but it will allow us to do business in a more efficient and productive way starting from 2021. More details will come during Q4 as part of our Deliver 2022 review.

Let me now hand back to Matteo to some closing remarks, and thank you again.

Matteo Del Fante {BIO 6237992 <GO>}

Thank you, Guido. Before taking your questions, let me close with some key messages that you find on Slide 27.

We're clearly navigating uncharted territories, but our business is safe and sustainable and our operations are resilient. Poste Italiane is well-equipped to continue to meet our customers, communities and shareholders' expectations. It is actually in crisis times that people see what a company is really made of, what is principles and priorities are? I strongly believe that in the past two months our key social and responsible role has been confirmed.

Our reputation and trust among stakeholders strengthened. We are promptly adapting to our clients' changing needs and our constant attention to digitalize solution provide us with the right tools to accelerate the digital journey across all our business segments. While it is too early to assess the effective macro and financial effects of the lockdown, the pillars of Deliver 2022 remain unchanged.

Of course, 2020 performance will be affected as we said. We're already focusing on the key medium and long-term emerging trends, which are embedded in our strategic direction and that have actually been accelerated. For example, we're experiencing a shift towards e-substitution and e-commerce as well as an acceleration in the use of digital tools, that we were expecting in 18 months to 24 months' time frame.

Looking at the execution of our Deliver 2022 plan, so far and the contingency we're facing, I am proud to say that I will not do anything different. Indeed, consistent ability to meet and anticipate those targets so far allow us to be steady in this crisis and well equipped for the new normal. We will learn from these unprecedented times and review our cost base to gain additional managerial flexibility and create operational efficiency to be ready for the new normal in the upcoming months, but above all for a fresh start in 2021.

Finally, last November we paid an interim dividend of EUR0.154 and the balance of EUR0.309 will be therefore paid next June 24, following AGM approval next May 15, next Friday. The AGM will also formally appoint the new Board of Directors for the next three years. We will then review our Deliver 2022 targets and disclose them later in Q4 this year. When we have gained greater visibility on the macro scenario.

Before Massi reads the question you submitted so far, let me thank you again for joining us today. And obviously as you can imagine, we're not traveling after these results. However, we will organize future road shows, and I hope to see you then. Thank you. Massi, please.

Questions And Answers

Operator

(Question And Answer)

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. So the first question is from Anna Maria Benassi from Kepler. I appreciate you will pay the balance of the dividend in June which has become unusual in the current trouble times and also that you will review the dividend policy at year end. But may I ask you if you feel confident to keep it at least unchanged to EUR0.46 as of last year?

Second question, congratulation on providing the numbers of March, unusual as well as helpful. Do you see a change in client attitude since reduced -- since lockdown on May 4?

A - Matteo Del Fante {BIO 6237992 <GO>}

Okay. On dividend, as you just heard, we kept our promise for 2019 dividend which was not obvious. We still have in mind our Delivere 2022 plan, and we're fully aware of how important is the dividend for our shareholders and for our stakeholders. Last March, we also confirmed our commitment to a 5% dividend increase for 2020. We all know that 2020 financial performance will be affected. But we also know that we have flexibility as we have returned earnings reserves, and starting from a low payout ratio below 45% in 2019. And at this point in time, on dividend, I must say this is all we can say.

On the second question, yes, we thought it was useful to give to investors a sense of the impact of March in terms of specific figures for two reasons: one, we were showing you that January and February, we're actually fully in line with our five year plan; and two, to see in which areas we were experiencing an impact.

The last, let's say, 10 days from the reduced lockdown that started in Italy on the 4th of May, we have actually seen a resume activity, as I mentioned in my presentation. And we are back to around 1 million visitors in our postal offices. To give you a feel, we reached a low around 400,000, if not below. And we were starting in February on 1.4 million, 1.5 million. So we are, let's say, more than halfway back to where we were in February.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. The next question is from Alberto Cordara, Bank of America Merrill Lynch. I see from the Slide 26, that you can cut up to 1 -- more than EUR1 billion in costs. How much willingness do you have to trigger these levers in 2020?

A - Matteo Del Fante {BIO 6237992 <GO>}

Okay. On Page 26, you have the perimeter of the cost-cutting initiatives. You don't have the actual target. The reality is that, we really see, and we don't want to be too cynic, but this is also part of our job. We see the current phase as a very good opportunity to push on some initiatives and find room to implement cost-cutting initiatives that in a normal and rosy scenario sometimes a difficult to implement.

And specifically you see that the HR component is very important in that chart. I would recommend to look at the by the pie -- the color pie that gives you a feel of how much, we call it propensity -- how much do we think we can activate in that base of cost space, under review. And again, the exercise I think is very useful because it's providing the company with a stable cost base reduction that will benefit 2021 and onwards.

In a way, we are sort of looking at this phase, the next few weeks and months with the following priorities. The first priority is to take the opportunity and do everything we can in this window to have a stronger company from next year onwards. The second is to do our best to protect and fulfill our commitments of 2020. And obviously, we look also at doing our best for the 2020 accounts, so that's obvious. But it's very important that we do and take this window has an acceleration.

We mentioned a few initiatives, the one related to customer care inbound calls for 170,000 people in a day with robo answering supported by AI cloud technology that was recognizing the last name of the person it was directing for the day and the office to the right place, the client was done in three days in an emergency. A project like that, that we could have done anyway, but my feeling, I've been clear in the company, it would have taken a few weeks.

So this is really time to try new things. It come to my mind the initiative about selling at a distance. We have 8,000 consultants, as you say, and they're now fully equipped to sell on the phone, the lowest change. We have the right to sell on the phone, and we gave them video support to show the product to clients. Many clients really appreciate this. They wouldn't expect it from Poste. And this will stay with us.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. The next question is from Ashik Musaddi from JP Morgan. What are the macro GDP assumptions you are using in your current planning? And would you use those assumptions to support your base case dividend for 2020, i.e. plus 5% year-on-year growth? Let me read also the second one. What sort of revenue decline should we expect for businesses like insurance and mail in coming two quarters based on your experience in April and March?

A - Guido Maria Nola {BIO 20719012 <GO>}

Hi, Ashik. Hi, everyone. So on the first point, I think Matteo was quite clear on what we were looking at for dividend on 2020. So towards -- the quick answer for you is that before all of this we were planning in the guidance we gave in March, we were planning something close to 1% GDP growth.

On the second question, I think we try all our best to give you as much data as possible and to share what we are looking at the moment. We gave you a quarter separated between January, February and March to give you a sense of the worst possible month. We gave you on Page 13, 15, a sense of what April looks like. And we also gave you Page 40 in the appendix, which gives you a sense of what is happening in our work in our post offices. So all of this to say, that is unfortunately very difficult for us to assess, not only the guidance for '20 but also what the few next quarters will look like because we are really experiencing every day, it's different from the previous one.

The good news is that as of yesterday, the numbers are looking much closer to what they were before the lockdown. So this is very promising, but it's just one point. So creating an expectation just based on very few points, would be a bit early. But again, we believe we are optimistic any the trends we've seen in the past few days continues, then we will, next quarter, be able to give you more guidance about the coming quarters.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. The next question is from Elena Perini, Banca IMI. As regards the insurance services, given the very good growth year-on-year recorded in the first quarter EBIT, are you still confident to meet EUR1 billion target as a result of lower revenues and lower premiums and lower costs essentially inter segment? Can you elaborate on the underlying trends and mix for life and P&C? Many thanks.

So allow me to answer myself as this is basically based on the answer, we though just gave. So let me add factually. As we've said, the visibility is not enough to talk about targets for 2020. But factually let's remember that our first quarter results are benefiting from higher volumes year-on-year because, as you -- not perfect you were during 2019, we had positive net inflows. So remember also that in the first quarter '20, we had the decline in gross written premium because of reduced activity. So as soon as this slowdown of Premiere are visible, we might slowdown also in terms of contribution to the top line factually.

In terms of P&C mix, let me flag that on Page 45 we also give you, let's say, some detail on the production on both life and non-life. As said, on the life side we are suffering from lower production related to lockdown. On non-life, I would say that most of the lines are healthy, especially the welfare side. And let me just flag that going forward, the combination of the protection and investment needs will be key for reviewing our commercial proposition as soon as we exit lockdown. Thank you, Elena.

A - Matteo Del Fante {BIO 6237992 <GO>}

Yeah. If I can just add, in terms of big picture, the EBIT of the insurance will suffer more potentially next year because of the lack of underwriting, and therefore we will have less financial margin next year. And this year we're still protected, as Massimilliano said, from last year at the EBIT level. But given this was the segment which was in Deliver 2022, most advance versus the original plan, we will do our best to keep the 2021 as strong as possible.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you.

A - Guido Maria Nola {BIO 20719012 <GO>}

If I may also, on a positive note, I think this is good for not just insurance product, but also for postal bonds, for example. Let me remind you, as we said few times over the last few weeks, you should remember that the balances of accounts and postal checkbooks are growing significantly. And this is all cash that stays with us, stays within the group. And this is exactly what our commercial people will focus on to start the commercial efforts as soon as the situation stabilizes.

So we are fortunate that our clients choose us to keep liquidity. Obviously, this is not investing at the moment. But this makes us feel that at some point we will have the opportunity to turn that cash into investments.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. The next question is from Manuela Meroni from Banca IMI. On postal savings, revenues for postal savings declined quarter-on-quarter and year-on-year, despite a positive net inflow in the quarter. Could you please elaborate on this tend? At EUR1.25 billion net inflow in postal savings is a very positive result, is this due to a flight of quality effector to specific commercial efforts you made during the quarter? May we consider this trend as a recurrent reverting the net outflow trend that you had in the past?

A - Guido Maria Nola {BIO 20719012 <GO>}

Well, I think it just continues with the last one sort of.

A - Matteo Del Fante {BIO 6237992 <GO>}

Yeah, I mean, it's -- I don't think it's flight to quality. I think it's simply the fact that we had maturities and money stays in our, as we do say it, passbook and specifically for postal savings current accounts that technically is where you credit the postal bonds when it goes to maturity. So I don't think you can extrapolate a reverse of the trend. But it's still money that is in the account that will help us restart selling. And this is the flip side of not seeing revenues in postal bond fees because we are selling less bonds. And so we're making less commission on selling them.

A - Massimo Rosini {BIO 20101636 <GO>}

Next question from Manuela Suella. B2C volume trenads were impressive in Q1 and they further accelerated in April. Do you expect this trend to continue? Do you have an update on the negotiations with Amazon or on the renewal of the contract?

If I may, let's combine this with another question from a Jacky [ph] from JP Morgan. She is specifically asking, please may I ask a question on inbound parcels from China, what percentage of parcel volumes is from China? How sustainable is the high volume from China? Was it partly driven by posting medical supplies to the pandemic?

A - Matteo Del Fante {BIO 6237992 <GO>}

No, it was absolutely not related to the PPE supply for the pandemic. It was an acceleration of use of the digital and e-commerce channel by clients, which lucky enough, we were able to deliver because we started three years ago establishing strong partnership in China and moving flows from all the mail networks to faster parcel routes. So this is there to stay.

As far as Amazon is concerned, obviously, increasing volumes in Amazon. Good news from our standpoint, a reduced reliance in terms of the market share of Amazon in our B2C. And I think one question that is emerging is, are this volumes in your expectation going to stay for the next two years? Are we going to restart the growth from this level? I believe that really and I talk to my colleagues around Europe, is the same perception that we have gone fast forward 18 months.

So the volumes we're seeing today, even this week which are higher than the one of Christmas, I don't think will be there in three to six months. But certainly the base from which we will resume growth is higher than one we would have had without CIVID. So we went 18 months fast forward, and we restart the trend from there.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. Our next question still from Manuella [ph]. Interest income is it fair to expect that an increase in the contribution of interest income in 2020 thanks to higher average deposits and higher profitability of government bond portfolio?

A - Guido Maria Nola {BIO 20719012 <GO>}

So, in -- when we last spoke on the 6th of March, we gave you our guidance, we expected a lower rates and lower volumes. So the answer is yes, we do have in this case expectation. We can't predict as we said. We have more volumes, we have about EUR2 billion in March and EUR2 billion extra cash in April sitting on our bank accounts, which we can invest, and we are investing at a higher yield than what we had planned. Obviously, we are confident that part of this liquidity will end up being invested, so we are investing more at the short end of the curve. But still as you saw what happened to BTPs in this week, we -- in these recent weeks, we were able to invest even at short term, short end of the curve at positive rates.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. The next question is from Giovanni Rizzoli from Equita. Any comment on the increased prudence required by regulators for insurance players on dividend distribution.

A - Matteo Del Fante {BIO 6237992 <GO>}

That's easy. We make our official and formal distribution of dividends from the companies in the group in the last quarter, so we were not affected by that initiative for the time being. So we will assess the situation. As you know, the assumption is a 50% payout from the insurance company to the holding company.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. Another question from Giovanni. Is it correct that next year as per the lever 2022, the contribution of capital gains from sovereign bonds will be zero? If so, I think we shall all be more relaxed with the evolution of mark-to-market over the BancaPosta digital portfolio, right?

A - Matteo Del Fante {BIO 6237992 <GO>}

I think you are right to be relaxed, but its' not zero. You have seen in the presentation, I think it was Page 16 that we already made EUR234 million capital gains in the first quarter. We have less than EUR100 million to go and we have in excess of EUR 1 billion of portion of the portfolio that has capital gains.

A - Massimo Rosini {BIO 20101636 <GO>}

So next questions are from Fabrizio Bernardi of Fidentiis and Irene Rossetto, Mainfirst. Allow me to say that we had answered both of your questions. So if you have any doubt, call me later after this call, so that we can proceed with Alberto Villa, Intermonte, with the following two questions.

Could you give us guidance on operating costs for 2020 and 2021 in light of the current situation? Do you envisage any specific cost efficiency and personnel costs and the COGS besides what's already indicated in the plan?

A - Guido Maria Nola {BIO 20719012 <GO>}

Well, I think we answered also this two questions, especially on cost. I think our CEO was very clear commenting on the levers that we have to activate. We can briefly remember that on HR cost, there are a number of, let's say, performance related costs. And also we mentioned the headcount flexibility that we always had, and we showed that we are quite able to work both on the number of FTE based on the service, the level of service we have to provide and we want to provide.

Also on non-HR cost, we mentioned that we're doing basically a tactical and a strategic approach to tactical. It's about reviewing all discretionary costs, looking at them in this new world and trying to assess if they're still relevant. If they need to be canceled or postponed. Obviously, I'm talking about all those costs that are not related to volumes.

Then we're taking a more strategic approach. And once again, I refer to what the CEO has said. This is a huge opportunity to revisit all our processes and go deeply into them and try to assess if you can do the same thing in a more efficient way, in a more cost-effective way. And this is, I call it, strategic because we think is going to be there to stay.

We mentioned one example that we believe is in between strategic and tactic is the internalization of some processes. Which means we will have some of our own people up-skilled or re-skilled to run certain activities that were dealt with outside the company before. And these are things that, as the CEO said, you can do pretty well in extraordinary times. It is more complicated to do it in ordinary times.

A - Massimo Rosini {BIO 20101636 <GO>}

Next question is related to the state of the art of negotiations on a USO obligation, Universal Service Obligation.

A - Matteo Del Fante {BIO 6237992 <GO>}

Yeah. The Universal Service Obligation has been confirmed for the next five year, stable at EUR260 million. And I think I owe an answer on the negotiation of Amazon. There is not a specific negotiation every year. As you know there is a peak at December and we see a few months ahead of the peak to make sure that we have the capacity, and this will happen also this year. Obviously, this year is going to be even more difficult for everybody, given the unexpected growth of B2C.

A - Massimo Rosini {BIO 20101636 <GO>}

(Inaudible)

A - Matteo Del Fante {BIO 6237992 <GO>}

No, I mean it's very early in the process. We had to sign something before December. And it's not been -- we have not opened the file.

A - Massimo Rosini {BIO 20101636 <GO>}

Thank you. And the next question -- the last question actually is from Federico Braga from UBS. Yield on the BTP banking portfolio decline from -- to 2.46% in Q1, down 20 basis points year-on-year. Can 2.46% be the new run rate for 2020 and the coming years? Or the recent spike in BTP yields can offer upside risk in the coming quarters?

A - Guido Maria Nola {BIO 20719012 <GO>}

Well, it is difficult to comment if that's going to be the new normal. The reality is that the volatility we've seen on the BTP has happened also after the close of the quarter, especially April and May. So the quarter -- after the quarter, I would expect the average to come up. Being that the new normal, I think it's impossible to say. So I think I'll take the positive effect from now.

A - Massimo Rosini {BIO 20101636 <GO>}

Yeah. And sorry, again, a top-up of the answer on the CDP agreement. As a matter of fact, the new Board which will be appointed on Friday by the General Assembly, for the first time is going to include one senior representative of our shareholder, which is the Ministry of the Treasury. And this is a signal the way we read it that the funding channel of the postal savings that from retail through Poste goes on CDP balance sheet. And then on the state balance sheet is clearly considered to be strategic. So we are comfortable that we will manage with CDP to find the right agreement, especially on the back of the fact that we revert the trend in the last 3 years and we exceeded targets for the first 2.5 years of the plan.

So thank you. We have a few minutes left. So I think we can also answer the follow-up to the next question from Federico Braga, UBS, about postal fees. Given the expected weaker sale in the first half of 2020, is there any risk to see postal saving fees close to the lower end of the fee range, i.e. EUR 1.55?

A - Matteo Del Fante {BIO 6237992 <GO>}

It's clearly going to be, I believe, below our February targets. But if the recent trends, recent I mean the last very few days are confirmed, I don't think we're going to go as low as 1.55 billion.

A - Massimo Rosini {BIO 20101636 <GO>}

The time is over.

A - Matteo Del Fante {BIO 6237992 <GO>}

Thank you very much, everybody, for finding the time and putting forward a lot of questions. If there are more, we will clearly doing the virtual road show go, more in detail with each one of you. Thanks a lot again.

Operator

That does conclude our conference for today. Thank you for participating. You may all disconnect.