

Q3 2015 Earnings Call

Company Participants

- Francesco Caio, Chief Executive Officer
- Luigi Ferraris, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Alberto Villa, Analyst
- Anna Adamo, Analyst
- Unidentified Participant

Presentation

Operator

Good day, and welcome to the Poste Italiane 2015 Nine Month Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Luigi Ferraris, CFO. Please go ahead, sir.

Luigi Ferraris {BIO 7424315 <GO>}

So good evening, ladies and gentlemen. Before reviewing the nine months 2015 numbers in detail, let me start on slide number two with the relevant overall financial highlights. The nine months ended September the 30th this year delivered a solid set of results.

First, we delivered revenues and operating profit growth, marking the positive momentum already evidenced in the first half year results. Second, ongoing action aimed at reducing operating cost, which were caused [ph] by 3.5% in 2015 versus 2014. Third, strong cash generation to support our dividend policy. Overall, we are well on track in the execution of our transformation plan based on superior returns in transaction banking and asset gathering, growth in insurance and asset management, the turnaround in mail and growth in parcels.

Let's now move to slide number three. Consolidated revenues and profits increased respectively by 6% and 27% in the period. This is mainly due to first superior returns of the financial services operations; second, outstanding growth in gross written premiums of the insurance services; and third, expected decrease in mail and parcels.

In more detail, financial services operating profit increased by 44% from EUR477 million to 687 million. The increase is mainly attributable to capital gains realized from the active

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management of BancoPosta asset portfolio and lower recharges from the mail and parcel business.

Insurance services, revenues increased by 10% from EUR15.4 billion to 16.9 billion, and operating profit maintained a 13.2% growth year-on-year, mainly due to the ongoing positive performance of life gross written premiums. Mail and parcels revenues were at EUR2.8 billion, down 6.5% on 2014 and this expected decline relates to a reduction of traditional postal volumes.

Let's now move into each specific business unit results. Starting with the evolution in our financial services revenues on slide number four. The revenues mix remained substantially unchanged versus the previous year, with a marginal decrease of the weight of the fees from transaction banking, which was more than compensated for by the increase of postal savings.

In more detail and I am now on slide number five, the financial services provides a breakdown -- which provides a breakdown of the financial services revenues is driven by the following key points. First, returns on current account deposit, higher income from the sale of financial assets more than compensated for by lower interest income from deposits. Second, fees from postal savings collection, the increase is a consequence of a new fee structure indicated in the renewed contractual framework between Poste Italiane and (inaudible) underwritten in December 2014.

Third, fees from transaction banking, revenues decrease is mainly attributable to volume reduction of both payment slips and F24 tax form. Fourth, distribution fees, revenues growth is mainly due to higher upfront fees as a consequence of offering simplification as well as a more long-term strategic approach to partnership. And fifth, payment card fees mainly due to the outstanding performance of the new Postepay Evolution card, reaching 1.4 million cards issued to date.

Let's now move to slide number six. On active portfolio management, let me point out the following major items. An increase in average deposits of BancoPosta accounts moving to EUR44.9 billion from 44 billion in 2014, or up 2%. The unrealized capital gains amounts to EUR4.9 billion vis-a-vis EUR4.3 billion of the previous years and more significantly, vis-a-vis EUR3.5 billion as of the end of June 2015. This is mainly due to the favorable Italian spread reduction over the period.

Let's now move to insurance services on slide number seven. First, let me underline the ongoing increase of our life gross written premium evolution confirming Poste Vita as the number one life insurer in the Italian market. On top of that, let me also highlight that even if our presence in the non-life industry is still marginal, we are strategically focused on growing this business and recently finalized acquisition of 100% of S.D.S. System Data Software is supporting the execution of this strategy.

More specifically, this acquisition enhances our presence in the health sector. We will benefit from state-of-the-art skill centralized management of (inaudible) service structures, both private and public hospitals and payments. As far as our asset management

operations are concerned, the recent acquisition of a 10% stake of Anima and the relevant commercial agreements already finalized are accelerating our penetration into the fast growing Italian asset management industry.

Specifically at the end of September, we started the distribution of the first asset management product in partnership with Anima. BancoPosta Evolution (inaudible) and so far we have already gathered about EUR100 million. This testify the strength and the robustness of both the quality of the product jointly offered by the Poste Italiane and Anima and the proximity of our natural (inaudible) customers.

Let's now move to slide number eight, on mail and parcel business unit. I have already commented on the revenue side. On volumes, let me highlight here that, on one hand, the expected decrease in traditional mail volumes, which declined 10% year-on-year. On the other end, parcel volumes increased by 10% year-on-year confirming the positive momentum mainly driven by the growing e-commerce penetration in Italy.

Moving to slide number nine. Firstly, let me remind you that intersegment revenues decreased by 3.5% or EUR122 million mainly due to the implementation of new internal pricing scheme related to the recharge of the natural cost to the financial services business unit.

I would also like to talk you through the outcome of our relevant managerial actions aimed at reducing our operating cost. Specifically mail and parcel operating costs have been reduced by about EUR250 million over the nine-month period, mainly as a result of lower labor cost, which had been reduced by EUR190 million related to the ongoing restructuring program also, based on an early retirement incentive scheme, as well as reduction in other operating costs for a total consideration of EUR130 million.

Let me also remind you that on October the 1st, the new ESO Regulation was introduced. These new rules imply a new and more flexible pricing structure based on a J plus 4 regulated products, and J plus 1 free [ph] price priority product, as well as a new distribution scheme based on other day delivery, which will be applied to 25% of Italian municipalities once at regime. The new regulatory framework will enable us to better cope with a new delivery needs of our customer and to accelerate the implementation of our turnaround product.

Let's move now to slide number 10, focusing on our cost structure at a consolidated level. I will comment on labor cost in the following slide. Here let me focus your attention on other costs and changes in insurance and technical provisions. Other costs increased from 282 million to 857 million. This is due to the relevant change in the fair value evaluation of financial instruments mainly attributable to Poste Vita assets. Please note that this increase is fully compensated forth by a reduction in the insurance technical reserves valuation. Change in insurance technical provision increased by almost 6% versus last year and this is due to the (inaudible) significant life gross written premium increase.

Moving to slide number 11. Labor costs are down 2.5% or EUR112 million year-on-year moving from 4.5 in 2014 to EUR4.4 billion in 2015, and this savings is mainly relating to

mail and parcels. As I already outlined, this is the result of the implementation of our transformation program and the execution of the early retirement incentive scheme program, which will continue in the future.

Please note that labor cost reduction and efficiency represents a key pillar of the mail and parcels turnaround plan.

Let's now move to EBIT evolution on slide number 12. Net income for the period equaled to EUR622 million versus EUR333 million in 2014, or 87% up. On top of the already commented EBIT dynamics, this is related to net financial income which totaled EUR41 million and taxes for a total consideration of EUR350 million corresponding to a tax rate of about 36%, which can be considered a good proxy for the normalized tax year for the entire year.

Let's move on to slide number 13 on Group capital expenditures. The optimization of the (inaudible) investment program for the period is part of the restructuring program. More specifically, the majority of the investment program is mainly related to information technology and TLC networks. The balance is related to property requalification, construction of data center building and parcel logistic operations. Please bear in mind once again that our mail and parcels business unit includes also the sales network.

Finally looking at cash generation on slide number 14, while the positive operational performance, which is the result of delivery of efficiency improvements and CapEx optimizations allowed the Company to generate cash to the tune of EUR658 million before working capital valuation. The cash will be available to support our rewarding dividend policy which so far is based on a minimum 80% payout of the net consolidated profit of the years 2015 and '16.

Thank you for your attention and let me hand over to CEO, Francesco Caio for some closing remarks.

Francesco Caio {BIO 1516226 <GO>}

Thank you, Luigi, and good evening everybody. I just want to -- on page 15 just share some closing remarks. You've seen that the results we've announced today confirm the positive trends that we have reported in the first half of this year with growth and the main KPIs of revenues, operating profit and operating cash flow. But I also would like to emphasize that our execution transformation -- the execution of the transformation plan continues.

Luigi has briefly talked about cost reduction, I just want to highlight some example of the new services that we have continued to push and promote over the last few weeks. We have now reached as for instance, more than 1.4 million subscribers to the Postepay Evolution that is this relatively new pre charged debit card that was launched about a year ago. We've completed the acquisition of SDS, which is an IT platform that we want to rely on to broaden the health insurance services for our offer. We have launched in the month of August, a new app for BancoPosta that is very effectively driving the volume of digital

transactions and we have had more than 600,000 downloads for this app. And we have put in our distribution network, the new investment product that we have developed in partnership with Anima. Many of you remember that we acquired 10% equity of the Anima equity back in June.

All this platform clearly gave us a good momentum towards the end of the year. Just a couple of comments that I would like you to take note on, as we begin to project year-end. The first one is that in Q4, we will accrue the transformation costs for the year 2016, that is similar to what has happened in 2015 and will be obviously an element of particular, if you wish, in the context of this year the one-off cost that we will be accruing. We've had the opportunity in discussing with many of you in the last few weeks to indicate that this is in a way year after year a recurring element of our transformation costs, in the context of the year, the costs will be accrued all of it in Q4.

And the other one that, you know, that we've reported the profit through the active management of our portfolio in quarters one, two and three. We expect at the moment to have a more contained profit from unrealized gains of our portfolio of government bonds from BancoPosta versus previous quarters. So good results, clear evidence of transformation gaining momentum, some particular elements to be taken into account in Q4, but all of that would not be divert the Company from a trajectory that notwithstanding the impact of the previous two point, we continue to believe we'll deliver full year 2015 which will be representing a marked improvement on the full year 2014.

I understand that this is an opportunity for you to ask some questions. And if you have some, we would be happy to provide indications to the extend we can.

Questions And Answers

A - Unidentified Speaker

Okay, thank you very much. We are now ready to start the Q&A session. I understand that we have Mr. (inaudible) from Mediobanca ready in the line to start the session. So Zanduka [ph] please go ahead.

Q - Unidentified Participant

Yeah, good evening, everybody. I have some questions. The first one is related to the transformation cost, you mentioned for Q4. And I was wondering if you can give us a bit more color behind these provisions you will make in Q4. And to understand if we should expect a net loss in the quarter or it will be a quarter with still some profits. The second question is related to the headcount reduction. I was wondering if you can give us the detail of the 1,000 people left the Group in the past 12 months, considering the people who got the early retirement package the natural churn, and new hiring you made in the period.

The third question is regarding P&C, also in the light of the acquisition you just made. If you can guide us in terms of how much you believe you will make in terms of premiums in the P&C segment in '15 or in '16. The fourth and final question is on the operating cash

flows. The number looks very high 658 million, including some CapEx that I would have expected to be a bit higher 229 million. Can you guide us on the full year CapEx you expect to book in 2015? Thank you very much.

A - Luigi Ferraris {BIO 7424315 <GO>}

So, Zanduka, this is Luigi. Let me start from the first question related to the transformation costs in the Q4. Well, as Francesco said, we are going to post in the last quarter the accrual for related to the restructuring cost, which will take place in 2016. As long as the other year, we are finalizing the discussion and the planning in the last quarter. And here we are talking about a size which is going to be a little bit lower than last year, because last year we had (inaudible) accrual for a total consideration of EUR300 million plus. This year, we are going to be lowering that even if as we said, we are going to post an accrual which will be very close to that number, which means that in the last quarter, you will see some one-off item as Francesco said, which will influence the expected profitability in the fourth quarter. Of course, I'm not in a position to say what will be the sign, but I leave it to you the calculation of what could be the impact of this one-off item, which will be fully concentrated in the fourth quarter (inaudible).

When we talk about headcount reduction, we report the average because we have to understand that in this Company, we are dealing with also temporary workers, which influences the number per se. So if we talk about the impact in terms of cost reduction, as I said before, the total cost of personnel (inaudible) about EUR120 million. And I can say that, starting in the region of EUR50 million is related to effective volume -- number reduction. We do expect that in the fourth quarter this number will further increase in terms of expected reduction of the average workforce. But the positive impact on profit and loss just related to volumes is about EUR40 million, EUR45 million.

Going -- the other question were related to the expected evolution in terms of premiums or revenues on the non-life business, well, we are starting to develop a new business segment. And of course, it takes a while before launching this business. We are confident that is going to be successful in the coming years. Thanks to our customer base and to our strategic position, but we have to wait time and to be more specific, you need to wait when we are going to present the new, the Industrial Plan in the coming year.

Cash flow generation. Well, we have reported a level of CapEx which is the result also of our rationalization optimization programs. Therefore, we do expect that the rates on a full year basis or the value on full-year basis of CapEx will be in the region of EUR400 million, taking also into account what we have spent up to now and what we have in our backlog. But definitely, we do expect to be very effective in rationalized optimizing the decision when it comes to the CapEx evolution and in particular to spend our money better in a more focused way. I would stop here.

Q - Unidentified Participant

Yeah, thank you.

A - Luigi Ferraris {BIO 7424315 <GO>}

Thank you.

A - Unidentified Speaker

Thank you. The next question is coming from Alberto Villa, Intermonte.

Q - Alberto Villa {BIO 16005221 <GO>}

Hi, good evening to everyone. A few questions from my side as well. The first one is on the, question, if it's possible to have the AUM evolution, so the AUM that Poste Italiane Group has got at the end of September broken down by the main areas and the same, if possible, on the net inflows. And the second question is on the net inflows for asset management. You just started with the launch of the first, let's say, product coming from the partnership with Anima. I was wondering if you can share with us, sort of general targets on what you are expecting to generate in terms of net inflows in 2016 out of this partnership, and eventually out of other -- the distribution of products of other asset managers.

And the third one, it's very interesting the slide at page 27 that allow us to understand better how it move -- the movements between the single segments, but I was wondering if you can give us any indication about the recharges that I understand were a little bit lower for the financial segment coming from mailing going forward, just to understand how to model this number going forward if you can help us understanding that a little bit better.

And the last one is on slide five regarding the evolution of the revenues for the single divisions of the financial services. Just trying to understand if fees from transaction banking decrease of around 11% is something that we can assume as a good proxy of what to expect going forward.

A - Francesco Caio {BIO 1516226 <GO>}

Okay. Thank you very much. Let me address couple of your questions. On the Anima products, as you said, we just recently launched the service. Basically, at the end of the month of September, we will be reporting some further indication of how the product is performing obviously at the beginning of next year when we report the numbers of last quarter. But in general, let me tell you that the way we look at this development is not dissimilar from the one Luigi was talking about a second ago on health service insurance and P&C. These are areas that we see as mid to long-term growth opportunities. We've been encouraged by the reaction of our distribution netted [ph] to be Anima product is obviously still marginal in the context of this year's numbers. I would ask Luigi then to elaborate a bit on the movement of the various category of assets under custody.

A - Luigi Ferraris {BIO 7424315 <GO>}

Yes. Well, firstly just to complete the first part of the question, the assets under management or administration if you want, because I think, in order to provide you with a global picture, I'll try to give you the breakdown as of September 2015 of what we have in terms of asset under administration management. When we talk about for instance, postal

savings at the end of September, we have (inaudible) of assets under administration. This is just a picture at the end of September, it is not the average. It is a picture.

Then we have about EUR100 million which is related to the insurance works, to be specific, EUR97.5 billion then we have asset under management for EUR5.4 billion. So the total value of asset under management is about EUR103 billion. Then we have the current account deposit for a total consideration of EUR44.9 billion. So all together, we should lend about EUR470 billion, EUR471 billion in total.

Moving to the other question, and if I'm not wrong, you were asking about the recharge from the different segment. First of all, let me confirm that we had a decline in September in terms of recharge from the mail and parcel to the financial services of about EUR120 million. This is the outcome of the change in the transfer price policy defined at the beginning of the year effective from 1st of January of this year, which is now based on a percentage of the total revenues of the financial services. Roughly speaking, we're talking about 80%, something around 80% plus of the total revenues as a parameter to be used to calculate the recharge of the costs of the (inaudible) again from mail and parcel to the financial services.

Just bear in mind that there are some other minor items, so very, very minor related to some costs that are in the book of the mail and parcels, which are recharged to financial services, for instance, some IT costs, but the vast majority is -- the 100% is related to the sales network. And I mean this is expected to continue also across -- around the year. So we do expect by the end of the year to have a decline in this recharge on the basis of this new transfer price policy, which is by the way also in line with the best practice and the Bank of Italy indication.

Then I think there was another question related to the fees from transaction banking, how do we -- how -- do we consider this minus 11%? Well, I think it's probably we do expect a slight improvement, but the 10% type is a decline that we can consider reasonable for the entire year. There might be some recovery at the end of the year, but bottom line we are talking about 10% decline.

Q - Alberto Villa {BIO 16005221 <GO>}

Okay, thank you. Thank you very much.

A - Luigi Ferraris {BIO 7424315 <GO>}

Welcome.

A - Unidentified Speaker

Thank you. (Operator Instructions) So the next question is coming from Anna Adamo, Autonomous Research. Please Anna, go ahead.

Q - Anna Adamo {BIO 16893946 <GO>}

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Hi, good afternoon everyone. My first question is related to the bond portfolio. Can you quantify how much realized gains have contributed to the operating profit of BancoPosta in 3Q? And the second question is related to that, and is regarding the duration of the portfolio, which has increased a lot during the nine months. Have you have a target in mind regarding duration, do you expect it to further increase the duration of the portfolio or should we expect this to remain stable? And finally, my question is regarding the 1.2 billion receivables from (inaudible) and when do you expect this cash to finally come in? Thank you.

A - Luigi Ferraris {BIO 7424315 <GO>}

Okay, thank you. So with regard to the first question, in 2014 we have reported a capital gain of about EUR339 million, EUR340 million, whilst this year we have reported EUR100 million more, so about EUR440 million. So there is a difference of EUR140 million. When it comes to the portfolio duration, yes, we have extended during the course of this year, because we have changed a little bit our portfolio by extending the maturity and by buying some new bond with longer maturity. But in the meantime, we have further benefitted of the interest rate scenario, which today as you know is improved versus what we have seen, for instance, at the end of June. Thanks also to driving decision [ph]. And that's why at the end of September, we have up calculated an unrealized gains in the region of about EUR4.9 billion. The strategy here is the same, there are no change. Our target is to maintain a stable return or stable level of revenues with regards to the management portfolio of this cash, this assets in the region of a couple of billion euro per annum. As of now, I think it is good that we have been able to extend the maturity, but we have also taken advantage of the current interest rates on that.

A - Unidentified Speaker

Okay, thank you. The next question is from (inaudible).

Q - Unidentified Participant

Hi, good evening to everybody. I have a couple of questions and a follow-up on a previous question. The first one is related to the -- you reported good improvement in volumes in the postal business in the third quarter. Just wondering if you can give us an indication of what is happening in terms of volumes after the kick in of the price restructuring?

The second one is related to the parcel business. You provided the trend in volumes, but I haven't seen trend in revenues in the nine months, maybe my mistake. If you can give us an indication and also a general comment on volumes trend for the overall market. And then a follow-up on the Zanduka question on the transformation cost that you are going to book in the fourth quarter. You said that last year, just a clarification, you charged 300 million, I was wondering 408 reported in your 2014 accounts, if you can kindly clarify. Thank you.

A - Francesco Caio {BIO 1516226 <GO>}

First of all couple of comments on your questions on the postal business. You haven't missed anything. We haven't reported the breakdown in revenues. We've reported the

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integrated revenues of postal parcels and then the breakdown in volume. And I think this is going to be like this for a while, as we continue the restructuring of the cost base in the processes that are to certain extent common.

The other thing that you were asking is the evolution of volume and price and the impact of the recent price adjustment, if I understand correctly -- said in the past, the prices have been adopted in the first half of the month of October. We intend to report and give some visibility to the market about the impact and the consequent price elasticity of the curve when we report numbers for Q4, which is going to be with the full year. And I don't know if Luigi want to --

A - Luigi Ferraris {BIO 7424315 <GO>}

Yes, with regards to the accrual related to the pre-incentive program reported in 2014, let me be a little bit very specific. The actual number say that, we have reported in total about EUR400 million, but the portion of that was related to 2014 and the portion of that was related to the following year. The portion related to the following year is in the region of EUR250 million. And we therefore all in all, last year we spent just a little bit lower or something in the region of EUR400 million.

What I said this year with regards to the expected accrual related to pre-retirement programs in 2016, we expect something in the region of EUR300 million. That's what we said, but it is too early to say, because we are still finalizing the exact number as Francesco said in the second quarter. So it will be lower than last year all in all and it is clear, but the precise number is not yet there.

Q - Unidentified Participant

Yeah. Thank you for the clarification.

A - Unidentified Speaker

Thank you. (Operator Instructions). Okay, thank you. I understand there are no more questions, thank you very much for (inaudible) this call. Of course the Investor Relations department will remain available for any further request. Thank you very much and (inaudible) thank you.

A - Francesco Caio {BIO 1516226 <GO>}

Thank you.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.

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