Q3 2018 Earnings Call - Pre-Recorded

Company Participants

- Jörg Schneider, Chief Financial Officer & Director

MANAGEMENT DISCUSSION SECTION

Jörg Schneider

Ladies and gentlemen, welcome to the Presentation of our Q3 Results. I now have the pleasure of providing you with the key figures and main messages. As usual, the conference call later this morning will then focus on Q&As where I will be joined by Christoph Jurecka, my successor as Group CFO.

At slightly above €2 billion for the first nine months, Munich Re remains comfortably on track to achieve its full-year 2018 net earnings target. The stand-alone net result for Q3 amounted to €483 million. ERGO posted strong earnings, which were also helped by on-balance positive one-off effects.

Due to nonrecurring effects in life and health and high cat net claims, the technical profitability of the reinsurance segments remained slightly behind our expectations, although the P&C segment coped well with the accumulation of large losses.

There were also negative FX effects of €127 million as gains in U.S. dollars were more than offset by losses in Canadian (00:01:30) dollars, yen, and various emerging market currency positions in our diversified fixed income investment portfolio. The tax burden in Q3 was relatively high with 33%. But for the full year, it should still be in line with our guidance of 20% to 25%. When adjusting for nonrecurring items and allowing for normalized tax rate, the underlying Q3 profitability meets our expectations.

The annualized return on risk-adjusted capital was 10.8% for January to September, and the return on equity totaled 9.9%. Both figures are quite pleasing.

Let me start my review of our financial development with the investment result of €1.3 billion in Q3, resulting in an RoI of only 2.3% for the group. While the RoI of 2.9% in reinsurance was more or less in line with our assumptions for the full year, the RoI of 1.9% at ERGO is particularly low.

The balance of write-ups and write-downs was negative in both fields of business and this was mainly due to equity impairments. The result from derivatives was positive in reinsurance, but negative at ERGO due to losses on interest rate and equity hedging instruments. The disposal gains were very low as we preserve the high level of our valuation reserves.

In light of anticipated relief as regards the ZZR, ERGO had lower financing requirements and measures to optimize the international business portfolio let to disposal losses. The Q3 running yield of 2.8% remained fairly resilient, taking into account that regular income in the first two quarters profited significantly from dividends.

The average reinvestment yield continued to increase to 2.5%. In reinsurance, the reinvestment yield of 2.7% almost matched the high level of the previous quarter due to the high share of U.S. dollar assets. This makes us even more confident that in 2018, the reinsurance run yield will bottom out at last year's level.

Let me now give you the highlights by business segment. In life and health reinsurance, Q3 produced a technical result plus fee income of €88 million and a net profit of €159 million. This is somewhat below our aspirations for a single quarter after a very strong first half of the year. This is largely because we recognized a technical loss related to the disposal of our group insurance carrier, Ellipse in the UK. The sale, which is planned to be completed in Q1 2019 at the latest, should eventually have an overall positive impact on our result in the low double-digit million range.

The Q3 result was also negatively affected by a large single loss in Canada. Apart from that, aggregate claims experienced was largely in line with expectations. After nine month, we remain well positioned to meet our full-year guidance for the technical result plus fee income of at least €475 million.

In P&C reinsurance, the combined ratio amounted to 100.7% in Q3. Large man-made losses were relatively benign, but the well-known series of major events, including Hurricane Florence and Typhoon Jebi resulted in quite significant nat cat losses.

New major claims are occurring in Q3 were offset by positive runoffs for claims in prior years that amount to 5.5% of net earned premiums. This underlines our cautious reserving practice also for single large losses. As a consequence, total major losses accounted for 12.5%, just slightly exceeding our average expectation of 12%.

There were two severe natural catastrophes after the reporting date. According to very early estimates, Typhoon Trami could cost Munich Re around €150 million. Hurricane Michael will probably cost around €200 million or perhaps even more. We continue to set provisions for newly emerging claims at the top end of the estimation range and expect corresponding profits from their runoff over time.

As in previous quarters, notifications from basic losses for prior years remained significantly below the expected level. Releases of reserves on basic losses amounted to 4 percentage points of the combined ratio, fully in line with our guidance. The main drivers for the normalized combined ratio of 99.9% in Q3 are once again weather-related and other events in our North American Risk Solution (sic) [Solutions] (00:07:35) business.

Net cat activity is typically higher in Q2 and Q3. Since these events are below our outlier thresholds, this leads to a worsening of the basic loss ratio and consequently the normalized combined ratio. For the full year, we expect a normalized combined ratio slightly above our guidance of 99%, but we believe that our business continues to run with an underlying combined ratio of around 99% when taking account of these adverse developments.

That's all for reinsurance. I now turn to ERGO.

Even when excluding on-balance positive nonrecurring effects of approximately €80 million in Q3, ERGO continued its strong financial performance of the first half of the year. We are again very pleased with the progress under the ERGO Strategy Programme, which is running slightly ahead of its targets.

The very good Q3 results for the Life and Health Germany segment was mainly driven by a change in assumptions regarding the allocation of profits from the life back-book. Stabilizing measures in recent years have shown positive effects. Therefore, more of the earnings capacity of the portfolio can once again flow into the net profit without there being a negative impact on financial stability and eligible policyholder interests.

This assumption change results in a onetime net effect of around €170 million in 2018. This Q3 one-off effect was partially offset by nonrecurring effects from optimizing our international portfolio related to a sale of smaller entities in the Netherlands and expenses for our banking cooperation in Greece.

These affected the investment and technical result with a net earnings impact totaling around €90 million. Therefore, the net result of ERGO International remains below the level of the first two quarters despite a very strong underlying development. The combined ratio improved further to an exceptionally good 93.3%.

In P&C business, Poland once again made a particularly high contribution, mainly driven by motor business. The development of our health business was also very pleasing. DKV Spain benefited from an improved portfolio mix with a higher share of individual business, and DKV Belgium contributed substantially higher earnings.

For P&C Germany, the combined ratio of 94.7% is in line with our ambition for the full year. In all, the segment posted a small loss for Q3. This was mainly due to the unusually low investment result with an RoI of only 1.2% and a catch-up effect related to the investments for the Strategy Programme.

The group's capitalization remains very sound. IFRS equity increased marginally in the third quarter, mainly reflecting the net result of the quarter, a slight decline in unrealized gains as higher valuation reserves and equities were offset by lower gains in our fixed-interest securities and ongoing share buybacks.

At more than 260%, the Solvency II ratio increased quite significantly versus the end of June. The SCR remained stable, as operating earnings were quite in line with the expectations and variances from capital market parameter changes more or less offset each other, the main driver of high economic earnings was updated market values of the

Munich Reinsurance Company's real estate investments. This is reflected in an increase in eligible own funds of more than €1 billion.

In IFRS accounting, the impact of this effect on the investment income and other operating earnings in reinsurance amounts to a net P&L contribution of only around €100 million. The remainder is accounted for in higher off-balance sheet reserves.

The capitalization of Munich Reinsurance Company, the group parent company, continues to support our flexibility in terms of distribution to shareholders. As part of our active capital management, we started our new €1 billion share buyback program in June, of which around €400 million has already been executed.

Let me now turn to the outlook for the rest of the year. In comparison with the interim report for the first half year, we have changed the outlook for ERGO net earnings to above €350 million for the full year 2018. This is on the basis of its strong financial development in the first nine month. Due to positive premium development in the property-casualty reinsurance segment in the year so far, we are narrowing down our target range to €48 billion to €49 billion.

For Munich Re Group, we are standing by our profit forecast of €2.1 billion to €2.5 billion and are confident that we will reach the upper half of the range, although there remains uncertainty from major losses of capital markets.

Thank you for listening. I look forward to our discussion at 11:00 o'clock Munich time.