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Q2 2017 Earnings Call

Company Participants

- Kjetil Ramberg Krøkje, Head of Investor Relations
- Lars Aasulv Løddesøl, Group Chief Financial Officer
- Odd Arild Grefstad, Chief Executive Officer

Other Participants

- Jonny Urwin, Analyst
- Matti Ahokas, Analyst
- Paul De'Ath, Analyst
- Peter D. Eliot, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Storebrand Analyst Call. My name is Anna, and I will be your coordinator for today's conference. For the duration of the call, you will be on listening-only. However, at the end of this presentation, you've got opportunity to ask questions.

I will now hand you over to Kjetil Krøkje to begin today's conference. Thank you.

Kjetil Ramberg Krøkje

Good evening, ladies and gentlemen. Welcome to Storebrand's second quarter 2017 conference call. My name is Kjetil Ramberg Krøkje, and I'm Head of Investor Relations at Storebrand. Together with me I have Group CEO, Odd Arild Grefstad; CFO, Lars Løddesøl; and Head of Economic Capital, Trond Finn Eriksen.

In the presentation today Odd Arild will give an overall view of the development in the second quarter and year-to-date 2017, and Lars will give some more depth on the results. The slides will be similar to the analyst presentation released this morning and are available on our webpage. After the presentation, the operator will open up for questions. To be able to ask questions, you will need to dial into the conference call.

With this, I now leave the word to Storebrand's CEO, Odd Arild Grefstad, who will start the presentation on slide 2.

Odd Arild Grefstad {BIO 5483351 <GO>}

Thanks, Kjetil, and thank you all for joining the call. Let's move directly to the results. The group results before amortization and write-downs was NOK 878 million for the quarter and NOK 1.549 billion for the first half. It's very satisfying to see that the operational result has a positive development due to growth within savings and good cost control. In addition, a strong financial result characterize the overall result for the quarter.

The growth within savings continues, while the guaranteed products are in long-term runoff. Growth in savings is illustrated by an asset growth of 18% within unit-linked compared to last year and 9% growth in asset management. Retail bank has a strong growth of 28% within retail lending, and by this we are the fastest growing bank in the Norwegian market. The underlying solvency position is increased by 5 percentage points during the quarter to 152%, and the solvency ratio including transitionals are 163%.

If we then move to slide number 3, this slide illustrates the two-fold strategy we have been implementing consistently throughout the past five years. The two-fold strategy will continue to be important going forward, with capital-light growth within savings and insurance and capital release from the guaranteed back book, which has reached its peak capital consumption level or peak capital.

If we then move to slide number 4, we can take a look at the changes in the solvency position in the quarter, and to explain the 5% increase in solvency there is three important factors. First, model and assumption changes causes a 2% point reduction in the quarter, and among other things, it's a small change in the cost allocation in this element. The second is that Storebrand has achieved a very good result in a quarter, which has contributed to increased solvency position. The increase in the paid-up policy portfolio reduces the solvency in the quarter. Summarized, the strengthening from the operations are 3% points, which is somewhat higher than they expect on a quarterly basis.

The third element is impacted by good financial markets in the second quarter. This means that we have not only achieved the expected risk premiums in the market, but also achieved returns beyond what we can expect on a normal quarter. The increase in interest rate has positively affected the solvency position. We have chosen to look at this as economic variance, and that contributes with 4% points in the quarter.

Then on slide number 5, we have the movement in Solvency II ratio described as we used to present it to you historically. It is worth noting that a 50-basis-point parallel shift of the interest curve (04:57) will – from today's level will still give a solvency ratio without transitional rules of about 140%.

Then if we move to slide number 6 and give us more update on the costs. We had a flat nominal cost level between 2012 and 2015. At our Capital Markets Day in 2016, we announced a new target to a flat nominal cost between 2015 and 2018. Since we announced the cost target, our cost base has been affected with a NOK 60 million increase on annual cost from the new financial tax in Norway. And we have also reallocated costs in order to support areas within strong growth, such as asset management and the digital development. In the same period, the number of employees has been reduced by 12%, that is 220 employees, from the beginning of 2016. We are now at a run rate of approximately NOK 800 million a quarter in costs and we will, of course, continue to have strong focus on cost improvements also going forward.

Then let's move to slide number 7. I have already discussed and commented on the strong growth within our savings area. A few comments now on insurance. The profitability within insurance is good, but the growth within insurance is lower than we want to see going forward. This is caused by the shift from expensive external distribution to more cost-effective internal distribution. This, and even more the transition to a new disability pension project in Norway, implies a lower growth rate for insurance in 2017.

Then we can move to slide number 8. This quarter, Storebrand Asset Management has passed NOK 620 billion in assets under management. This study from PVC (sic) [PwC] (07:29) shows that we have a very competitive cost/income ratio compared with even the large asset manager with substantially more assets under management. This means that we have a very effective scalable platform in our asset management, and the reason is that we have a cost level at around 8 to 9 basis points of assets under management.

To continue with asset management, let's move to slide number 9. One of our main growth engines have been the Swedish mutual fund company, which has grown by 20% annually over the last nine years. We are now the fifth biggest fund manager in the Swedish market after the four big Swedish banks. We see the strongest growth within external assets, discretionary mandates, and in the Swedish retail market. Revenues from the Swedish part of the asset management now amount for 32% of the total revenues in asset management and 40% of the assets under management. We are now further strengthening our distribution capacity in Sweden and also utilize our full scale, our full – our scalable Nordic asset management platform in the Swedish market and expect also strong growth going forward.

Then let's move to slide number 10, and now we are back in the Norwegian market. And finally, the Norwegians will get individual pension product, as we call IPS with real tax incentives. The Norwegian Parliament introduced the product in connection with the revised national budget in 2017. The IPS scheme enters into force from 1st of November, 2017. Savings up to NOK 40,000 per year are tax deductible in ordinary income. And in addition, there are deferred tax return and exemption from wealth tax.

The government has now enabled private pension savings with real tax benefits. And there is a great need for increased pension savings in Norway and we look forward to enter into this market.

Storebrand is well-positioned for individual pension savings with our pension expertise, sustainability-focused asset management, and several world-class funds with good historical return. This market is, of course, starting from zero, and it will not be a boost on the result on the short term. But, of course, this is long-term money and with a strong growth profile going forward.

Then finally let's move to slide number 11. As I mentioned talking about the cost earlier, we now shift our activity into more digital solutions. On the operational side, it is worth noting that we have made successful payouts from the new Swedish core system. This is a large undertaking in the Swedish subsidiary (10:59), and it's great to see that it's running as planned.

During the quarter, we have formed new important partnerships that further digitalize our business model. Storebrand has partnered with the fin tech app Dreams for distributing savings. Launch of Dreams in Norway, in cooperation with Storebrand, will take place this autumn. The app was launched in Sweden in 2016 and has currently 80,000 registered users in Sweden. We have also developed Norway's first and only electrical car in France in cooperation with Norwegian Electric Vehicle Association. This product will be launched in August, 2017.

And lastly, we have piloted our insurance Chatbot this quarter. It is really interesting to interact with it. And given that it is the first version, I'm quite impressed and excited about rolling out this technology in that business.

And by that, I give the word to Lars to go a bit deeper into the numbers.

Lars Aasulv Løddesøl

Good afternoon, everyone. Please refer to page 12, key figures. In the upper left-hand corner, we show the results split into operating results, financial results, and special items typically of a non-recurring nature. This quarter the operating result is a solid NOK 565 million. We have previously communicated that this figure will come in at approximately NOK 500 million per quarter, and gradually grow from there.

With the numbers we present today, we confirm this trend. A normalized result will be somewhat above NOK 500 million going forward. Please note, however, that the results will swing around the normalized number and the significant market movements naturally will impact the actual future profitability.

We have been able to harvest good premiums in most asset classes this quarter, which has generated good returns to customers and the company. The good returns have been used to build a high book return and additional buffers. We have also generated an unallocated result of NOK 3.7 billion, which will be allocated between owners and customers at the end of the year. Part of this result will be used to formally finalize the longevity reserves strengthening, while the majority of the rest will be used to further strengthen our buffers.

Earnings per share after tax and adjusted for amortization of intangible assets come to a strong NOK 1.89 in the quarter.

Please turn to page 13. The top line, fee and administration income, is once again growing in the quarter and year-to-date. We have gone through a period where the runoff of revenues from the guaranteed business has been faster than the growth in front book revenues, but this is now turning. The results from the insurance business are also improving in the quarter and year-to-date.

In the reported numbers, it looks as if the cost line has been growing, but this is explained entirely by a one-off gain of approximately NOK 100 million in the second quarter of 2016. The underlying cost level is developing according to plan, and there is generally good cost discipline across the group. The financial results are strong. This is explained by the previously announced sale of our shares in Formuesforvaltning that generated a gain of NOK 88 million, combined with strong returns on company funds and profit split from the Swedish guaranteed business. The tax charge in the quarter is only 4%, as the gain from the profits from Formuesforvaltning sale is exempt from tax and because of estimated return taxes from last year.

Please turn to page 14. The top table in this picture is the same as on the previous page. The bottom table splits out the results into three categories: savings, insurance, and guaranteed. We see the improvements in all three areas, despite the previously mentioned one-off gain in the comparable numbers from 2016. Under other, we include the result from the sale of Formuesforvaltning shares. Excluding this, the underlying number is around zero, which is around normalized for this area going forward.

In summary, we have delivered a good result so far this year and the group ROE ended at 13.4% for the quarter and 10.9% year-to-date.

And with that, we open up for questions.

Q&A

Operator

Thank you. We already have three questions coming through, and the first one is from Paul De'Ath from RBC. Please go ahead, your line is now open.

Q - Paul De'Ath

Yeah, hi. Thanks for taking my questions. A couple, please. Firstly, on the DB to PUP conversion rates, there was another NOK 5 billion that moved across during the quarter. Was that kind of larger than you had expected and/or was it kind of in line with ongoing expectations? And I guess on that, how does that impact anything going forward? Does it change anything around the speed at which capital could come back to shareholders? That's question one.

And then the second point was just on the insurance business, looking at the claims ratio in the quarter, it improved significantly, particularly in the health business, which I think was due to dissolution of reserves within employers' liability. I just wanted to check, is that kind of a one-off prior year gain coming through? Obviously, we expect a much lower claims ratio going forward in that business. Thanks.

A - Lars Aasulv Løddesøl

Okay. So I'll take the first question, the conversion from defined benefit. In the first – or at the year-end last year, we had a slightly higher conversion from defined benefit to paid-up policies than we anticipated, as explained in the first quarter. What you see in the numbers in the second quarter is that we have in the – due to the change in disability – public disability pension in Norway and a consequential change in the legislation around disability insurance for occupational pensions, all of our occupational pension coverage that was previously included in defined benefit plans by force goes into paid-up policies. And that's the main explanation of about NOK 5 billion of the conversion in the second quarter.

It must be said, however, that this disability portion of – that becomes paid-up policies has a lower guaranteed rate of return and a much shorter duration. It only has a duration until people retire, not after the retirement. So it's a short duration and a low rate of guarantee. And the change taking place as a consequence of the legislative change in disability pension has been finalized with this, so there is no more to come. So from here on, we expect normal transition away from defined benefit to paid-up policies at a declining pace going forward. And in terms of what it means for dividend capacity and other things, it has been truly been absorbed by the solvency numbers, and thus as such has no further impact on any solidity numbers.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Yes. On health and group life, there was an effect from dissolution of reserves in the quarter. We have an overall combined ratio of 88% in the quarter. If you adjust for the dissolution reserves, we are in the targeted range of 90% to 92% combined ratio. And that's what we're going to continue to target going forward.

Q - Paul De'Ath

Great. Thanks very much.

Operator

And the next question comes from Matti Ahokas from the Danske Bank. Please go ahead. Your line is now open.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes, good afternoon. It's Matti Ahokas here from Danske. Two questions, please, both on the fee and admin income in Q2. Firstly, you mentioned that the margins in Sweden on the unit-linked side were improving. What was the reason for this? Was it one-off or should we expect that the margins remain at this level?

And the second is actually slightly the same, but on the DB business in Norway. The reserves, as you said, fell quite a lot, but then the fee and admin income went up. Was this because it happened late in the quarter, or how come the margins also in that business improved during the quarter?

A - Lars Aasulv Løddesøl

If I take the first question. I think we said in the first quarter that the defined-contribution margin or unit-linked margin in Sweden was a little lower than we expected going forward. And if you look at the quarterly numbers, they typically vary a little bit around these levels from quarter-to-quarter. So I think you can basically look at the average of the first and the second quarter as an estimation as to where it's going to go forward, and we don't see a trend in these numbers neither positive nor negative. So that's basically just a normal variation.

[05JRJM-E Odd Arild Grefstad]Yeah. On the DB portfolio in Norway, yeah, I'm afraid it's little bit of the same answer. If you look at year-to-date number, that should be okay estimation going forward. And there's some [ph] prioritization (21:31) on when these different contracts are billable that comes into the numbers.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks a lot.

Operator

The next question comes from Peter Eliot from Kepler. Please go ahead, your line is now open.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you very much. If I could just follow-up, first of all, actually on one of Paul's questions. Just to clarify, that NOK 5 billion was transferred, could you – apologies if you said this, I missed it. But could you say how much of that was from the change in disability legal definition of customization (22:12)? And then, my first main question was the Q1 results, you very helpfully showed us the capital requirement of the first parts of the business and guaranteed business is like NOK 15.8 billion. Are you able to give us an update on that at all?

And then secondly, the financial result for SPP, I guess, was quite a bit higher than the, I guess, what we sort of estimated from the sensitivities that you provided. I'm just wondering if you could give us a little bit of color on that.

And then final point, just to prove I'm paying attention and just to prove I'm trying to understand the growth of the unit-linked reserves in the quarter, in your presentation you show NOK 151 billion. But in your supplementary information, you show NOK 71 billion for Norway and NOK 83 for Sweden, so NOK 154 billion total. Just wondering if you could clarify what the difference is or which number I should be going on there. So, obviously, makes it a double – the delta across the quarter is doubled on one versus the other. Thank you very much.

A - Lars Aasulv Løddesøl

If I pick up on the first one, the conversion from DB to PUP. I said NOK 5 billion was the – only the conversion of the disability proportion. In terms of savings, we see approximately NOK 1 billion in terms of conversion per quarter. And as I said, that is declining. So last year with NOK 7.6 billion, we estimate a similar number this year, and then going down from there, and then in addition consist NOK 5 billion from disability.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Yeah. Second question on capital requirements development, we haven't given update on that, Peter, and I don't think we're going to do that whole exercise each quarter. Basically what's happened is that the solvency ratio has been improved. And in that sense, that capital has been tied up, but it's not any large changes as such in the distribution between the various product lines.

On the SPP financial result, main deviations here from the sensitivities was the slope of the curve that changed the discounting as it uses the same discounting as the Solvency II interest rate curve with the Smith-Wilson extrapolation model. This has an effect that can't (24:55) be read out from the sensitivities. And in addition, we had some returns from real estate, which is ultimate reflected in sensitivities.

A - Lars Aasulv Løddesøl

Yeah. I can also add to that that on the interest rate curve in Sweden, we are using the volatility adjustment similar to the one we used for our solvency calculation and volatility adjustment of 1 basis point during the quarter, which also has minor effect.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

And on the last question, Peter, in my supplementary, I still get NOK 151 billion also on the unit-linked Norway and Sweden combined. We can compare notes afterwards, but I can't find the NOK 154 billion right now. But it might be a mistake somewhere. So if that's the case, then my apologies.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay. I was just adding the two numbers up at the bottom of page 12. But that's great. And apologies if I'm not paying attention on the first point on the transfers. Thank you.

Operator

The next question comes from Jonny Urwin from UBS. Please go ahead. Your line is now open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Well, thanks for taking my question. Just two from me. So, firstly, on slide 4 the solvency walk. Thanks for providing that again. I just wondered why the treatment of new paid-up policies is included in the model and assumption change rather than the operating earnings. Is that because of the sort of one-off nature of the NOK 5 billion conversion? And if we didn't have that NOK 5 billion, would you include it in the operating earnings? I guess, I'm just trying to figure out, because, obviously, you're giving 5% to 10% Solvency II cash flow generation guidance. That is after the paid-up conversions, I assume.

And secondly, the buffers in Norway, they've obviously trended down for quite some time now. You mentioned that they're going to be sort of topped up at the end of this year. I just wondered where do you see the appropriate level for those buffers once the top-up's been done. Thank you.

A - Lars Aasulv Løddesøl

I can start with the walk of the change in the solvency position. The changes coming from conversion from DB to paid-up policies has to be viewed in connection with the surplus return in the portfolios. It's quite technical, but the way we get the reserves from our systems make this somewhat hard to separate. That's why it's included in the economic variance, as such.

Q - Jonny Urwin {BIO 17445508 <GO>}

So every quarter it will be included in the economic...

A - Lars Aasulv Løddesøl

Yes, it will.

Q - Jonny Urwin {BIO 17445508 <GO>}

Well, it says – you're splitting it once, say, this (28:23) in model and assumption changes rather than the...

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Yes. Sorry, Jonny. It's two different things. The one that's on model and assumption changes is actually an assumption change on how we invest new paid-up policies. So it's more, I would say, a correction of the model on how we invest new paid-up policies. So we say that when you now get new paid-up policies, which has high buffers and have more risk capacity, we will invest them in slightly more risky assets than the average paid-up policy. This gives us slightly negative effect on the solvency calculation. So that's just a...

Q - Jonny Urwin {BIO 17445508 <GO>}

It's basically a one-off model change. That makes sense.

A - Lars Aasulv Løddesøl

Yeah.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

And it also, obviously, makes you expect – give you a higher expected return.

Q - Jonny Urwin {BIO 17445508 <GO>}

Sure.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

I think it was a question about buffer levels as well on paid-up policies. And it's difficult to say exactly what is the right buffer level, because we have different sub-portfolios here, and some of these portfolios are truly reserved with all the necessary reserves, other have very little reserves, and we are trying to build that up. The more reserves we have, the better we are suited to deal with future financial volatility or market – volatility in financial markets. So I think the maximum in all portfolios is around 8%, but it's never going to beat that area, but somewhat up from 5.3% makes sense at the current – in the current market.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thanks very much.

Operator

There are no questions coming through, so I will now hand the call back to you. Thank you.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Okay. Then I just want to thank you all for joining the call. For those of you who have not had a summer vacation yet, we wish you all a nice summer vacation. And I hope to see some of you in London tomorrow. Thank you.

Operator

Thank you for joining today's conference. You may now replace your handset to end this call. Thank you.