Q1 2015 Sales and Revenue Call - Interim Management Statement

Company Participants

- Jackie Hunt
- Michael Andrew Wells
- Nicolaos Andreas Nicandrou
- Tidjane Thiam

Other Participants

- Abid Hussain
- Alan G. Devlin
- Ashik Musaddi
- Blair T. Stewart
- Greig N. Paterson
- Jon M. Hocking
- Oliver G. Steel

MANAGEMENT DISCUSSION SECTION

Operator

Hello and welcome to the Prudential Plc 2015 First Quarter IMS Conference call. And just to remind you this conference call is being recorded.

Today I'm pleased to present Group Chief Executive, Tidjane Thiam. Please begin your meeting.

Tidjane Thiam {BIO 7518525 <GO>}

Thanks, Jerry, and good morning everyone. I am joined this morning by Mike Wells, Jackie Hunt, Nic Nicandrou and Pierre-Olivier Bouée. The group has made a positive start to 2015, driven by a very strong performance from Asia. Our first quarter performance is well aligned with our strategy, which as you know is to grow in growth markets, in our case Asia, while we flex volumes in the more difficult mature markets of the U.S. and U.K. to deliver earnings and cash to our shareholders.

In these first quarter performance comments I will continue to use the constant currency basis to discuss our Asian and U.S. businesses, to maintain comparability with the comments we made in the first quarter 2014.

So in this first quarter the group has reported new business profit of £496 million and APE of £1.25 billion. Within these headline figures Asia, which is the only region where we have explicit profit growth of 50s (1:24) has made excellent progress. In Life, Asia new business profit in the first quarter grew 22% on a local currency basis to £309 million led by higher volume.

In APE terms they were 28% higher at £681 million. In reported currency terms NBP grew an even stronger 27%, while APE grew by 34%. So some of the headwinds we had last year have become tailwinds this year. Our team's consistent execution has now delivered 22 consecutive quarters of APE sales growth since the fourth quarter of 2009 averaging 16%.

In Asset Management, so moving on from Life but still in Asia, in Asset Management in Asia Eastspring attracted £2.3 billion of net inflows, more than twice last year's already record levels. We're crediting these strong flows and positive market movement, overall third party assets under management, a key driver of earnings grew by 48% to £29.8 billion, which is more than double the stock of assets at end of 2009.

In the U.S., leaving Asia, separate account assets, which really drive our earnings and our cash generation, grew by 16% to £89.2 billion. We remain convinced that our personal business, which adopts volumes across the cycle to maximize returns, is the right one. In the first quarter, new business profit was 28% lower at £153 million, reflecting this volume discipline, a historically strong first quarter 2014 where we took very opportunistically and the adversity part (3:16) of lower interest rates.

In the U.K. our business is adapting well with new environment. In the Life business first, retail sales grew by 8%, to £169 million. So very strong and commendable performance, as customer demand for our retirement and accumulation products more than offset the lower demand expected and observed for individual entities.

Retail new business profits fell by 11% to £34 million, primarily reflecting reduced individual energy sales, which were very profitable. We remain selective in bulks, completing one attractive transaction in majority after the quarter but none in the first quarter.

Still in the U.K. but lastly in Asset Management, M&G attracted £0.7 billion of third-party net inflows led by continued strength in Continental Europe.

So in summary we continue to deliver profitable growth in Asia, one of the world's most attractive, vastly under penetrated, and fastest growing markets, while being focused in our approach in the mature U.S. and U.K. markets on value over volume.

So now let's take, as we usually do, a closer look at each of the geographies and businesses in turn. Starting with Asia. Our focus on delivering quality growth through a professional growing agency sales force and our proven bancassurance model remain key competitive advantages for us in the region.

Our first quarter performance provides stronger evidence of the strength, with booked agency and bancassurance channels making handsome contributions. In there, agency channel first, APE was 25% higher with eight local business units delivering double-digit growth. Pressingly this group was driven both by increases in the active manpower base and by higher APE for activation for productivity.

In the banking channel APE, if we exclude the discontinued agreements (5:18 - 5:23).

Our relationship with Standard Chartered Bank continued the strong momentum since renewal in July, delivering 46% APE growth year-on-year. Even after 17 years of strong growth we have only penetrated 3% of Standard Chartered customer base. And we can confidently say that we are not about to run out of growth from SEB any time soon.

So let me now make a few specific comments about some of our Asian markets. And I'll cover Hong Kong, China, Singapore, Indonesia, Malaysia, and the Philippines in this order.

In Hong Kong as you have seen we have delivered another outstanding quarter with APE sales up 74%. Here clearly we are benefiting both from strong local demand and the growing interest from the increasingly wealthy Mainland Chinese customers for our products.

To meet these demand we have significantly increased our distribution scale and launched new products with a particular focus on protection. We now have the largest and most productive agency sales force in Hong Kong with first quarter APE growing by 70%. This was complimented by a very strong performance from SCB, which delivered 45% APE growth.

And our newly launched protection products, a long-held ambition for us in Hong Kong to increase protection sales, are proving very popular with Health & Protection APE in the first quarter up 50%.

This enduring success in Hong Kong is testament to our team's ability to grow scale and deliver profitable growth in a market, which many have seen as being mature. Something we don't really agree with.

Now I'm going to spend a few minutes on the Mainland China itself, a market where we have been executing for a number of years and which is becoming increasingly material for us after many years of effort. Our business in China is doing very well, and that delivered first quarter APE growth of 37%. Our strategy remains the same. Similarly to what I highlighted in Hong Kong, we are expanding our distribution and improving the protection content of our product to enable us to deliver high quality growth in one of the world's largest insurance markets.

In the agency channel in China APE grew 27%, due to higher active manpower and strong demand for protection products. Our protection APE in China grew by 71%, very, very good number.

In Banking we are seeing success in selling for our joint venture partner, CITIC Bank, sales – where sales grew 82%. We are also seeing renewed momentum in Standard Chartered, which is one of the territories I believe in your improvement (7:54), and since last year the sales grew by 89%.

So in summary we are executing well in this important market. APE sales growth since the first quarter of 2013, so over the last nine quarters, has averaged 39%. So as a result and you it shouldn't be a surprise, China on a 100% APE basis is one of our largest units in the Group, posting this quarter, second in Asia after Hong Kong. But we are also now the leading foreign owned IP insurance (8:28) business in the country.

With access to an addressable population of 600 million, we are positive about our prospects in China. At a time when there is an increasing understanding that promoting health insurance is crucial if a Chinese citizen is expected to save less and consume more.

Let's move now to Singapore. Here the first quarter reported APE was down 19% at £72 million. And this was largely impacted by the loss of two bancassurance relationships. We mentioned that in prior result. Maybank, a successful relationship which was taken in-house by Maybank in July last year, and Singpost, where we were out beat as what we consider uneconomical terms.

On a like-for-like basis excluding these two banks, APE was down 7%, but new business profit was up 2%, which is what matters the most to us, as we saw more protection products, which are lower volume, but higher value.

So the key message here is that we remain focused on delivering long term profitable growth in a market where we are a leader, over 24% market share.

Next Indonesia. In the first quarter APE sales grew by 7% to £93 million. We are pleased to see a return to growth in this important market. We continue to invest for the long term and have stepped up our agency recruitment efforts to be well-positioned to benefit from gradual market recovery we expect.

In banking – in bancassurance we're seeing good momentum in SEB here too, albeit from a low base, after we have secured exclusivity in this market. We remain optimistic and positive about our long-term prospects in this large Southeast Asian country where we currently only have 2 million customers.

Now let's talk about a market where we have seen some signs of improvement following our efforts to refocus our business, Malaysia. In the first quarter APE in this market was up 26% with broad-based growth across our agency and banking channel.

Our focus on selling protection products and on growing our Takaful business, which is fundamentally oriented to the Bumi profitability (10:26) or the Bumi salesforce has delivered good results. In the first quarter overall Takaful sales were up 50%, contributing a third of overall volumes, while protection sales were up 23%.

Malaysia is an example of our abilities, because we have reconstructed one of our oldest and historic businesses in the region to meet to growing customer demand for Takaful, while also achieving our financial goals.

In the Philippine (sic) [Philippines] (10:52) we continue to make strong progress year-after-year, delivering APE growth of 17%. We're making headway in building out a high quality agency salesforce and this channel remains central to our performance.

The Philippines continue to a bright economic spot in the high performing Asian region. And as you know the IMF recently upgraded its GDP growth forecast, reinforcing its position as the fastest growing economy in the region with a 95 million population.

Still in Asia moving to Asset Management, Eastspring, our Asian asset management business have seen strong third-party net inflows of £2.3 billion in the first quarter, more than double prior year's levels. Stronger equity market coupled with healthy investment performance have driven good flows into both our equity and bond funds, particularly in Japan, China, and India. So overall funds under management grew 32% to £86 billion, reflecting both strong third-party and strong LIFOs and higher (11:50 - 11:52) - reflecting strong third-party and LIFOs and higher market levels.

In summary our first quarter performance highlights the strong progress we are making towards the delivery of our 2017 Asia objective, by profitabiliting from growing investments and protection needs of the Asian middle class.

In our more established markets we are consolidating our leadership positions, while at the same time, we are accelerating growth in our nascent markets. China and the Philippines are clear examples of this progress with our second largest business this quarter (12:22).

Looking ahead we're building the foundations for sustainable long-term profitable growth from this region. Asia remains at the heart of everything this Group does and is becoming increasingly material to the Group's long-term prospects. We're well-positioned across the region. And have only scratched the surface what is a multi-decade opportunity for our Group.

Moving now to the U.S. Our success in the U.S. is underpinned by our disciplined approach to a cyclical VA market, which allows us to deliver earnings and cash flow across that cycle. To achieve this we are focused on growing our separate account assets, which ultimately for a fee income, rather than purely focusing on quarterly AP, which only describes gross flows, which of course allows us to be opportunistic in the market and to maximize return to shareholders.

In the first quarter we have grown separate account assets by 16% year-over-year to £89.2 billion, driven primarily by higher net inflows. At the same time APE declined by 15%, mainly reflecting a particularly strong first quarter 2014 and the subsequent actions taken to manage sales of VA with living benefits within our annual risk appetite. New business profit fell by 28% to £153 million, reflecting, one, this volume discipline; two, a very strong quarter in 2014, it was Jackson's strongest ever first quarter; and three, the negative impact of U.S. 10-year Treasury yields are going down 80 basis points year-over-year.

Moving on to reinforce we remain well positioned. We have over 97% of the book being issued below S&P levels as at March 31, 2015. And our hedging performance is tracking in line with our expectations.

Let's now look at the U.K. In the Life sector in an environment of unprecedented change, our sales is working well. Retail APE sales were up 8%, reflecting strong demand for our PruFund-backed product wrappers, including our newly launched items, have done very well. PruFund's attraction of strong investment performance and volatility control for smooth returns continues to drives its popularity.

Overall, PruFund's assets under management have grown by 9% in the first quarter to £12.6 billion. This strength has offset the 61% fall observed in individual annuity sales, which was in line with our expectations. Retail new business profit of £34 million declined by 11%, mostly reflecting these lower individual annuity volumes.

Please allow me to (14:56) but when we make capital allocation this year and then we manage the business we do not – we have no regard for margins. We allocate capital based on return on capital and capital consumption to maximize absolute profit, not to have the highest margin business possible, but to generate the maximum amount of profit for our shareholders.

So turning to wholesale business, which is in application of that philosophy, we did not write any bulks in the first quarter, because we didn't find an offer (15:26) matching our appetite. But we have completed one very sizable transaction we closed in (15:33) April.

Our teams are working hard and we are encouraged by the strong customer response to our overall product offering in the savings space. And we continue to maintain latitude (15:44) for the development pipeline and change portfolio to meet changing consumer needs and to help us prosper in this new environment.

Staying in the U.K., let us move on now to M&G. M&G had a good quarter with net return inflows of £0.6 billion, driven by 1.5 billion of inflows from Continental Europe, offsetting outflows in the U.K. Overall, retail funds under management grew by 10% year-over-year, £75.7 billion, with the international business accounting for 43% (16:13) of these assets.

M&G has now delivered strong net inflows for a record 14 consecutive quarters, which as we have previously flagged is an exceptional performance in what is a cyclical business. As you hear us say every time.

In April following a strong start for the year, our Europe and retail flows were negative, leaving the overall retail business in a cumulative net outflows position for the first four months. These outflows however have to be viewed in the context of the overall retail fund of £75.7 billion, which is the ultimate driver of earnings and cash.

So after this tour of Asia, the U.S., and the U.K. let's move now to balance sheet. We remain defensively positioned on the asset side of our balance sheet. At the end of March, our IGD surplus was robust at £4.3 billion, which is after deducting the 27 -- 2014 sorry final dividend of £0.7 billion. And which is equivalent to a cover of 2.3 times.

So just a word to close these opening comments about outlook. In the first quarter the group has continued to make good progress in executing on a clear unchanged strategy by making good progress in converting the Asian promise into growing and tangible returns for our shareholders.

Turning to environment. Global group profit remained uncertain, while markets are increasingly pricing in the prospect of diverging monetary policies between the U.S. and Europe. We've seen a rising dollar, while yields remain persistently low. The start of quantitative easing in Europe has trailed or exacerbated the slow year environment, which is a challenging backdrop for our industry.

We at Prudential have taken decisive actions to de-risk our earnings over the last seven years by lowering our exposure to interest rates. But we are not completely immune (17:59 - 18:02) by the impact of the first quarter.

In this context our scale positions in the most attractive insurance market in the world in Asia provide a reliable engine of long-term profitable growth.

The rise of the Asian middle class offered us a historical opportunity, like the one we had in the UK in the 19th century to meet the significant investment and protection needs on the coming decades.

In the U.S., we continued to meet effectively and profitably the retirements needs of 77 million baby boomers. While in the U.K. we are focused on providing investment and retirement products to an aging but wealthy customer base.

So in summary we remain - we believe we remain well-positioned to deliver a good value to our customers and quite uniquely in this sector, both growth and cash to our shareholders.

So thank you for listening to these comments. And we can now move on to Q&A.

Q&A

Operator

Thank you very much. And our first question comes from the line of Blair Stewart of Bank of America Merrill Lynch. Please go ahead. Your line is now open.

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

Thank you very much indeed. I have – and good morning.

A - Tidjane Thiam {BIO 7518525 <GO>}

Morning, Blair.

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

I have three questions. The first one on Asia, huge growth in Hong Kong. I just wonder if you can talk a little about the growth drivers coming from the Mainland China? And if you're noticing any difference in the purchasing behaviors of those customers relative to the Hong Kong customers?

Secondly, on the U.S. a lot going on in that business, interest rates moving around as well. I just wonder what you see the outlook for the rest of the year there? And if you could comment as well at what point you would expect to make an announcement on Mike's [Wells] replacement at Jackson.

And finally, a quick one on M&G. You talked about outflows in April. Could you just comment on whether they're coming from bond or equity mandates please? Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you. Thank you, Blair. Asia, some color on Hong Kong. It's number of factors driving that. First of all, (20:22) both are doing very well. So bancassurance we said up 45%, thanks to the Chartered contribution, and agency doing very well too.

But within agency Derrick – you've met Derrick (20:34) – has driven a very effective recruiting – recruitment drive for a number of years now. We have close to 10,000 agents, so we by far are the largest sales force. We are skewed towards Mainland customers in our agency, which is part of why we're getting disproportionate (20:52) upside from this influx of Mainland customers, because we're structurally more geared towards that.

If you look at what they buy, they are – it's higher case size, so that's another, if you wish, lift too. More of those customers very good because they have more money than the Hong Kong customers. A significantly higher case size.

So we have more agents, more activity, bigger case size. And then they -- what you see in China is that they kind of fall out of love with their own currency, strong appetite for U.S. dollar. Don't forget a little of our – of what we sell in Hong Kong is U.S. dollars. So they like that. And they also like the protection product.

So really and actually a lot of that is regular premium. That's really worth noticing.

So when you ask us about those customers, we always say, well they're genuine Hong Kong customers. And if you wish first of all, we cannot sell a policy to someone unless they have an explicit economic interest in Hong Kong.

And they actually sign regular premium contracts. So the fact that they happen to be going back and forth between the two is not so relevant. They really -- I can't remember the number, don't know if any of you knew it -- it's a high proportion of regular premium, very, very significant. We can -- if we find it we'll give it to you during the call.

So really that's the color. So very good, very profitable business, increasing proportion of protection, very sticky, regular premium, higher case size. There's nothing there not to like.

If I may just add one thing from into U.S., it's you see that in the China numbers, I've said already 27% (22:30) growth in Mainland China. That whole kind of appetite in China for life insurance is something that we see in Mainland China, and that's also grown true Hong Kong, because the clientele that goes to Hong Kong is also slightly more affluent than the general clientele we have in China.

And I'm told 95% of APE is regular premium in Hong Kong, so that's actually very, very high, so very profitable.

The U.S. I'll let Mike talk about the outlook. And maybe I'll say a word to get the rate of you on the replacement. As we've done for the group, we have succession planning in place. We have very good processes in place and that process will yield a candidate. And we'll communicate back to you in due course. But, Mike, do you want to talk about the outlook?

A - Michael Andrew Wells {BIO 4211236 <GO>}

Yeah, Blair, I think the U.S. franchise looks as strong as ever. I think we've certainly seen an increase in competitor appetite for VA, but I don't think we're seeing any displacements of the relationships or distributors we have.

Remember we – the volume controls we put in place at year end, we didn't turn back on prospective too (23:50) in the full sense until the second week of January. So there is a – no small effort for the wholesalers to revitalize those relationships to – we saw some clever tactics I think by competitors to try and win some of our advisors over. From what I hear anecdotally those were not particularly successful. So that's good to hear that the producers are sticking with us.

And the franchise looks very good. So I don't – without getting into a forecast I don't think – I don't have any concerns there in our abilities.

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

Just a follow up, Mike, if I can. Is there any impact from some of the regulatory noise? I know you talked about there has been some noise about distribution conduct and distribution compensation.

A - Michael Andrew Wells {BIO 4211236 <GO>}

Yeah, there's two major issues out. There's a letter from Senator [Elizabeth] Warren that got a lot of publicity. And that was, Blair, on how incentives were built into the U.S. market.

And the other was -- is on the DOL's [Dept. of Labor] proposal, which we've discussed at a couple of other meetings. It's in the comment stage for another somewhere between five - and I think you'll see that, the latter one, finalized four months to six months from now.

On the Warren letter Jackson has applied the FINRA SEC standards to sales practice management on all products for a dozen years. So we do not have any concerns about this discussion. We don't - the way we - as you're probably aware they're very restrictive. Everything that's done with the advisors is tracked. There's limits on anything from entertainment to value of gifts and it's - we have systems that track all that. So that's not really a concern for us.

And we apply those same rules to the non-registered products, which should be the fixed index annuity and the fixed, even though they're not applicable by statute. We have by policy just carried them across. So that's a nonevent for us.

The second, the DOL, there's - no one knows where that's going to land. I read a number of competitors' comments on it. I think the two comments I guess I would say generally, it will be a test of capabilities. That's one of our favorite chests. When something changes, your firm's ability to react is I think one of our strong suits.

And the other is I think in an owner-ist model it's probably a 15% or 25% reduction in volume, and volume is not one of our concerns in the U.S. Managing volume is one of our concerns.

So again I don't think for us - I think it will be work for us. But we have an excellent product for the consumer. I think it will do very well in that regulatory look. And I think any adjustments they require we can make as quick as anyone can in that market and accurately deliver them. So it'll just be a normal tactical issue to deal with as far as I'm concerned.

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

Thank you. And on M&G, quickly?

A - Tidjane Thiam {BIO 7518525 <GO>}

M&G is the last one. Look, on M&G we have - we're talking about Europe, okay, my comment was about Europe. We've had 14 consecutive quarters of net inflows in Europe. And we have repeatedly said -- so you've heard Michael (26:53) say this many times, which is this was (26:55) performance, and we always also recognize that it's a cyclical business, but is susceptible to change.

So we have seen negative flows from our bond funds, to answer a question (27:05), and particularly one lumpy outflow. But we also - so a general increase in outflows, and we think they are due to concerns around liquidity of bond funds and the relative very strong performance of equity funds. So we are picking up some of this stuff elsewhere.

And I should mention here that actually multi-assets is doing well (27:23) both in Europe and in the U.K. So overtime we want to see that strength coming through.

So it's too early to say whether this trend is likely to continue through the rest of the year, because for instance market performance is one of the many unknowns, but it will have an impact. But so far the outflows are small in comparison to total funds. And we don't think that they are likely to have an impact on earnings.

But clearly of course continued sizable outflows would impact earnings from 2016 onward. But so far we don't see more than kind of normal volatility, given the size that the business has now reached, you will see from quarter-to-quarter outflows.

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

Great. Thank you very much indeed.

A - Tidjane Thiam {BIO 7518525 <GO>}

Thank you, Blair.

Operator

Thank you. Our next question comes from the line of Oliver Steel of Deutsche Bank. Please go ahead. Your line is now open.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Morning all, and thanks for taking the call. Two questions to start with. First of all, you talked about a 3% penetration rate at Standard Chartered. And I was wondering whether you can give us sort of any, not specific examples, but sort of general examples as to what sort of penetration rate you could get to in a typical bancassurance deal?

And then back to Hong Kong. I mean Hong Kong is now - I think it's 36% of your Asian sales in the first quarter. I wonder what stage does that get outsized relative to the rest of the Asian business?

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. No. Thank you. Thank you, Oliver. Yes, we have commented on 3% at the time of the - all I can say is that the business is - I think the number I have in mind, 170 times bigger than when we started in 1998 in terms of sales. And that we have very strong growth, we said 45%. I think (29:18 - 29:22). We think that we can grow comfortably a double digit for a long time in SCB. So we won't give you a target penetration rate, but it can be significantly in excess of 3%. Just a way to say that demand the organic is not a good phrase (29:37 - 29:40).

On Hong Kong just looking at what affecting now (29:46) maybe benefit of hindsight and the number of quarter, we said 22 quarters, 16% average growth (29:57) on Asia, but we will deliver at a regional level.

The rarity is this stock is a way of an emerging markets play. There is no way to say that emerging markets are not volatile. (30:11) large platform, a diversified platform. That's all you can do in emerging market.

So in all my years I've put into it, I've always heard comments along the lines of well it's coming from wrong place. Or it's too close on trade key (30:22). Or it's not straight enough.

The reality is those markets move in such a way - this is why we are adamant on never giving you guidance by country. It was really this - if you wish for standard deviation, the sigma is very high. That's a nature of those economies. They stall, they grow, they grow very strongly, they come back for two years into a major story (30:39 - 30:42), and then also, oh you're a one-trick pony investing in Asia. (30:45) Guess what? We become a one-trick pony in just Hong Kong.

And then you've seen what Asia coming back (30:50). I think my own ability to predict going forward on country by country level, I consider zero, close to zero, surprises over time.

But the reality is they're moderately so healthy, the focus on distribution is so strong. The focus on growing the distribution on activating the Asians, on selling quality products and getting new distribution is so strong. But when you do that in spite of the large, larger numbers - if you ask me what - a subset of 10,000 Asians out of 470,000 (31:21) that we have in the sweet spot is going to do, well our ability to believe that (31:26) is very weak.

But my ability to predict what the 470,000 (31:29) are going to generate, it's just the law of large numbers, is very, very strong. And what you've seen growing through.

So yes, you are right. Right now we are very concentrated in Hong Kong. But I'm very confident that is the way the zone operate as a region. And that growth will come through. I just cannot tell you where it's going to come from. I cannot tell you when Indonesia is going to come back on the stream (31:50). I cannot tell you when Hong Kong is going to slow down. I cannot tell you when Singapore is going to pick up.

It's a complicated story on the market-by-market level. But the fundamental drivers of this - the growth of the middle class at a regional level, the under-penetration at the regional level, the strong demand for our products at the regional level remain very, very strong.

So Hong Kong I think is a good story. The fact that China is going in the same direction gives me confident that there is really something going on there. If you look fundamentally the Chinese have become wealthier. I've been talking about their growth for a long time. (32:30 - 32:33)

And really what they're doing is diversifying their holdings. They are behaving like every reasonable investor, the same way rich Europeans have U.S. equity and all kinds of assets in their portfolio. The Chinese are no different. So you can see with the roll of money coming out of China, and it's growing into - one day I was now thinking Hong Kong is very happy to use it

You know that there are projects to allow Chinese investors, connect projects between Hong Kong and Shenzhen to allow them to invest more abroad. That's going to be a huge wave, and it's trillions of assets in there that are going to come. So I think that story is still some way to go.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Can I just sort of follow-up quickly on that? I mean obviously Hong Kong is becoming so large, it almost needs to be sort of split into component parts dare I say that we can try and understand the drivers a bit more. I think you said that the Chinese - Mainland China flows were half of the Hong Kong flows now. Where does that come from? Just so that we have a sort of a guide as to just how much of an impact that has had?

A - Tidjane Thiam {BIO 7518525 <GO>}

What do you mean when you say where does it come from?

Q - Oliver G. Steel {BIO 6068696 <GO>}

Well sorry. Not - well what percentage of flows was that in 2014 or first quarter of 2014?

A - Tidjane Thiam {BIO 7518525 <GO>}

(33:48 - 33:50) That's kind of what we said, it's 50% of the sales, of the flows that are on Mainland. Okay?

Q - Oliver G. Steel {BIO 6068696 <GO>}

So that hasn't - so that has... (34:00 - 34:10)

A - Tidjane Thiam {BIO 7518525 <GO>}

Hong Kong per se is also doing very well. I think that's the message that maybe we don't understand, because people tend to look what changes. So yeah, Mainland is growing but Hong Kong is doing very, very well. I mean very, very strong - very strong growth.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Okay.

A - Tidjane Thiam {BIO 7518525 <GO>}

And also protection story, don't forget our protection story in second (34:28).

(34:29 - 34:34)

(34:35) that Hong Kong would grow. And we were being told that it's a business that wouldn't go anywhere. It was mature. Why pay for businesses in Hong Kong?

I'm very happy to be sitting here and having a big debate around the extraordinary growth of Hong Kong, the mature market. I think it's just another message about the power of this story. But Hong Kong grew in excess of 40%, the local Hong Kong business itself, forget Mainland. The local Hong Kong (35:07).

Q - Oliver G. Steel {BIO 6068696 <GO>}

Okay.

A - Tidjane Thiam {BIO 7518525 <GO>}

In excess of 40%, which is really a strong one, counting (35:11) domestic Hong Kong.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay.

Operator

Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Thank you.

Operator

Our next question comes from the line of Abid Hussain of Société Générale. Please go ahead. Your line is now open.

Q - Abid Hussain {BIO 17127644 <GO>}

Hi afternoon. Just three questions if I can please. Firstly, on the U.S. So there was some material deterioration in the new business margin, more so than I would've thought given the pricing action that you were probably putting through. Can you just talk about what drove deterioration in the first quarter? And what sort of pricing action you may have left obviously for the rest of the year? That's the first question.

The second question is on Singapore. I was just wondering if the base bonds on (36:00) the minimum healthcare benefits there that have come in, has that impacted your APE sales? Or was it entirely your own decision to refocus the business on higher value protection products?

And then finally on Indonesia. You said the macros have been challenging, and it seems that they've been challenging there for a while now. And I'm just wondering what needs to change in order for you to be more comfortable with Indonesia? And if you might suggest a sort of timeline? I know you just said that your ability to forecast country-by-country is zero, but just sort of if you could add some color on that that would be helpful.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay, thanks Abid. And again good morning. Just maybe one comment before I let Mike and Nic take that. But really again we're not great believers in NBP, and this quarter just illustrates why. You've heard us drop down embedded value for a long time, we about IFRS and cash. I tell you (36:59) all over the place, which is why we dropped the NBP target for Asia. We just don't believe in NBP as a short-term indicator quarter-by-quarter. So the margin is directly derived from that. It's what I leave to Mike, but really I've been dreaming – I was dreaming of dropping NBP as an objective. We've done that for 2017, thank god. And I was contemplating (37:20) taking margins out. But even if we took it out, we would still compute it.

So we have been thinking of just like not disclosing it. But it just leads to (37:32 – 37:34) sorry about that. (37:36 – 37:38).

A - Michael Andrew Wells {BIO 4211236 <GO>}

(37:37 – 37:39) to not try and defend the NBP number.

Abid, it's Mike. I think there are two things. The interest rate implication is material. And so it depends on how much weight you put on that sort of movement and that sort of point in time metrics on rates. Again I think Tidjane's made it clear we don't value that particularly highly.

You had a couple weeks where you didn't have the most profitable product in the marketplace. That's not trivial, given the number of weeks in the quarter. And the product we brought online has a full array of guarantees as you have seen. And it has got very good margins in it and is selling well. And the accounts are appreciating it as they should for the consumers, and we benefit from that. So there is no economic outcome from the first quarter in the U.S. that we're not happy with.

A - Tidjane Thiam {BIO 7518525 <GO>}

Absolutely. You've seen the assets on the American going up 16%, yeah. (38:30) if you want to see IFRS (38:33).

Q - Abid Hussain {BIO 17127644 <GO>}

So can I just come back on what sort of economic metrics are you sort of fixing on? It's clearly some of the biggest margin here at one. (38:41 - 38:44) What metrics are you looking at?

A - Tidjane Thiam {BIO 7518525 <GO>}

A fantastic question.

A - Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

Okay. We look at the internal rates of return that we generate on the products that we sell. Let me just remind you of the history here. We saw interest rates fall at really low levels for the second half of 2012. At that point Jackson repriced all its product set under VA in order to deliver the very demanding returns that we required for VAs at the time. So at the time we repriced it to give you high 20s% in the IRRs.

Then interest rates recovered for a period of 18 months. And those IRRs became exceptional, exceptionally high, as we didn't reprice to give that value back. Our interest rates are back in the last six or so months. So what we've come back to is a very strong IRRs, maybe not as attractive as they were, and when interest rates peak up again. So that's what we use.

And the other mechanism on -- so, no, we are very happy with the returns that we're getting, even at these levels of interest rates. As I said high IRRs, very fast payback on the product.

And our mechanism in terms of counter managed volume is gone beyond simply repricing. We're now giving ourselves more flexibility by creating slightly different flavors or guarantees, which have slightly different pricing structures. Clearly the lower the guarantees, the lower you can charge.

And that nuance and that flavor isn't coming through very strongly in the NBP measure. It's not nuanced enough to pick that up, as is the case with Elite Access. We said Elite Access is a high IRR product, but in NBP terms it's not very.

So these are all the -- these are -- hopefully that gives you a little more color around what's happening in the underlying dynamic.

Q - Abid Hussain {BIO 17127644 <GO>}

Yeah. That's very helpful.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. No, thank you. It's important points (40:54) -- for us to comment on that.

Quickly you asked about Singapore and Indonesia. Singapore is completely our decision. We really want to increase our protection content there. (41:06 - 41:09) headline down

19% (41:12 - 41:14) and NBP up 2%. (41:16 - 41:18) And we're going to continue doing that.

Indonesia, you kind of answered your own question. I really always shy away from making microeconomic forecasts. That's really a very, very, very, very dangerous thought.

But fundamentally I think the government is focused on the right thing. There's a bit of impatience there. They're trying to clearly focus on the infrastructure, absolutely vital. They really must do that.

And as always they've got to both drive (41:47) short term and long-term economic growth. (41:51 - 41:53) seeing employment, construction, et cetera, et cetera. But the reality (41:57 - 42:00) in this market. People want to grow ahead of itself. (42:03 - 42:07) takes time, takes time. They'll get there, but it takes time to get the projects off the ground, get the funding in place, and it takes a long time.

So we're very confident again in the medium term prospects of that economy. Very happy to be there. Plus 7% is (42:23 - 42:27). I don't want to be quoted on calling a quarter-by-quarter growth. (42:32 - 42:34)

Q - Abid Hussain {BIO 17127644 <GO>}

Okay. Thanks.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah. But we think overall again, the Asia performance will be strong. And we have enough levers to pull, enough diversification that you see the performance coming through (42:45 - 42:48).

Q - Abid Hussain {BIO 17127644 <GO>}

Okay.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Greig Paterson of KBW. Please go ahead. Your line is now open.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Morning gentlemen.

A - Tidjane Thiam {BIO 7518525 <GO>}

Hey, Greig.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Just a few. Indonesian active agents' recruitment in the first quarter. I wonder if you could give us the year-on-year growth there?

And then in terms of the other markets, I wonder if you'd give us an idea where active agent growth is accelerating? Which markets are accelerating besides Indonesia?

And in terms of the U.K. bulk annuities what was the sort of change in the competitive environment versus second half of last year? Because you wrote no bulks in the first quarter. One of your competitors implied that it was competitive, but there hadn't been a change. I was wondering what your view on that was?

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you, Greig. On the first one yeah, very legitimate question. But as you know we don't - we really don't communicate on the activity levels country-by-country. In Group that discussion we just had on our ability to forecast or have - on a 720,000 (43:58) sales force, but not in sub-segments of that (44:02) country-by-country. So we're always recruiting. We're always activating. The experiences out there (44:07) varies a lot from one quarter to a quarter, from one country to another country.

But again if you look at the group, it has been a good balance between recruitment, activation, and if you wish productivity (44:26) case size. So that's all I would say on that. Jackie, on the bulk and the current market environment?

A - Jackie Hunt {BIO 16204866 <GO>}

Yeah sure. So, Greig, in terms of the competitive environment we've actually seen no change from when we last updated you. I think at the last year-end results I was indicating that the pipeline is very strong. It remains immensely strong.

We are disciplined. And we don't say those words lightly, so we do make sure that the deals that we do transact we're not chasing quarters. We do actually find the deals that match our risk and return profiles. And you see that paying through in the deal that was written shortly, within a few days of the quarter end. We didn't kind of - weren't concerned I guess about the impact in terms of the lumpiness of that business.

So I think the outlook is very strongly. We continue to focus on the right metrics. We make sure for example that we have the assets that we're comfortable with to back some of these deals there of the nature of M&A. But you should expect it to be lumpy by nature. That's how we act in this market.

Q - Greig N. Paterson {BIO 6587493 <GO>}

(45:31) thank you. Keeping - and just a point if I may, just in terms of our forecasts and for this year. I'm just wondering which markets are seeing strong active agent growth and which are not? I mean for instance we know Singapore is not. I was just wondering so we've got some kind of - something to hang our hats on in terms of forecast?

A - Tidjane Thiam {BIO 7518525 <GO>}

Yes. I understand the question, but I... (45:54 - 45:46)

Q - Greig N. Paterson {BIO 6587493 <GO>}

So no comment.

A - Tidjane Thiam {BIO 7518525 <GO>}

No. We're not going to give you active agents. Of course you can imagine we know that when we go over a performance of a business, we go line-by-line, country-by-country.

Q - Greig N. Paterson {BIO 6587493 <GO>}

(46:05 - 46:06)

A - Tidjane Thiam {BIO 7518525 <GO>}

It's not helpful. I mean it's not helpful. You really - it's not helpful to put it in the public domain, because it just moves a lot. All I can tell you is that roughly should have a growth in Asia, Q1, it's about healthy growth in activations and healthy productivity roughly. But that will move around. I've seen it move around. Going to be 50/50 one quarter, it can be 30/70 another one, it can be 20/80 another one.

So it's as I've told you many times. When you look at the country-by-country level, it really depends on a lot of factors. You push hard the quarter, you push that hard the following quarter, because you need to digest what you've taken on board, et cetera.

So you could really trigger too much noise to start having those discussions country-by-country. I know you. We've been having this dialogue for a number of years. Maybe you'll convince Mike to... (47:02 - 47:06)

Q - Greig N. Paterson {BIO 6587493 <GO>}

Well when I find out where he lives in London, we can talk. Yeah? Excellent. Thank you very much.

A - Tidjane Thiam {BIO 7518525 <GO>}

Greig.

A - Michael Andrew Wells {BIO 4211236 <GO>}

Thanks, Greig.

Operator

Thank you. Our next question comes from the line of Alan Devlin of Barclays. Please go ahead. Your line is now open.

Q - Alan G. Devlin {BIO 5936254 <GO>}

Hi, thanks guys. A couple of questions. First of all to follow-up on the DOL fiduciary responsibilities. There was some discussion about moving away from commissions to fees. You did (47:33) actually quite positive for the industry. It will being the advisor remuneration more in line with how these guys make profits. And then secondly on that again, would there be any potential to move away from the non-guaranteed products to the guaranteed products where you can issue more tangible value to the client?

And then just a last question on the U.K. one of your largest competitors just closed its profit's fund (47:58) this year due to lack of net flows. Wondering if you could update us on what you're seeing in Pru? With profit's fund some (48:05) success when others can't seem to make it work. Thanks.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Alan, thank you. Do you want...

A - Michael Andrew Wells {BIO 4211236 <GO>}

Again the DOL piece is a work in progress. So it's hard to comment, to get too granular on it. But the direction the Travol Commission (48:21) look like they will be a part of it. I think if you think of the U.K. sort of reasons why letter or our U.S. investment policy letter of a registered investment advisor, you're going to see something along those lines, if you read the text carefully.

Those exist now in certain broker-dealers, it's not an unusual – there's firms that have that process in place around variable annuity sales. The – one of the key components is the disclosure of the compensation made to the advisor (48:50). And again which firms operate successfully with that model now.

The fee/non-fee piece, I do think the alignment of interest piece on that is not as simple as how the advisor is paid. There's an implicit trade with the consumer that they're giving up a bit of duration for -- on liquidity over the discerner (49:12) charge period in exchange for a better product.

So I don't accept necessarily the premise that a fee-based product is better than a commission-based product with a trail surrender (49:24) charge. But again that's something we can talk about offline if you want.

And then finally on the guarantee/non-guarantee. We deal with this with Elite Access. There's some firms that don't allow Elite Access and qualified plans for a variety of reasons. It just affects you distribution strategy, it affects how the consumer saves. There's a lot of ways to add value, and Elite Access is a good example.

Getting institutional solutions on diversification is what that product does, getting them away from having to use simply a total return bond fund to get non-correlated returns. We have lots of ways to get value to consumers in the U.S., and obviously those are transportable to other markets if we chose to.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah. And really we've had various talks with policy makers in the U.S. And the understanding we have is as a group that the U.K. experience on commissions. And we have no intention of flowing that example (50:16). So we haven't heard any attempt or intention to touch commissions.

Jackie, with profit policy making?

A - Jackie Hunt {BIO 16204866 <GO>}

Yeah, so thanks for the question. I mean clearly with profits there's a core part of our proposition. And we've - having considerable success with a lot of momentum and with profits business.

I think if you compare our proposition with some of our competitors, I'd raise a couple of observations.

The first is that pre-funded sales is what we would see as a modernized form of with profit contract. So it's considerably more transparent. It's easier in many ways for consumers to understand what it is they're getting and feel less that it's a black box, which I think was always the concern expressed about some of the more traditional with profits products.

And I think in terms of how that has landed and continued to grow in the market share, we talked about the 9% growth in PruFund more generally. We have seen ongoing interest in PruFund as a proposition.

If you put that then alongside the fact that actually the returns out of our with profit funds have been very strong over whether it's a five-year, 10-year, 20-year timeframe on most metrics. And the with profit product have outperformed relative examples in the FTSE by some margin. And I think consumers have valued obviously that trend about performance. It's critically important to the proposition and what the consumer gets out of it.

You then put that against the fact that actually if you look over the last 18 months, one of the things that we set out to do and what we're starting to deliver now is we're broadening the product proposition. So for example we're putting it into new raptors (52:03). We talk in the release a little bit about the fact that we now have an ISO version (52:07) available. I mean it's not a big contributor to Q1. I think about £3 million of AP. But by the end of April - we only launched on the 27 of February - end of April it was £9 million. And we think there's a lot of legs in it.

So we're broadening the proposition. We are also adding considerably new - more new advisors. Actually if you look over the course of the last 15-odd months, since RDR was implemented, we are seeing new advisors coming to the proposition off the back of training that we give, WebExes that we run. And just an understanding that actually smoothed returns at a time of significant volatility really work from a consumer perspective.

So it is one of those environments where in some ways we are backing the trend. But actually if you look at the components, if you look at the strength of our distribution, if you look at the strength of the product proposition, if you look at it, what it is that consumers need around more smooth returns and good solid returns, our with profits fund is really playing well into that space.

Q - Alan G. Devlin {BIO 5936254 <GO>}

Thanks for the answers.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Thank you, Alan. Jerry, to another question?

Operator

Yes indeed. And our next question comes from the line of Jon Hocking of Morgan Stanley. Please go ahead. Your line is now open.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Hi there. Afternoon everybody. I've got two questions please. I just wonder whether you could give an update on the specific items you called out at full year results? On obviously to specifically the transitionals for the annuity bulk handle. So the aggregation of the Asian business, whether there has been any update there?

And then secondly just on the U.K. business that the drawdown volume is very high in Q1. I wonder whether that's sustainable? And whether that's something which is ramping up post the pension freedoms? Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. Well thank you and good afternoon, Jon. Nic you want to take on those two?

A - Nicolaos Andreas Nicandrou {BIO 15589153 <GO>}

Sure. As you said, Jon, we gave you some very full disclosure with our prelims, explaining actually the capital generative nature of our business even on through this particular land. And illustrating that and also commenting on the open areas of discussion if you like, the points on the discussions at the time. I mean we've continued those discussions. There's no update to give you.

But to reiterate the points that we made on Asia fungibility, a question under Solvency II. Let me just reiterate, this has no impact on dividends from Asia, because Asia will continue ultimately to be regulated on a local basis, which has been forming our dividend flows.

It's simply a question of how much of the excess are over and above the local rate, we're bringing to the Group, Solvency II number. Clearly we'd like to bring it all. We're not going to be able to bring it all. But let be emphatic with it's not going to be nil. It's going to a number that that is greater than nil.

And on transitionals we – yeah. We continue with the process in terms of making -- preparing our application. And no update there.

So we'll keep you updated. We said we'll have certainty towards the end of the year, but there's no change in the key message that Tidjane and I gave at the prelims that the Solvency II impact will be manageable for our Group.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Okay. Thank you.

A - Tidjane Thiam {BIO 7518525 <GO>}

Okay. So I think that's my final question of my...

A - Jackie Hunt {BIO 16204866 <GO>}

Drawdown.

A - Tidjane Thiam {BIO 7518525 <GO>}

Oh drawdown. Sorry I dropping -- sorry, sorry. Drawdown did very well effectively, I mean sorry. I was in a hurry to close this. Sorry. Jackie?

A - Jackie Hunt {BIO 16204866 <GO>}

Yeah. No. The quick answer is that drawdown I think, a significant deal of the period (55:41). We see this as actually being the alternative. The vast majority of conversations we're having with both existing and new customers are either about them taking money as cash, if they tend to small sizes (55:54) or if they're younger or if they are in a sort of more affluent, more asset rich position. It gives you better drawdown products of some form.

So I think this is a structural change that's happened to the market in these seven years (56:07). And into drawdown and various other savings and investment type products. And we're clearly gaining market share in that space.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah. I think we're triple.

A - Jackie Hunt {BIO 16204866 <GO>}

Tripled, yeah.

A - Tidjane Thiam {BIO 7518525 <GO>}

We're tripled year-on-year, so it's a really good performance. So my final question as the fool (56:24)? Anybody? One final...

Operator

Yes we have a – we do have a question on the line. And that is from the line of Ashik Musaddi of JPMorgan. Please go ahead. Your line is now open.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Good afternoon.

A - Tidjane Thiam {BIO 7518525 <GO>}

Yeah.

Q - Ashik Musaddi {BIO 15847584 <GO>}

And Tidjane, I won't take longer. Just like a very short question. Any update on Malaysian regulation? I remember there was some debate on the commission, et cetera. Any update on that would be great. Thank you. And I won't take your lot of time.

A - Tidjane Thiam {BIO 7518525 <GO>}

(56:54) important question, but really there's no -- nothing else. I said I think we've been very reassuring when we've answered this in last time that we did not expect any major change.

But we attempt to download the – sorry, to capital loadings (57:09) that anywhere you've seen the numbers in Malaysia. What the Malaysian authorities want is the development of takaful market. And I think the industry explained to them what we needed to deliver that. And they have been very (57:23 – 57:29). So I think those concerns, as far as we knew, have not materialized in a negative way for the industry. So far, so good there.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah.

A - Tidjane Thiam {BIO 7518525 <GO>}

So thank you all for attending our call and for your questions. Our first quarter results demonstrate the power of our strategy. Probably some indication of the policy (57:48) of our individual businesses. We are continuing to deliver profitable growth by embracing (57:53) capital at double-digit IRRs, an attractive equity story in an environment of very low returns, historically low return.

In this uncertain and low return world Prudential remains a long term high-quality investment with an attractive positioning in Asia, the U.S., and the U.K., and well placed to deliver value for both our customers and our shareholders.

So in my final and results (58:16) presentation, I'm happy to see that it is Asia (58:18) of the Group's progress, driving it to our own performance.

I thank you all for your support during my time here at Prudential and hope that you will continue to support a great company with a great future. I wish Mike, who is great successor, and the management team all the best. And I'm very confident that under his strong and effective leadership, Prudential will continue to deliver value for our customers and shareholders.

So thank you all and have a good day.

Operator

This concludes our call. Thank you for attending. Participants you may disconnect your lines.