Q1 2013 Earnings Call

Company Participants

- Catharina Hellerud, CFO
- Helge Leiro Baastad, CEO
- Janne Merete Flessum, IR Director
- Mats Gottschalk, EVP

Other Participants

- Gianandrea Roberti, Analyst
- Matti Ahokas, Analyst
- Per Gronborg, Analyst

Presentation

Operator

The conference is now being recorded.

Janne Merete Flessum {BIO 19368607 <GO>}

Welcome to the presentation of the First Quarter results for Gjensidige. As usual, our CEO, Helge Leiro Baastad, will start with presenting the headlines for the quarter; before this time our EVP, Mats Gottschalk, gives some insight into Gjensidige's own Pension and Savings business. Then our CFO, Catharina Hellerud, will give you the details on the financials. And finally, we will open for Q&A session, as always.

I'll leave the word to Helge.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Janne. Figures for the First Quarter indicate a good start to 2013. Profit before tax expense was NOK541 million. And as you have seen, the Insurance result amounted to NOK343 million, corresponding to a quarter combined ratio of 92.3%. If we would have discounted reserves, the figures would have been 88.8%.

It is a satisfactory First Quarter result; the period that normally characterized by a lot of weather-related events in the Nordic region. The increase in the combined ratio from 88.4% in the First Quarter of last year is mainly due to a more normal proportion of large losses, combined with a lower run off gain. Adjusted for this, the combined ratio was on par with the First Quarter in 2012, which, as you remember, was particularly good.

Good underlying profitability was driven by continued good customer (and) risk selection and no significant negative weather effects in the quarter. And as always, is that element of random variation.

Go to the financial result; amounted to NOK173 million, affected by the impairment loss on Storebrand we announced about 1.5 weeks ago of NOK611 million. Gjensidige is well capitalized and it's important for me to repeat that it is the Board of Directors' clear intention that the impairment loss shall not affect the dividend for 2013.

This is exactly the same communication regarding dividend for 2013 as we presented to the market 1.5 weeks ago. The annualized return on equity before tax was then 8.4%.

Then if we move to page, is it 4? Yes, I will briefly comment on some of the most important highlights of this quarter. First, the growth in premiums in the quarter was solid. Adjusted for the exchange rate, we had a growth in premiums of 2.8%.

The very important private segment in Norway had a growth of 3%. And the growth in premiums was also very good in the commercial segment, due to a high proportion of policies being renewed at the turn of the year.

Adjusted for the loss of two pension agreements, as you have heard about before in the second and Third Quarters last year, this was a strong performance from the Commercial business in Norway.

In addition, the development in our international operations was particularly pleasing, with a growth in premiums of 8.2% in the Nordic region and as much as 17.8% in the Baltics, both adjusted for exchange rate effects.

I now want to highlight the activities in the Nordic region in particular this quarter. As mentioned, the growth in premiums, adjusted for the exchange rate, was a solid 8.2%. The result was driven by a high level of activity and good renewal rates in the commercial segment.

Since the acquisition of Nykredit Forsikring in 2010, Nykredit has been our most important distribution partner in the Danish market. In the First Quarter this year, we entered into an agreement concerning adjustment of the existing cooperation model.

From, and including April, we will be taking over the first line customer dialog. This strengthens distribution and helps to bring insurance expertise closer to the customer. As such, it's fully in line with our goal of becoming the most customer-oriented general insurance company in the Nordic region.

We think this adjustment of the distribution agreement with Nykredit will support both customer orientation and sales, going forward, in the private line.

It's then pleasing to see the high level of activity in the Bank and that it has resulted in the growth in lending of almost 21% from the First Quarter last year. The target customers for groups for the Bank is primarily Gjensidige's loyalty and (inaudible) customers. Gjensidige Bank shall be among the most competitive regarding pricing within these target groups.

The terms of the Bank is perceived to be very competitive, and the activity level is still high, and with good inflow of customers also into the Second Quarter. In addition, the Bank is small, but cost efficient. The management and the employees are focused on improving results, in combination with good ability to deliver.

The Bank has a strong (risk management). This is important and makes it possible to achieve good lending growth, without changing the risk profile of the portfolio.

Finally, so far this year, we have received three awards for customer service, and customer treatment. And we see this as a recognition of the effort we put into every day in our dealings with customers.

Value creation takes place through contact with customers, and focusing on cost efficiency, has not resulted in poorer customer service, only smarter and better handling of customer enquiries.

Page 5, and my last page, some words regarding the unique customer dividend model. Model contributes to loyalty and increases Gjensidige's attractiveness among insurance customers in Norway.

The Gjensidige Foundation will shortly receive NKK2.1 billion in dividend from Gjensidige, which, after deduction of expenses, will be distributed to our Norwegian insurance customers in May, June. This year, our customers will receive approximately 15% of the premiums paid for 2012 from the Gjensidige Foundation, provided that they were customers on the date of the Foundation's general meeting last Friday, May 3.

Since the IPO in 2010, Gjensidige has paid dividends of more than NKK8 billion, of which close to NKK5 billion to our general insurance customers in Norway.

This year, as before, the Gjensidige Foundation will invest in profiling the model and the Foundation's work through a big marketing campaign. The results of last year's campaign show that increased focus on profiling works, has a retaining effect, generates loyalty, hence to create awareness about choosing Gjensidige Insurance as insurance supplier.

(Market campaign creates) recognition of the unique model among the general public. 90% of the customers know about the model, but only 55% of the population knows about this model. The building of recognition takes time. It provides potential for increasing customers. 6% to 8% more people will consider choosing, and/or choose Gjensidige, due to this customer specific model.

So with that last final words, we can continue with Mats, and Pension and Savings business.

Mats Gottschalk {BIO 17501562 <GO>}

Thank you, Helge. We wanted to provide you with a strategic update as to our thinking with regards to the financial services businesses in Gjensidige.

Turning to page 7, Pensions and Savings is one of two non-insurance operating businesses that we currently have. Those two businesses are both closely linked to our strategy, and our strategy for the Norwegian market only.

With regards to Banking, as you heard our CEO, we've gained strong momentum in developing a simple and easy banking offering to our retail insurance customers, and we're very pleased with that development.

Similarly, we are focusing on building a defined contribution pensions business, mainly servicing our SME commercial customers, again in strong cooperation with the insurance company.

These are two integrated businesses utilizing the distribution model of the Group as a whole. They both contain relatively simple, modern and cost efficient products, and we're starting to see a contribution in terms of profitability that is approaching the Group requirements in terms of ROE.

Combined, or collectively, the Retail Bank and Pensions and Savings contributed NKK60 million to our Q1 result, the majority of that coming from the Bank. However, we think that, over time, as the pensions market develops, we should also expect to see an interesting income stream coming from our Pensions business.

Turning to page 8, we have today developed, effectively, the fourth largest defined contribution business in the Norwegian market. This is still a very, very small market. We've come a long way from starting this business back in 2007, 2008. As you can see from the chart, our assets under administration have grown from about NKK3 billion, to just shy of NKK23 billion, as of Q1, 2013.

The mix of assets is roughly half and half, split between pensions and savings. We expect, going forward, that the bulk of the growth in AUM or AUA, is coming from pensions. We're more excited about that market. More of our resources, in terms of distribution, are allocated to the pensions market, and we think that the revenue base, again from pensions, is somewhat more interesting.

Moving to page 9; as we've commented on before, there is a number of regulatory changes going on within the Norwegian pensions market. Our strategy remains the same as before, to provide a simple, defined contribution product to our core customers.

What's interesting about the legislation and the regulatory changes is that we think it's going to actually support our core market, as we've tried to illustrate in the presentation. We expect to see traditional guarantee type products within the pensions market to decline over time. The decline is going to be gradual, but we expect to see the majority of growth coming from defined contributions, which is what we are specializing and focusing on.

Our view is supported by the dialog that we continue to have with our customers around this product. Our sense is, employers, both small and large businesses, would like to see easier, less costly pension plans, going forward, and we think that we're well positioned for that.

So in summary, on page 9, we think that we developed a competitive business model. It's scalable; it requires very little capital. We think that we can grow the revenue base, over time. We'll have to patient, but over time, this business features attractive ROE prospects.

And we're going to apply the same strategy to developing pensions as we have in developing insurance. We're going to be disciplined, we're going to be selective in picking our customers. We're not primarily focusing on market share. We will focus on the best risk and the best customers, and we will stick to the SME market as our main playing field.

With that, thank you. And Catharina will continue.

Catharina Hellerud {BIO 17276650 <GO>}

Thank you. Insurance operations continue to deliver strong results. The Insurance result of NOK343 million is a strong First Quarter result, and there is good underlying stability in all the segments. The decline, compared with the corresponding quarter last year, which was a very good quarter, is largely due to lower run-off gains and a higher proportion of large losses.

The Bank also recorded a very positive profit performance in the quarter, with a pretax result that is more than twice the result in the First Quarter 2012. Increasing volume and less interest income, cost efficiency and a reduction in write-downs and losses contribute to the strong performance in the Bank.

The result in Pension and Savings is on a par with the corresponding quarter last year. However, this year we have taken into account that the financial profit for the paid-up policy portfolio will be used as provision for higher loss expectancy.

The owners' share of the financial profit corresponding to (NOK1.4 million) in the quarter, was allocated in its entirety as a provision in the First Quarter 2013. The return on the investment portfolio amounted to 0.3% in the quarter, adjusted for the impairment loss in the stake in (Storebrand). However, the investment portfolio recorded a satisfactory yield in the quarter of (1.3%). Taken together, this means the profit before tax expense of NOK541 million for the quarter.

Turning to page 13, the combined ratio for the general Insurance operations ended at a total of 92.3% in this quarter. The cost ratio was unchanged and ended at 15.7%. The loss ratio ended at 76.6%, which is an increase from 72.6% in the First Quarter of 2012. As mentioned, however, the increase in the loss ratio, compared with the corresponding period last year, is mainly due to a lower run-off gain and a higher proportion of large losses.

There is (still) underlying profitability in the portfolio. Since 2009, we have worked on developing a modern, more (life)-based price models in a large part of the Norwegian portfolio. In the First Quarter, annual tariff for the workers' compensation product was implemented in Norway. A new motor tariff for the Danish part of the market was also launched in the First Quarter. We are now in the process of developing a new tariff for the Danish property and contents product. At the same time, work continues on developing the Norwegian tariff.

In addition to the underlying profitability in the quarter, the claims' frequency is still above favorable levels. Although we had a more normal winter this year than in 2012, the frequency level was positively affected by the lack of extreme weather events and the negative weather effects in the quarter.

The favorable frequency level continues for motor claims in the private market in Norway. The same applies to property where we see lower frequency levels than we would normally expect during winter, although the figures are somewhat weaker than the corresponding quarter last year. There are also somewhat weaker frequency developments within the commercial portfolio, and especially within agriculture.

Turning to page 14, there was good increase in earned premiums in the quarter of (2.4%) with an underlying increase of (2.8%) if we adjust for the negative exchange rate effect in the Nordic segment. Private recorded a good growth in premiums of (3%). The number of customer is stable and the growth in premiums is mainly due to higher premiums.

Commercials increased in earned premiums in the quarter of (0.2%), despite the loss of the two large accounts that Helge mentioned previously. Adjusted for this, the growth in premiums was very satisfactory in the quarter also in the commercial segment.

Nordics reports very strong growth in earned premiums of 5.9% in the quarter. In local currency, the increase in earned premiums amounted to (8.2%). This is mainly due to an increase in the number of new commercial customers, and the strengthening of the cooperation agreements Nykredit is, of course, expected to contribute to increased sales in the product market in the time ahead.

(General) operating expenses increased by NOK15 million in the quarter while the cost ratio was unchanged as a result of the growth in premiums.

Turning to page 15; large losses in the quarter have an effect on the combined ratio 3.3percentage points (sic; see slide 15 "3.3%"), well below the expected level for the quarter of 5.4percentage points (sic; see slide 15 "5.4"). Although the portion of large losses was lower than expected in the quarter, it was, nonetheless, higher than in the corresponding quarter last year, when the proportion of large losses had an effect on the combined ratio of only (1.0percentage points).

Page 16, there was a run-off gain of NOK34 million in the quarter, corresponding to a positive effect on combined ratio of (0.8percentage point) compared with (2.7percentage points) in the corresponding quarter in 2012. I would like to remind you that the provisions are made on the basis of the best estimate principle. So that the expected run-off value is zero in the long run.

In the period from 2000, as you can see from the graph, the run-off gains have had a positive effect on the combined ratio of about 0.8percentage points on average.

Page 17; the internal risk-based capital requirement for the operational segment has not changed material during the quarter. There are some changes between the segments as a result of the portfolio being moved from Private and Nordic to Commercial in First Quarter. The capital requirement for the Pension and Savings business and the Bank, which is based on the capital adequacy regulations, have increased somewhat during the quarter as a result of growth in volume.

The asset risk has increased from NOK3.5 billion at the end of the Fourth Quarter to NOK3.6 billion at the end of the First Quarter. This is mainly due to the portfolio being larger at the end of this quarter, compared to the Fourth Quarter 2012, in addition to a somewhat increase in the allocation per share, private equity and property in the free portfolio.

Total (diversified) capital requirement amounted to NOK10.8 billion at the end of the First Quarter. However, as you can see from page 18, it is still the rating requirement from the S&P, the A rating requirement, that is the most binding of the (three) capital perspectives. The calculated excess capital amounted to NOK5.1 billion at the end of the quarter. Available capital increased during the quarter; that is the total capital requirement for asset and insurance risk increased slightly more. Excess capital was reduced by NOK0.2 billion during the quarter.

And also, I would like to mention here that the comprehensive income for the period is not included in available capital during the year. For the First Quarter, the comprehensive income amounted to NOK422 million.

The asset allocation; you will find asset allocation on page 19. The investment portfolio amounted to NOK57.9 billion at the end of the quarter, mainly more or less the same allocation that you saw in the end of the Fourth Quarter.

Turning to page 20, adjusted for the impairment loss on the Storebrand stake, the portfolio yielded a return corresponding to 1.3% in the quarter. The Match portfolio has a return of 0.8%; the biggest part of Match portfolio is the (bond) classified as amortized cost. It's achieved a return of 1.0%, which is unchanged from the previous quarter.

At the end of the First Quarter there was an excess value in this portfolio of NOK1.1 billion, which is a doubling from the end of the corresponding quarter in 2012. The increase in value reflects the falling interest rate level, which can also be seen in the reinvestment rates in the portfolio. And during the quarter, the average investment rate for these bonds has been around 4.4% compared with approximately 4.5% in the Fourth Quarter.

The return on bonds classified as short-term bonds was 0.1% in the quarter. This portfolio mainly consists of (Danish) fixed income securities, and the level of return reflects the low interest rate level in that market. Associated companies recorded a negative return of 9.7% in the quarter; that is, of course, the result of the impairment loss in the Storebrand holding of NOK611 million. Adjusted for the impairment loss, the return was 2.4%.

The Free portfolio yielded a return of 2.0% in the quarter, and the return on shares private equity and properties was a gain, while the return on the properties result was negative. The general interest rate level in the period was stable to falling, while the credit margin there was falling as well, and this contributed positively to the yield in the Free portfolio.

So to sum up, with the exception of the holding in Storebrand, the remaining investment portfolio yielded satisfactory returns in the quarter.

Janne Merete Flessum {BIO 19368607 <GO>}

Operator, then we are ready to take the questions, please.

Questions And Answers

Operator

(Operator Instructions) Matti Ahokas, Handelsbanken.

Q - Matti Ahokas {BIO 2037723 <GO>}

Since you presented the Pensions and Savings business very well, a question on that side. Firstly, what kind of asset base are you targeting, or could you see in Gjensidige on the Pension and Savings business in a couple of years' time, just to get some kind of feeling that what kind of ballpark figures we're talking about?

Then the second question is actually on the same topic that, if we look at your competitors, it's clear that this business doesn't require a lot of capital, but it's very, very scale dependent. So are you willing to look at potential acquisitions to reach your targets in the Pension and Savings business? Thanks.

A - Mats Gottschalk {BIO 17501562 <GO>}

Hi, Matti. Thanks for the question; it's a good one. I'll try and address it this way. We were excited about the fundamental growth in the DC pensions market but, as we commented earlier, this market has taken quite a long time to develop. And we're seeing a meaningful momentum in terms of the willingness of our clients or customers to move into this market and change their pension plans into this market.

And we've tried to illustrate for you our best estimate as to how we think the market, overall, is going to develop, and we put that in the presentation on page 9. And as you can see it is a -- we're talking about a market expansion by a factor of maybe 4 or 5, or even more in the near term. However, I'd like to qualify that by saying we are not chasing purely volume for the sake of volume.

We have been, and we continue to be, disciplined in terms of targeting the SME market, and we will participate to the extent we can see economics and returns in some of the bigger pension plan schemes. But they tend to be brokered, the risk margins tend to be competed away and so, therefore, I wouldn't guide you as to necessarily how we think our overall volumes are going to develop. We're much more focused on actually getting a good book of pensions business with sufficient returns and the appropriate risk margins in it.

Q - Matti Ahokas {BIO 2037723 <GO>}

But what kind of market share should we expect that you guys are going to have in this business, say in five years' time?

A - Mats Gottschalk {BIO 17501562 <GO>}

Well I couldn't comment on where the market share is going to be in five years' time, but as of today our market share, I think, based on DC reserves, is just shy of 10%; it's somewhere between 8% and 10%. And I think, when we look at the number of DC pension plans that we have, our market share is probably around 15%.

And that goes to my point earlier, that a bigger portion of our customer base that are insurance customers with Gjensidige tend to be smaller companies with fewer employees. And so, by definition, the overall volume of those contracts will be smaller, but we think that the profitability and the returns and the risk profile in those pension plans are better for us.

Q - Matti Ahokas {BIO 2037723 <GO>}

And what about the acquisitions?

A - Mats Gottschalk {BIO 17501562 <GO>}

We've been a consolidator in this market; when the DC legislation was first introduced there was a large number of participants, both from the insurance sector, the pensions sector, and also from the asset management and banking sector, who wanted to play in this field. And over the years, Gjensidige has actually consolidated quite a number of the smaller participants. We're now left with a situation where there is effectively only a handful of players left.

I would not speculate as to whether or not there's actually going to be any acquisition opportunities in this space, precisely for that reason. It's a relatively thin market and there aren't that many players left to compete with or to consolidate.

Q - Matti Ahokas {BIO 2037723 <GO>}

Fair enough.

Operator

Gianandrea Roberti, Carnegie.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

A couple of questions on my side. One is related to the capital structure. Wouldn't it be fair to say that, considering what we know about life insurance in Norway and your stake in Storebrand, any kind of discussion about Gjensidige's own capital structure is probably postponed at least to 2014, if not even after that?

I think recently, Helge, you mentioned that you didn't need full visibility, but at least enough to take in that kind of discussion, but it seems to me we are really not getting close to have this enough visibility. So any comment on that would be much appreciated.

And also, if you can highlight how you see the competitive position or your key leading players versus Gjensidige after an incredibly profitable year like 2012, it would be much appreciated. Thanks.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Yes, hello. The first question regarding capital structure visibility on the pension legislation, we have had some more visibility, as you know. It's still a hearing process regarding longevity and the period for reserving. It's also uncertainty, going forward, related to the old book and also, it's uncertainty regarding the paid-up policies, so we have had some more visibility.

If we are going to release more information regarding capital structure in '13 or '14, we are working with the questions, together with the Board of Directors. I hope that we can be more clear regarding the future in the period of 12 months from now, I hope so.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Thanks.

Operator

Per Gronborg, Danske Markets.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

I didn't comment the competition situation; maybe I should do that before we continue. We have had a very strong First Quarter for most of the players, both in 2012 and 2013 actually. Underlying results is very strong also from Gjensidige, so when you adjust for large losses and run-off gains, it's a very strong underlying result.

The competition situation is more or less the same as it was last year and last six month. I would say that the major players, the Nordic players, they act increasingly rational, more or less in the same type or way today, compared to one year ago. They have more or less the same type of financial targets, and they are more or less in the same -- they had more or less the same targets and the same timeframe.

So we can see some increasingly competition in Denmark from small players. We have seen some price reduction actually from small players in Denmark. In Norway, it's not increasingly competition from the banks, but it's maybe somewhat more active smaller players in Norway, like (Stualdom and Nairme) and (inaudible) in some segments.

But I would say that the competition is more or less the same as it was the last six months in 2012. But of course, it has been, though, a period with very low frequency, especially for motor in both First Quarter 2012 and 2013, so it's hard to estimate what kind of competition we will have, going forward.

But we do not believe that the frequency figures is sustainable as it has been in First Quarter in '12 and First Quarter in '13, so our price increases is more in line with what we expect will be the long-term claims inflation, and that's around 4%, as we had said before, for motor, and it's about 5% for the property.

But we started with price increases slightly before some of our main competitors, so we had ability to be more, I would use the word, maybe smart in some attractive segments. So the average price increase is slightly below then 4% for motor and 5% for property.

That was some words regarding the competition.

Q - Per Gronborg {BIO 15910340 <GO>}

I have a couple of questions as well. The first one related to large claims; you're guiding for a run rate of some 5.4% of premiums. If I look back over the last 17 quarters, where you have data for large claims, you've been above that level one single quarter, and clearly below most of the others. Is it fair to see this as a quite cautious view on where your normalized large claims should be or, otherwise, why should it be materially worse the next four years, compared to what has been the last four years?

My second question, when I look at your asset mix, you added quite a lot to current equities last year; you only seem to have net invested some NOK200 million this quarter. What are your thoughts on your asset mix? Could we see the equity allocation go further up? That was my two questions.

A - Catharina Hellerud {BIO 17276650 <GO>}

I can start with commenting on the large claims. The expected level is based on calculations on our internal model and it's based on all the data that we have going many years back. So it's based on the historic data and it's also, of course, based on our current reinsurance program. So it's not conservatism built into this estimate; it's based on the actual historic data from our business history.

Q - Per Gronborg {BIO 15910340 <GO>}

So basically, you've just been lucky 16 out of the last 17 quarters?

A - Catharina Hellerud {BIO 17276650 <GO>}

Excuse me?

Q - Per Gronborg {BIO 15910340 <GO>}

Basically, you have just been lucky 16 out of the last 17 quarters with large claims being below your expectations?

A - Catharina Hellerud {BIO 17276650 <GO>}

Large losses can happen just -- you can have some large losses more than one in one quarter, and then you can have quarters with no large losses; it happens with no regularity or it's -- yes.

Q - Per Gronborg {BIO 15910340 <GO>}

Okay, good. What about the asset mix, the net investments into equity? Should we expect that to continue?

A - Catharina Hellerud {BIO 17276650 <GO>}

Were you talking about the asset allocation? Yes. What I commented was that we have a slight increase in allocation to equities at the end of the First Quarter, compared to the end of the Fourth Quarter, reflecting our market reviewing during the First Quarter this year.

Q - Per Gronborg {BIO 15910340 <GO>}

But also taking into account that we added quite a lot to equities, (I believe you added some) to equities also last year. What are the sorts -- do you find the equities are more interesting asset class due to the low interest rate environment, or is it just a temporary fluctuation?

A - Catharina Hellerud {BIO 17276650 <GO>}

It's, as I said, based on the market view during the First Quarter, where we put on some more technical assets than we envisioned in the Fourth Quarter.

Q - Per Gronborg {BIO 15910340 <GO>}

Thank you.

Operator

(Operator Instructions) At this time, no further questions.

A - Janne Merete Flessum {BIO 19368607 <GO>}

Okay. Then we will just thank you for your participation and wish you a continued nice day. Thank you. Bye.