Company Participants

- Carsten Stolz, Chief Financial Officer
- Gert De Winter, Chief Executive Officer
- Markus Holtz, Head of Investor Relations
- Matthias Henny, Head of Corporate Division Asset Management

Other Participants

- Farquhar Murray, Analyst
- Frank Kopfinger, Analyst
- Jonny Urwin, Analyst
- Kevin Ryan, Analyst
- Peter Eliot, Analyst
- Rene Locher, Analyst
- Simon Fossmeier, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the half year results 2019 analyst conference call. I'm Sandra, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode and the conference is being recorded. The presentation will be followed by a Q&A session. (Operator Instructions) The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Markus Holtz, Head of Investor Relations. Please go ahead, sir.

Markus Holtz {BIO 20240672 <GO>}

Good morning, everyone, and welcome to Baloise Q&A call about our half-year results 2019. In our call today, we have our CEO, Gert De Winter; our CFO, Carsten Stolz; and our CIO, Matthias Henny. So now, I would like to hand over to Gert. He will give you a short overview of our results before we start the Q&A.

Gert De Winter {BIO 19720616 <GO>}

Thank you, Markus. Today, we are very pleased and proud to present a very strong half-year result for Baloise and a very dynamic and a high momentum first half of 2019. We generated a very good profit for our shareholders of CHF395 million. This result is based on our unchanged strong profitability as well as on our very strong balance sheet.

Certainly, a highlight was the excellent combined ratio of 87.4% in non-life. In life, we report again stable margins with an interest margin of 118 basis points. Despite the challenging environment, also our asset management team was able to maintain its investment result at the previous year level. Our high dynamics are also reflected in the strong growth of our business volume with 10% in the first half of 2019. All these numbers show a very strong operational power of the core of our insurance business in which we continue to invest also and organically, and this is shown by the successful takeover of Fidea, the Belgian insurer.

In addition to the investments in the core of our business, we were also able to consequently expand our ecosystems in mobility and home with new partners. This allows Baloise to further diversify itself as a service provider that is characterized by simplicity and security, in one word, Simply Safe strategy. Baloise confirms its excellent condition and it's good on course to achieve the goal set for the strategic phase simply phase -- Simply Safe. So again, strong half-year results and high dynamics in the first semester.

Good morning also from my side, and welcome to the analyst conference call. Sorry, maybe it was not clear, but it's open for questions now.

Questions And Answers

Operator

Excuse me, sir. We will now begin with the question-and-answer session. (Operator Instructions)

The first question comes from Peter Eliot from Kepler Cheuvreux. Please go ahead, sir.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much. I'll try to limit myself to three initially. And the first question, I guess, predictably [ph] on the life result. I'm just wondering if you're able -- what you can -- guidance you can give us looking forward? I mean, if interest rates stay at the current level, can you give us any guidance on what we should expect at -- in H2 and also in a normal year thereafter? I mean, I think you're sticking to the more than CHF300 million EBIT guidance. But I don't know if you can add anything about how far interest rates would have to fall before that guidance has to be revisited. That's the first question. Thank you.

And secondly, on tax rate, so I was wondering if you could just talk about what you expect there for the future? Carsten, I think you said at the full year results, you guided to 20%, and my understanding was that that included the lower tax rate from (inaudible). But I'm just wondering what that guidance might -- whether you want to revisit that or whether that may come down further as other cantons make their tax decisions.

And then finally on the M&A front, I guess, now that you've done FRI:DAY, I'm just wondering how likely is it that you will do anything else? And if in the near future, you're not looking -- you don't expect anything big, I'm wondering if you can comment on the sort of appropriate capital structure you consider as a long-term being appropriate. Thank you.

A - Gert De Winter {BIO 19720616 <GO>}

Thank you, Peter. Gert here. I will certainly -- I will try to tackle the questions from a high level and then hand over to the colleagues if further details are required or appropriate. In terms of the life result, what we have been doing over the last years is, of course, a lot of actions in order to tailor our life business in accordance with the low interest rate environment to keep it on a long-term profitable, capital light solutions going away from guarantees, investing in assets that are long-term stable and so forth, and then optimizing the business mix. The life result in the first semester indeed is affected by additional reserve strengthening, given the low interest rate environment. And we should not forget that last year, half year 2018, we had also an exceptional release of reserves from -- out of Belgium. Going forward, we stick to the CHF300 million area of EBIT in life. Of course, it's difficult to predict how interest rates will develop in the second half, but we stick to the guidance we have given.

Tax rate, I'm sure that Carsten will go into detail with that, but I think indeed, given the changes in the tax regime in Switzerland, going forward, we expect the tax rate of around 20%, which is slightly lower than the tax rate we have -- than the tax rates we have known so far.

And on the M&A front, actually, nothing changes in our strategy. That means we primarily look into interesting opportunities in the four countries, Belgium, Switzerland, Germany, Luxembourg. We have done so in the past, especially in Belgium and in Luxembourg. If from a business case point of view, from a cultural fit and the price is right, if these conditions would apply, we would continue that M&A strategy. Besides the classical M&A strategy, we have of course what we would call the alternative M&A strategy, which is the building of alternative business models, like FRI:DAY, like Mobly, like Movu, so the ecosystems around home and mobility which is -- which can be, let's say, exported more easily than brick-and-mortar classical M&A.

But Carsten, do you have anything to add on the tax on life?

A - Carsten Stolz {BIO 6055047 <GO>}

Yes, maybe. Peter, thank you for your questions. Also, good morning from my side. You asked with regard to the guidance of the Group corporate tax rate around 20%. What we've seen in the first half with the interest rates -- sorry, the tax effect that has been communicated, it has certainly been the bulk of the effect. And that is why -- that's because those cantons in Switzerland where most of our taxes are paid have voted. So, I would assume that's -- that this has been certainly the bulk of the effect. Some other cantons might -- will vote in the future, but this will impact us much less than this effect. So closing the loop, it means that we stick to the guidance given that on a Group level that we will be in the 20% corporate tax rate area going forward.

And with regard to the life results, as said, we stick to the CHF300 million EBIT area. Since half year, interest rates have tested new all-time lows, so we carefully observe and adjust as we continue to move in 2019. But as you see also in the presentation and Gert has alluded to it that we have -- we are acting on an interest rate margin of 118 basis point, and this to me is important because that is also the foundation of the life segment being able to remit cash to the holding and therefore contribute to our cash remittance target. And we do not expect a direct impact coming -- on the cash remittance capability of the life segment coming from challenging interest rate situation.

And your last question was on capital structure, I think nothing new on that front. We are continuing to execute on the share buyback program as promised, so we are handing back shareholder money through the share buyback program at the moment, and therefore, there is nothing new on the capital structure. We're still and continue to act on a strong capital position, and that remains unchanged for -- as we speak.

Q - Peter Eliot {BIO 7556214 <GO>}

Okay. Thank you very much.

Operator

The next question comes from Simon Fossmeier from Bank Vontobel. Please go ahead, sir.

Q - Simon Fossmeier

Good morning. I'm Simon. I got two questions on the Fidea deal, if I may. If you could elaborate on the financial targets that you have there beyond the CHF35 [ph] million profit target that you've communicated, and if you could indicate what time frame you're envisioning there? And the second question is, if you could give us some idea what will be the solvency impact of the Fidea acquisition? Thank you.

A - Gert De Winter {BIO 19720616 <GO>}

Thank you, Simon. Let me try to tackle the questions first. So if you look at the Fidea deal, of course, in the first half of 2019, the numbers are not yet in. Closing has taken place beginning of July, so the second half -- the second half of 2019 and year-end closing, the numbers will be in. If you look at volume, we are talking about EUR250 million premium in non-life and about slightly over EUR100 million in life, so in total EUR350 million of premium in core insurance. You've alluded to the CHF35 million of bottom line, which indeed we confirm. The integration is going as planned, but it's always takes two to three years to actually really integrate it fully, but we expect the bottom line impact of CHF35 million indeed to happen as of 2019.

Solvency impact, I'll hand that over to Carsten.

A - Carsten Stolz {BIO 6055047 <GO>}

Yes, thanks for the question. The deal has been closed in early July. So the effects that Gert mentioned will come into the numbers in the full-year figures. All the processes to integrate Fidea financially into the numbers are ongoing. From a solvency perspective, we do not expect a material impact since Fidea joined Baloise Group well capitalized, so we do not expect a material solvency impact to come from that. But again, as said, integration, also financial integration is ongoing at the moment. We'll have clarity around this at year-end.

Q - Simon Fossmeier

Okay. Thank you.

Operator

The next question comes from Frank Kopfinger, Deutsche Bank.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Hi, it's Frank Kopfinger from Deutsche Bank. I have two questions. My first question is also on life. In the first half year, your current yield declined by almost 20 basis points to now 2.43%. Is this 20 basis points, the natural decline, we should expect going forward, and also looking at the current interest rate level, whether this is really the right number? And then secondly, also on Fidea, can you quantify the -- I think you also mentioned that there are some integration costs coming in H2. I think, at least at your full year call, can you remind us on the cost you expect on this?

A - Gert De Winter {BIO 19720616 <GO>}

I propose that Matthias takes the first question, Frank.

A - Matthias Henny {BIO 17600048 <GO>}

Sure. The decrease in current income is due to various factors. First of all, of course, the low interest rate environment, which leads to lower reinvestments, also to certain extent due to the lower equity quote that we have, and as dividends are mainly paid out in the first half, this has a more than proportionate effect. But on the other hand, it was also -- has to do with the FX composition. We decreased the U.S. dollar bonds with a high yield before FX hedging costs reinvested into Eurobonds. And this shows now in the pure current income number at a larger than natural decrease. The natural decrease we estimate roughly at around 10 basis points per annum.

A - Gert De Winter {BIO 19720616 <GO>}

Maybe do add. I think that in 2018, we had a very low number of expiring bonds, which actually explains why it remained stable between 2017 and 2018. We have some renewals in 2019. That's why indeed the -- it has gone down slightly. On Fidea integration costs, I think there's -- I don't know whether we have given guidance on that, but that's certainly integrated into the overall business case. There is nothing spectacular about it, it's primarily some IT investments, some synergies that need to be taken, it's a low-double number at a million digit.

Q - Frank Kopfinger {BIO 16342277 <GO>}

And the CHF35 million profit contribution is net of these integration costs?

A - Gert De Winter {BIO 19720616 <GO>}

Yeah. It's net off. Yeah.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay. Thanks.

A - Carsten Stolz {BIO 6055047 <GO>}

But just on a -- if I may add -- Carsten speaking -- the CHF35 million that we had communicated when we announced the deal is the run rate after finalizing the integration. So that is the run rate after the end of integration.

Q - Frank Kopfinger {BIO 16342277 <GO>}

Okay, thanks.

Operator

The next question comes from Jonny Urwin from UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks, good morning. Just three from me, please. The -- I guess, just more philosophically, what you think [ph] the levers are that you have to manage low bond yield risk from here? Clearly, non-life performing well. What about the life? What can you do to sort of offset the yield pressure going forwards? Secondly, the 3 points of improvement in the underlying loss ratio and (inaudible) what drove that, please? And is it sustainable? And then finally, how are the German med mal reserves developing in the legacy unit? Thank you.

A - Gert De Winter {BIO 19720616 <GO>}

I'll try to tackle the questions at first, but I certainly think that Matthias and Carsten would add to that. In terms of low interest rate environments, basic, I think, asset management strategies, one to invest more in real estate on one side and secondly is with given the high exchange costs we are switching from U.S. bonds into Eurobonds. But Matthias will certainly deepen that point.

On the combined ratio, the normal development of last year reserves would be in 2 percent points to 3 percent points that has always been the historic average. There are -- it's certainly hard work to achieve these kinds of combined ratios. I think we have built over the last 10, 15 years, one of the best or the most profitable non-life books or portfolios in Europe. So we will continue to do that. Anyway, half year, we don't steer half year, so we should not overestimate the result in half year. And the German (inaudible) malpractice as half year and actually in a development of around zero. So it's fully reserved and under control. So it confirms actually the reserve strengthening we have done in the first half year of last year.

Although yields on low bonds --

A - Carsten Stolz {BIO 6055047 <GO>}

Maybe just to add to what Gert has already alluded to. First of all, we have rolled a small duration gap. So, we have invested into long-dated bonds, long time ago, that how -- that dampens, of course, the effect of the low interest rate environment. Secondly, we have changed the strategy, moving more into asset classes that deliver a high stable yield, such as real estate, corporate bonds and all the senior secured loans. And within the remaining bond portfolio, we try to optimize depending on the yield curve, depending on the FX hedging cost, optimizing by investing into bonds that deliver higher yields and sell those bonds that deliver highly-negative yields, and thereby we managed to dampen the negative interest rate environment.

So, since Matthias was talking about the left-hand side of the balance sheet and everything that can be done there and maybe I add a few points to what can be done on the right-hand side, meaning on the book itself. As you've seen on Slide 22, what brings down the average guarantee in the back book is the measures we are taking like reserve strengthening and business mix management. Those levers we've played over the last few years continually [ph], and they do help to adjust to the situation. Obviously, that is the back book management measures. And then also on the new business, we are very carefully with regard to what we are offering to the market in this environment, but this you're all aware of.

If I may just add a -- add some color to the non-life question that you had. We did have a very good first half year in -- with regard to the current year claims. After the end of half-year reporting period, we did have some natural claims in some of our countries and some large claims. So we expect this situation to normalize as we speak as we go into full year. The prior-year loss development contribution, again as Gert already said, is 2 percentage points to 3 percentage points, and it had tailwinds from the sale of the run-off operations as disclosed. So bringing it all together, as of today, we expect for full year to be at the low end of the 90% to 95% combined ratio, the target that we have set ourselves.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you very much.

Operator

The next question comes from Farquhar Murray, Autonomous Research. Please go ahead.

Q - Farquhar Murray {BIO 15345435 <GO>}

Morning, gentlemen. Just two questions from me. Firstly, just coming back to the life business. Thanks for reiterating the structural guidance of CHF300 million per annum. My question is probably a little bit shorter term, which is, could you give us a sense of how to think about modeling the second half of this year, given the interest rates were down 50 bps as compared to 28 bps in the first half and we are into new lows that I thought there's probably be some degree of free reserving?

And then secondly, FINMA has within the just last hour or so, and I apologize if you have no time to look at it, they kind of published some commentary on mortgage lending on investment properties and stated that it will actually also apply to the capital requirements for the insurance sector too. I just wondered if you had some -- perhaps, some preliminary understanding of that change and whether it's material to you or all the actual insurers in more generally? Thanks.

A - Carsten Stolz {BIO 6055047 <GO>}

Thanks Farquhar. So with regard to the obviously, the new lows that you alluded to on the interest rate side, I think given the dynamics and given the volatility in it, it's too early to make a statement with regard to the full year. We have also some offsetting effect. I would like to remind you that interest rate, obviously, play an important role, which our performance plays a role as well and spread -- credit spread development plays a role. So, that's why I said we are carefully observing and adjusting to the environment. There is still a long way to go, until year-end and if we -- we'll see where interest rate level and the other levers will finally lend at. But having said that, and that I want also to remain clear, if we remain at current levels, there will be further re-reserving needs in some of our portfolios. That's clear. Again, very confident with regard to the cash remittance capability of the life segment, which, as you know, is a performance indicator that I do like pretty much.

Now, with regard to the other discussion, apologize if I don't have exactly the communication that you alluded to, but I will have a look at it afterwards. But I'm -- we are fully aware of the discussions going on with regard to the valuations on the real estate markets. There is discussions on the banking side with regard to fear of overheating, especially on mortgages, so these discussions, we know. I haven't heard of any discussion that goes into the direction of measures tend to be taken on the insurance front.

Q - Farquhar Murray {BIO 15345435 <GO>}

Okay. Thanks.

Operator

The next question comes from Kevin Ryan from Bloomberg Intelligence. Please go ahead.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thank you. My question, I'm afraid to be boring again, is about the life business. Could you give us a few for your appetite for doing more group life business in Switzerland? And also traditionally, this has been a slightly lower margin business than some others, how you intend to manage that proposition going forward? Thank you.

A - Gert De Winter {BIO 19720616 <GO>}

Thank you, Kevin. We, of course, on a continuous basis, evaluate the strategy we follow in group life in Switzerland. We have been extremely selective in signing a new business taking into account the structure -- the age structure of the group and also the balance between the mandatory and the non-mandatory part in group life. And so it's very selective and every new business, we actually add, increases the profitability of the whole group. So that's one point. Of course, there is an exceptional volume effect in the first half year, which is due to the fact that AXA Winterthur from the group life business in Switzerland.

And of about, I think, the CHF670 million additional premium, about CHF560 million comes from AXA. But again, which is very selective signing -- underwriting guidelines, you might even call it a bit cherry picking. So we remain very selective and careful, but we are also committed to offering the full range of solutions to our clients. There is a lot of demand for the group life insurance. We also, of course, offer the semi-autonomous Perspectiva solution, which has grown substantially over the first semester too, so that's more or less our group life strategy moving forward. Careful, cautious, selective, but actually good profitable business.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thank you.

Operator

(Operator Instructions) The next question comes from Rene Locher, MainFirst. Please go ahead, sir.

Q - Rene Locher {BIO 1921075 <GO>}

Yes, good morning all. Well first of all on the life business -- the non-life business. And you have achieved a combined ratio of 87.4% in H1 although with the help of some PYDs [ph] and low claims.

Now for H2, when you target the lower end of the 90% and 95%, I mean, you're not very positive on H2, if I can phrase it that way. And then perhaps on -- I'm just standing, if I go to Slide 19, if I compare year-end '18, the Swiss business group life now with H1 '19, I could see an increase in the technical reserves, but the increase is mainly driven by annuitized and other. So I was expecting, given that you have taken on AXA business, I should see the increase in the non-mandatory or in the mandatory technical reserves. Perhaps you can explain a little bit the mechanics?

And last question if I may, the buyback, I mean, you started April '17, we are now at September '19, I've learned and (inaudible) 56% still to go on till April 2020 targets up to 3 million shares. Should I expect a bit of a speed up in the buyback in the coming months? Thank you.

A - Gert De Winter {BIO 19720616 <GO>}

Let me try to tackle at least a question one and three, and then maybe on the life reserves, I will leave it to Carsten. As said before, we have one of the most profitable non-life portfolios, which have -- we have built up over the last 10, 15 years, by focusing on target customer management, on operational excellence. So that's really a big assets, we of course are very pleased with 87.4% first half year, which was a bit of tailwind given the relatively claim-free claims -- not claim free, but relatively benign claim environment and the sale of the run-off portfolio. Going forward, as Carsten as already said, we have had some summer storms and larger claims, so there's a Tornado in Luxembourg which has -- had a big impact on the Luxembourg business. So we remain cautious, but are very confident actually to end up in the lower end of the 90% to 95% bandwidth of the combined ratio. But indeed, we expect second half year, as the traditional second half year, is mostly somewhat worse than the first half year.

On the buyback care program, indeed, we have -- we are fully committed to the buyback care program of 3 million shares. We have executed so far 1.6 million more or less, which is towards the 60%. Of course, the algorithms are targeted to trying to buy below the average price, which in an increasing share price, of course, slows down a bit the buyback program. So, we will accelerate over the next coming months to live up to the expectations and the commitments we have taken. On the life reserves, I would hand over to Carsten. Second question.

A - Carsten Stolz {BIO 6055047 <GO>}

Yeah. Well, thank you, Rene for the question, that is mainly an accounting effect, a major part that is in that unearned premiums, which will level out in full year. So, the AXA business is in fact as you're correctly stated in the mandatory and non-mandatory bucket.

Q - Rene Locher {BIO 1921075 <GO>}

Okay. Thank you.

A - Carsten Stolz {BIO 6055047 <GO>}

And to complete the picture, I mean, you've read that the overall AXA effect was CHF560 million effect in the first half of the year, both comprising continuous premiums as well as the one -- overtaking effect of the year of the book.

Q - Rene Locher {BIO 1921075 <GO>}

Okay. Thank you very much.

Operator

We have a follow-up question from Peter Eliot from Kepler Cheuvreux. Please go ahead.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much. Just a couple of a small points actually. First of all on non-life, Slide 14, I guess, its most of this place. But the other expenses went up quite a lot to minus CHF63 million this half year. I'm just wondering if there's anything in particular affected that? And the second question, I mean, you sort of -- you're well on track for cash and the life result and it hasn't really impacted the cash flows. Are you able to give us any numbers or any updates on what cash has been remitted in the half year? Thank you very much.

A - Gert De Winter {BIO 19720616 <GO>}

I think on the first part, there are of course some technical details on the expenses. I think the most important thing that happened there is, we are investing quite intensively in a new IT solutions and digital solutions, so that certainly is also an impact on the slight increase of the cost. So that's absolutely planned for and conscious that we are investing in these kind of solutions. On the cash remittance update, we don't provide the half-year updates on cash remittance. But we are very confident that we are at the end of the year, as Carsten already said, we'll deliver against the commitments we have taken going forward.

Something to add on the expenses in non-life, I don't know, Carsten?

A - Carsten Stolz {BIO 6055047 <GO>}

Yeah. Well, on the expenses in non-life, I think it's half-year figure, so there is a -- how do you say, an occurrence [ph] of effect, an effect that will split it into the two different parts of the year, so parts of that increase will level out on the yearly -- year-end basis. There is also elements in that that can be attributed to the Fidea transaction. So some transaction costs from the M&A transaction in the first half is in there as well, as well as some branding investments in FRIDAY, but the major effect is that it's the split between the two halves, where we have hurt more than in equal parts, it will level out over the year as we expect today.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you. Do you have a feel for what that should be on an annual basis going forward? I'm just wondering to what extent some higher investments might continue.

A - Carsten Stolz {BIO 6055047 <GO>}

No, guidance on that, I think we should -- we stick to the 90% to 95% overall in the technical performance guidance targets for non-life.

Q - Peter Eliot {BIO 7556214 <GO>}

Sure. Thanks very much.

Operator

(Operator Instructions) Gentlemen, so far we have no more questions.

A - Markus Holtz {BIO 20240672 <GO>}

Well, if there are no more questions, then I would like to thank you for an interactive Q&A. If of course there are follow-up questions, the investors relationship team is, of course, ready and able to answer the detailed question going forward. Having said that, again, thank you and again we are proud to present a strong half-year results and the high dynamics inside our beloved Baloise Group. Thank you very much.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call. And thank you for participating in the conference. You may now disconnect your lines. Goodbye.