Q2 2012 Earnings Call

Company Participants

- Jarmo Salonen, Head IR
- Kari Stadigh, CEO and President
- Peter Johansson, CFO
- Ricard Wennerklint, Deputy CEO If P&C

Other Participants

- Blair Stewart, Analyst
- Gianandrea Roberti, Analyst
- Giulia Raffo, Analyst
- Hakon Fure, Analyst
- Hans Pluijgers, Analyst
- Matti Ahokas, Analyst
- Robin Buckley, Analyst
- Unidentified Participant, Analyst
- Vinit Malhotra, Analyst

Presentation

Jarmo Salonen {BIO 1860650 <GO>}

Ladies and gentlemen, welcome to this conference call on Sampo Group's Second Quarter 2012 results. I'm Jarmo Salonen, Head of Investor Relations at Sampo. And with me I have Kari Stadigh, our Group CEO and President; Peter Johansson, our Group CFO; and Ricard Wennerklint, Deputy CEO for If P&C. We'll have the same procedures as always. I'll hand over to Kari in a few minutes. And, after Kari's introduction into Q2 developments, we'll take whatever questions you have.

Let me remind you that you can follow this on our Website, Sampo.com/results as a live transmission. And a recorded version of the call will later be available at the same address. And it's actually result, not results, the correct address.

I'll hand over to Kari for his introduction.

Kari Stadigh {BIO 1504152 <GO>}

Welcome to the conference call on my behalf as well. Sampo had a very strong quarter and reports a profit before taxes of EUR440 million, up 19% compared to the same period last year. An EPS of EUR0.66 for the quarter is the best ever result when looking at Sampo Group in its present form, including our associated company, Nordea.

In our previous conference call three months ago, you could already hear how confident we were with our non-life operations. The first half year numbers are impressive. A return on equity of more than 34%. And the combined ratio is the best ever for the half year, at 89.4%. And the standalone quarter is second-best ever. And, on top of everything, we lowered our combined ratio guidance for the full year to 89% to 92%. Very strong numbers indeed.

Also, Nordea performed well. Total income was the highest ever for one single quarter. And quarterly operating profit was also best ever. Our book value for Nordea is now EUR7.40. And the share price was EUR6.77 at the end of Second Quarter. As the share price has lately been, roughly, EUR0.80 or EUR0.90 higher than this, it converts to an increase in our NAV of more than EUR1.2 per share. When looking at the NAV at the end of the quarter, I want to remind you that the NAV of EUR15.49 is calculated after the deduction of the dividend of EUR1.20 that was paid in the Second Quarter. Also, you should note that the Nordea dividend was already included in the First Quarter NAV with an effect of EUR0.40 per share.

Mandatum Life's pretax profit was EUR32 million, down EUR8 million from the corresponding quarter; this, however, after EUR10 million had been used to lower next year's discounting rate to 3%. And I just want to remind you that the discount rate for this year has already been lowered earlier to 2.5%. Gross written premiums increased slightly. And our main distribution channel, Sampo Bank, performed especially well.

On the Group level, our net debt is unchanged at roughly EUR1.7 billion. And our cost for carrying this debt is below 3%.

All in all, you have seen our guidance. And, in fact, I don't have anything to add. My general feeling, even with southern Europe and ECB showing no real sign of coming to grips with their problems, is positive. I see good prospects for Sampo Group. The high quality of our earnings forms a good basis for this. All in all, I'm quite confident that we continue to perform.

Jarmo Salonen {BIO 1860650 <GO>}

Operator, we are now ready for the questions.

Questions And Answers

Operator

(Operator Instructions) Hakon Fure, DnB Markets.

Q - Hakon Fure {BIO 16623060 <GO>}

Two P&C-related questions from me. Firstly, in terms of the positive claim strength, what's the main driver of this? Is it low claims inflation, or is the frequency element more important?

Secondly, in terms of the relatively high reserve releases in Q2, is this still case settlements and lower inflation, or is there something special this quarter? Thanks.

A - Ricard Wennerklint

Okay. First question on the positive claims trend. It's a combination of the claims frequency and the claims inflation, especially in Norway.

On the second question, it's the same answer as we have had before. It's the same reason as we have had before. It's a mix of case reserves and reserve releases. And I would advise you to look at the number for the first half year that's very close to what we have had before for a first half year.

Q - Hakon Fure {BIO 16623060 <GO>}

That was very clear. Thank you.

Operator

Blair Stewart, Bank of America Merrill Lynch.

Q - Blair Stewart {BIO 4191309 <GO>}

You've given guidance on the range for the combined ratio and P&C. I wonder if you could just talk a little bit about investment income, particularly in P&C but also in Life if you'd like to -- just how challenging it is to maintain the current level of investment income and what assets you're managing to find in order to do that. That would be very helpful. Thank you.

A - Kari Stadigh {BIO 1504152 <GO>}

I think that this question has been put forward to us in every quarter during the last two or three years. And I can't say that the reinvestment risk, which you are really asking for, is becoming any easier. Our running yield in If was 3.8%. And Mandatum Life is 5.3%. And we can clearly see that coming slowly down.

Our investment theme is the same. We don't have appetite for more equity risk at this moment. We have a healthy equity position in both companies. We still want to look for corporate bonds. However, the supply is not that big in the geographical areas where we look for it. And, therefore, our cash position has been slowly growing. So I would expect our running yields to slowly inch downwards. What the slope of that is -- it's very difficult to predict.

The duration is, of course, such that I'm quite comfortable with this situation, at least a year going forward or year and a half. And, if nothing changes, then this will become an issue in 2014. However, if the interest rates stay this low or even inch lower, I think it's quite natural that, then, we are going to see value in equities, which should compensate for the problems we face then in the low interest environment. Very difficult to predict. This is very much in line with what I have been saying for the last one and a half years.

Q - Blair Stewart {BIO 4191309 <GO>}

Is there any possibility, do you think -- if yield does become very scarce in the market, is there a possibility that you can be more aggressive on P&C pricing?

A - Ricard Wennerklint

I think what we have seen the last 6 to 12 months is a general acceptance in the market that the yields are very low and, therefore, lower combined ratio is needed. And we have seen price hikes in most Nordic markets.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Thank you, very much.

Operator

Hans Pluijgers, Cheuvreux.

Q - Hans Pluijgers {BIO 16245530 <GO>}

First, a follow-up question on the runoff profits. You said that the first half was a normal level. Could you give some feeling for what you see for second half? Do you see, let's say, also last year's runoff profit as also a normalized level? So, if you could, give some feeling there.

Secondly, looking at developments in combined ratio in Sweden and Denmark, could you give some more color on what is happening? Was it more specific files or a general trend in deterioration in Denmark? Also, Q1 was relatively high but was more an individual file. Could you give some feeling there?

And, lastly, on Mandatum Life, expense ratio edged up quite significantly from 107.5% to 116.3%. What's the reason behind that. And what do you expect going forward?

A - Ricard Wennerklint

Okay. Let's start with runoff profits. I think the first half year has been fairly normal, looking at the last three, four, or five years in If P&C. There is no way to predict prior year gains, given the fact that they can come from individual large claims and can come from changes in our views of needed (inaudible), et cetera. But I wouldn't be surprised if we continued to release roughly the same amount as we have done before. I think that's what I can say on the runoff profits.

The second question about the combined ratio in Sweden and Denmark. It's, of course, very much impacted by the fairly high level of large claims that we had the first half year. We had SEK480 million higher large claims than expected. Many of those were affecting the Swedish and Danish result.

A - Peter Johansson {BIO 20728335 <GO>}

On the Mandatum Life's expense ratio, that's, of course, excluding the kickbacks. But, overall, if you look at the expense result, it was actually lower for the first half compared to the first half in 2011. Normally, we start to see a better expense result already in Q2. But, partially, it's affected by higher sales in the beginning of the year. But we're expecting, at least, roughly the same level of expense result as last year for the full year.

Q - Hans Pluijgers {BIO 16245530 <GO>}

Okay. Thank you.

Operator

Gianandrea Roberti, Carnegie.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

I have two questions. The first one is probably a bit detailed. It's on non-life and your performance in Norway, which, clearly, the combined ratio of 68.9% looks nearly extreme in this quarter. Now, I understand you had a bit of luck with large claims in the quarter. I remember, at the capital markets day two years ago, you disclosed at the time that, in a normal year, you would have around SEK2.4 billion of large claims, which is around EUR265 I guess. If I assume that 40% of that should come from Norway, then I calculate around (26 million or 27 million) normally in a quarter. Assuming that that number was zero, then 68.9% becomes 75.5%. I'm pretty sure Ricard wouldn't like this math. But I would like to hear a comment on that point. That's the first question.

A - Ricard Wennerklint

Okay. And the question is -- was that whether your math makes sense?

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Whether, really, it's close enough to reality, the 40% of your normalized, large-claim guidance at the time can come in a normal year for Norway. And, really, in this quarter, you have been quite lucky with the large claims in Norway.

A - Ricard Wennerklint

Okay. To be honest, that's not a number that I know, the SEK2.4 billion. Yes, that's how we look at normalized large claims, roughly. It's a very rough number on where we mesh or how we define large claims in our book. We look at this by business area. Obviously, this is industrial and commercial business. We don't necessarily look at this by country. It's probably a fairly good estimate. But it's not a number that I recognize or can confirm. Sorry about that, Gianandrea.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

No. Thanks. The second question is probably even more nitty-gritty for you, Peter. I was looking at some of your Norwegian peers. There's more than one that is getting hit right and left on their pension liabilities. I think this is coming, actually, from the pension scheme on their own employees. But it's an item called (inaudible) gain/losses on fair value that both Gjensidige, Trygg. And some other players in Norway are taking really big hits in their shareholders' equity. And, I guess, on a like-for-like basis, it should be a much smaller item for Sampo. But, when I look at your change statement in the shareholders' equity quarter by quarter, there's nothing like that. So I'm just wondering if you pay the pension to your employees in a very different way, or it's just so neglectable for you that you don't even show it.

A - Ricard Wennerklint

The number for If is outside of shareholders' equity. So it's not accounted for in shareholders' equity. So that's the reason why you can't find it there. It's in the notes of the full year statement. You can find the excess or how much (risk there is).

A - Peter Johansson {BIO 20728335 <GO>}

Actually, if you look at the solvency calculation -- we have to deduct it from the solvency calculation already. And, under IS-19, we will start to deduct it also from shareholders' equity. It's roughly EUR150 million.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

For the full year 2011 or what?

A - Peter Johansson {BIO 20728335 <GO>}

I think end of Q2 and, roughly, also full year.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay. Thanks.

Operator

Giulia Raffo, Autonomous.

Q - Giulia Raffo {BIO 7573856 <GO>}

I have three questions, please; firstly, one clarification on the (Lifing) side, because, if I look at the interim statement, it looks like the hit to the life BBT coming from lowering the discount rate was unchanged at the half year relative to Q1 in the sense that you mentioned EUR117 million, which is what we did have for the end of Q1. But, at the same time, the discount rate on your 2013, with profit, has been lowered from 3.25% -- that was the level at the end of March -- to 3% at the end of June. And, in your speech, you mentioned EUR10 million impact in discrete Q2. So I was just trying to see why I don't see that EUR10 million hitting the EUR117 million.

My second question, then, is on the net debt. I think it has increased by roughly EUR500 million in Q2. Should we expect the net debt to go backwards -- to fall more towards EUR1.2 billion to EUR1.3 billion as If will channel dividend, which hasn't done yet to the parent company.

And, then, my third question, just to follow up on Blair. Can you give us an indication for where your new money yields are at the moment in both Life and P&C? Thank you, very much.

A - Peter Johansson {BIO 20728335 <GO>}

First, to the EUR117 million that we had reserved -- so, basically, we could have released EUR9 million to EUR10 million in the Second Quarter. But we rolled that forward the next year. We simply rolled it forward and brought down the discount rate from 3.25% to 3%. And that's the reason why the level stayed the same.

On the net debt side, yes, you're correct that the net debt increased from EUR1.2 billion to EUR1.7 billion. But I would say that, if you look back in the history. So pre-dividend, we always have the lowest net debt, which is basically at the end of Q1. And then, when we paid the dividend, we have gone back to EUR1.7 billion. So we're pretty -- this has been a fairly stable level for a few years now.

A - Kari Stadigh {BIO 1504152 <GO>}

I think it's quite natural that, when we collect the money from the subsidiaries for a dividend, depending on when we do that, then you see the net debt moving. And we haven't made a decision yet when If will pay the dividend. It has to do also with our view on currencies. But I wouldn't -- but there is no reason to expect anything different from earlier years. We have a very strong dividend capacity. And the cash flow in the Group is very strong.

On new money yields, I don't have any hocus pocus to tell you. You can look at the allocations that we have. And there are market rates for each investment class. I can't give you any specific number. Or you can yourself analyze the blend -- what you think we have between cash and corporate bonds. I think the best way to analyze this is to see that, at this moment, the running yields are 3.8% and 5.3%. They are slowly inching downwards.

Q - Giulia Raffo {BIO 7573856 <GO>}

I think, at the Q1, you were pointing to something around 3%. So I was wondering -- presumably -- you know what happened to the short part of the curve. And you mainly have a duration of one to two years. I would assume that you can no longer invest on a blended average of 3%.

A - Kari Stadigh {BIO 1504152 <GO>}

Well, I think your guess is as good as mine. Let's see after we release the next quarter how it ended up.

Q - Giulia Raffo {BIO 7573856 <GO>}

Okay. Just one quick follow-up on the Lifing side. Can you just clarify whether these EUR9 million or EUR10 million impact on the 2013 with profit discount rate -- did it impact it negatively due to -- ? Was there a net charge of EUR9 million to EUR10 million?

A - Peter Johansson {BIO 20728335 <GO>}

Technically, if we would have kept the discount rate at 3.25%, the result would have been EUR9 million to EUR10 million better.

Q - Giulia Raffo {BIO 7573856 <GO>}

Yes. Okay. Thank you, very much. All clear. Thank you.

Operator

Matti Ahokas, Handelsbanken.

Q - Matti Ahokas {BIO 2037723 <GO>}

Two questions, if I may. First, continuing on the large claims issue, you write in the report on page six that the level of large claims was EUR54 million higher than the normal in the first half. If I do the math this time, I would get to -- it's like EUR130 million is the normalized level. And so, currently, it was EUR184 million or EUR185 million in total, the large claims. Does this figure ring a bell? And, also, how much of the EUR54 million was in Q1. And how much was in Q2?

The second question is regarding the Life business. There's been some stuff on the screens today that, potentially, Danske bank is interested in selling their life insurance operations. Is Mandatum Life and Sampo interested in expanding the Life operations outside of the current scope? You guys have a distribution agreement with Danske Bank already. I'd like to hear your thoughts on this. Thanks.

A - Ricard Wennerklint

Okay. Let's start with large claims to expand a bit on the EUR54 million. It's right it's the six-month deviation from what is expected as a normalized large claims development. We don't release the exact definition of normalized large claims. And the reason is that this change from year to year and over the year, depending on what business we write. But, to give you an indication on how much large claims we expect to have, it's roughly SEK100 million every month in industrial and roughly the same number in commercial. So total for the Group would be SEK200 million per month, roughly, in large claims. And large claims in this case is defined as everything above SEK5 million. So that's what I can give you on large claims.

A - Kari Stadigh {BIO 1504152 <GO>}

On Life, I think you know this. I think that we are not in an acquisitive mode in life. And we are not really fond of life outside Estonia and Finland. So there is no reason for us to speculate on any M&A in life.

Q - Matti Ahokas {BIO 2037723 <GO>}

Very clear. Thanks.

Operator

Vinit Malhotra, Goldman Sachs.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Just two or three points here. One is on the liability side adjustment in the economic capital. It was quite strongly negative in 2Q. Is that something -- ? Is it just low interest rates, or is there something there that you could comment on?

The second thing, on your assets. I noticed that there was a 3% move out of money markets into bonds, this mainly coming in Finland money market and bank investments. Is it the same thing linked to the liquidity before and after dividends because that is what is also contributing to the net debt?

And, lastly, on the large claims, take on board everything that this could have been a tough quarter. But the industrial segment combined ratio, 105%, probably highest in four or five years on a quarterly basis. And I know you don't like the bad luck factor. But is there something you want to change here or any corrective actions or whatever you think? Thanks.

A - Peter Johansson {BIO 20728335 <GO>}

On your first question on the liability side adjustment, you're right that, if you look on the economic capital and, especially, on Mandatum Life -- we already had a negative effect on discounting all the liabilities with the yield curve in Q1. And that actually increased in Q2. So that's simply the interest rate movement.

The movements in money market investments has also mainly been driven by our dividends because we paid out the dividend in the beginning of Second Quarter. So that reduced the amount of money market investments.

A - Ricard Wennerklint

Back to the large claims then. The EUR54 million deviation for the first half year -- that's, of course -- basically, all of that is within the industrial business area.

If I look at the combined ratio and the volatility in large claims, it's not at all that we think that we have a problem with industrial or that we see a profitability problem. Our average combined ratio for the last eight and a half years in industrial has been 92.4%. So I think that has been fairly stable to the industrial business. And the volatility that we see in industrial doesn't really give an effect of a lot of increased volatility or difficult volatility on the Group numbers. So I'm not very concerned.

Having said that, what I think we also have said before is that we expect to see some premium hikes. And we see a need for premium hikes in the industrial market. It's not huge. Premium rates definitely need to come up a couple of percentages.

A - Kari Stadigh {BIO 1504152 <GO>}

I think, also, it's worth mentioning that, every time we have a large claim, I think we have an internal due diligence that has all our underwriting guidelines and so on being followed. And, in all these cases, they have been followed to the last point. There is no alarming behavior in underwriting or no room for a judgment call or anything. So everything has been fine. This is (inaudible).

Q - Unidentified Participant

All right. Thanks very much.

Operator

Robin Buckley, Deutsche Bank.

Q - Robin Buckley {BIO 3596512 <GO>}

Just two questions, if I could, please; first of all, just in terms of those reserve releases in the Second Quarter. Are you able to comment in terms of which geographies or which business segments those came through from?

And then a second question is just related to the Life economic solvency ratio, which I think was back below 100% in the quarter. Can you just comment on to what extent that is of concern to you, if any at all, given it's not a regulatory constraint? And, more generally, I guess, as we move, potentially, closer towards the implementation of Solvency II, what impact do you see this on the current business model for your Life operations and, indeed, the asset mix? Thank you.

A - Ricard Wennerklint

Let's start on prior years. As you know, we don't give details on specific BAs, specific markets. But, to give you some information, this is pretty well spread across BAs and markets. So it's not that the entire prior year gain is one BA or one market. It's pretty well diversified. And that's also the case if I look back at prior years.

A - Peter Johansson {BIO 20728335 <GO>}

On the Life economic capital, you're correct. It's an internal model, where it's an internal target and internal requirement in the sense of having at least EUR1 billion of capital. The regulator in Finland only looks at the Solvency I for the time being. And, if we look at our

Solvency I capital situation, we're one of the -- or most likely one of the strongest capitalized life insurance companies in Finland. So, from that perspective, it's not an issue.

If we would move -- or when we move into Solvency II regime and we would have a situation like this, we would be in the region of minimum capital requirement and solvency capital requirement. And then, of course, the regulator would ask how do we meet the solvency capital requirement. And an easy way to do that would be to increase hybrids in the Life company.

A - Kari Stadigh {BIO 1504152 <GO>}

Personally, I haven't been a great believer in Solvency II for the last five years. And I have always said that it will be postponed. And it has been postponed several times. And then I have also said that it will be diluted. You almost start to laugh when you hear the latest rumors in the market that Solvency II would be only implemented in the new book or something. I think there is desperation in these comments that the decision makers in Brussels and central Europe understand that. If you would implement the total Solvency II as they think now, I would like to see where the UK life companies and so on find the capital. Our stance has always been that, when we maintain the position that we are with the highest solvency ratio in our Company, then all the others in the market will face big problems before we do. And, anyhow, we are prepared. If the worst came to worse, we are prepared to meet the challenge of very rigid Solvency II as well.

Q - Robin Buckley {BIO 3596512 <GO>}

Thank you.

Operator

Hans Pluijgers, Cheuvreux.

Q - Hans Pluijgers {BIO 16245530 <GO>}

Going back on the increases in pricing. First of all, looking at the industrial side, is that some -- few percentage points increase, let's say, done at the end of the year? When is the timing of that?

Secondly, more in general, on pricing, what do you see in the market? Are there any (buckets)? Do you see still, also, price increases are required a little bit? Discuss the price environment at the moment in the Nordic market.

A - Ricard Wennerklint

The first comment on industrial -- well, most of the book is renewed by yearend. So, obviously, that's the timing to take the negotiations with the clients. It was more a comment towards the industrial market in the Nordics -- that I believe that there is still a need to lower the sort of expected normalized combined ratio.

Secondly, on price increases, we continue to increase prices in line with expected claims inflation. And, as you know, we have a pretty safe view on claims inflation, where we take into consideration claims inflation looking backwards. It's slightly higher than current-experience claims inflation.

Q - Hans Pluijgers {BIO 16245530 <GO>}

And how do you see, let's say, competition behaves? Any material changes there?

A - Ricard Wennerklint

Most markets are -- bar maybe the Baltics market, I think competition has been very stable and professional the last quarter or last six months.

Q - Hans Pluijgers {BIO 16245530 <GO>}

Let's say, more in general, could you argue that, in 2010 and 2011, you were clear in price increase by the competition ahead of the market and then, now, we are more or less seeing movement in line with claims inflation? Is that a fair comment?

A - Ricard Wennerklint

Extremely difficult to comment on. Sorry.

Q - Hans Pluijgers {BIO 16245530 <GO>}

Okay. Thanks.

Operator

And we now have no further questions coming through. (Operator Instructions). And we now have no further questions coming through. So I'll hand you back to your host.

A - Jarmo Salonen {BIO 1860650 <GO>}

Thank you, operator. Ladies and gentlemen, thank you for your attention. Have a very nice evening. Thank you.

Operator

Ladies and gentlemen, thank you for joining today's conference. You may now replace your handset.