Q2 2019 Earnings Call

Company Participants

- Helge Leiro Baastad, CEO
- Jostein Amdal, Executive VP & CFO
- Mitra Hagen Negard, Head of IR

Other Participants

- Jan Erik Gjerland
- Jonathan Denham
- Kevin Ryan
- Matti Ahokas
- Phil Ross

Presentation

Operator

Good day and welcome to the Gjensidige Q2, 2019 Results Presentation. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms.Mitra Hagen Negard, Head of IR.

Please go ahead, ma'am.

Mitra Hagen Negard {BIO 3974076 <GO>}

Thank you. Good morning, and welcome to the second quarter presentation of Gjensidige. My name is Mitra Negard and I'm Head of Investor Relations.

As always, we will start with our CEO, Helge Leiro Baastad, who will give you the highlights of the quarter; followed by our CFO, Jostein Amdal, who will run through the numbers in more detail. And we have plenty of time for questions at the end.

Helge, please?

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Mitra. Good morning, and welcome, everyone. I'm very pleased to report a strong set of second quarter results, which reflect the clear improvement in our underlying profitability to a large extent due to strong and effective profitability measures.

Starting with a few comments on our second quarter results on Page 2, we generated a profit before tax of NOK1.7 billion, significantly up from the second quarter last year. Group underwriting results amounted to NOK1.3 billion corresponding to a combined ratio of a solid 79.3%.

The strong result was to a large extent driven by strong performance in our Norwegian operation and I'm particularly pleased to see profitability for our Norwegian motor insurance back at a very good level. The result also reflects relatively normal weather conditions in Norway compared to the harsh winter we saw last year also stretching into the second quarter.

The performance of our operations outside Norway was mixed. Denmark reported a significantly better result while Sweden and the Baltics came in on par with last year. Large losses were lower than expected and runoff gains were higher than the expected level. And we continued to demonstrate good cost control. Our investment portfolio delivered returns of NOK513 million or 0.9% in the quarter.

Annualized return on equity year-to-date adjusted for the gain on the sale of Gjensidige Bank was 23.5%. This is well above our annual target of 20%. Jostein will revert with more detailed comments on the results.

Then turning to Page 3, I would like to elaborate on the operational status in a few key areas. We have, over some quarters now, successfully put through significant price increases in Norway both in the private and commercial segments.

In the private segment, we have had particular focus on the motor and property lines. Profitability for motor in Norway continued to improve in the second quarter after having reached a turning point in the first quarter. Based on thorough analysis, we identified the actions we needed to take to get back on track and we have succeeded.

Thanks to effective adjustments of firms and conditions, we see expected claims inflation coming further down to somewhere in the three to four percentage points range. And with continued pricing efforts, reflecting expected claims inflation, we expect profitability to remain around the current good level going forward. We are very pleased to see that new sales in our private segment have picked up significantly this quarter and that customer retention remains at a very high level, despite the significant price increases and strong competition in the market.

Although the running 12 month multi-turn is up, we have seen a clear positive development during the second quarter, and we expect this to continue going forward. The impact from the termination of the NITO agreement is lower than in the first quarter as expected.

Our pricing efforts in the commercial segment continued successfully in the second quarter, and we are very pleased with the July 1 renewals proving our strong and superior position in Norway. We still see the need to continue our pricing initiatives going forward, especially for large corporates and certain other segments.

The positive momentum in our cooperation with Nordea has continued. We are very pleased to have extended our corporation into the commercial space, where we also see strong potential particularly for SME customers. The corporation agreement will be put into force when approved by the FSA. Our operations outside Norway are progressing according to plan. I am particularly pleased with the progress in Denmark so far this year.

We are confident in our ambition of achieving an underwriting result of NOK750 million ex run-off from these operations in 2022. We will continue implementing profit-enhancing measures, improving our cost structure and increasing efficiency. We need to strengthen our position in these markets and increase customer loyalty, and we are getting ready to take part in the market growth, both organically and through acquisitions given the right targets at the right price.

Finally, a few words on the latest development of our operational targets, we have had a significant increase in the share of automated tariffs now at 30%, thanks to the latest inclusion of tariffs on the private motor and property lines. This is an important catalyst for improved efficiency and profitability. We have also climbed further on online claims supporting and claims straight through processing now at 68% and 16%, respectively in Norway.

Then turning to Page 4 and our unique customer dividend model, the Gjensidige Foundation has again distributed its regular dividend from the Gjensidige to our general insurance customers in

Norway as it has done every year since our listing in 2010. This year a total of NOK2.2 billion was returned to 800,000 customers. The payment corresponds to 14.1% of the premiums paid in 2018. The model is highly valued by our customers and complements our strong brand and delivery of superior customer experiences in building customer loyalty.

The dividend model is well known as you can see from the results of a customer survey. This year, we launched a marketing campaign with a new angle focusing on sharing being a choice and we choose to share with our customers. The campaign has been very successful and well-received by the market.

With that, I will leave the word to Jostein to present the second quarter results in more detail.

Jostein Amdal {BIO 19939645 <GO>}

Thank you, Helge, and good morning, everybody. I will start on Page 6. We delivered a profit before tax of NOK1.7 billion in the second quarter. This is considerably higher than the second quarter last year, primarily driven by the significant increase in underwriting result.

Our operations in Norway and Denmark were the main contributors to this improvement. A high return on investment portfolio also contributed to the rise in profit. Profits from our pension business were broadly in line with the second quarter last year.

Turning to Page 7, earned premiums were up 1.6% or 1.4% adjusted for currency effects. In the private segment, the significant price increases we put through, primarily from motor and property were somewhat offset by lower business volume as expected.

As Helge has pointed out, we have seen a positive shift in the trend during the second quarter. Together with the successful turnaround in motor and our strong competitiveness, this provides us with ample flexibility going forward.

Our pricing initiatives in the commercial segments contributed into the second quarter resulting in a healthy 6.2% growth in earned premiums. We'll continue the price increases to reflect expected claims inflation. Our repricing and reunderwriting activities outside Norway, over the last 12 months, resulted in yet another quarter of lower earned premiums in Denmark and Sweden.

Out of the 13% decline in Sweden, 4 percentage points are related to the termination of two large and profitable contracts. We see a need for further price increases in Sweden where the current repricing and reunderwriting initiatives in Denmark are getting closer to completion. The Baltics reported a top line in line with the second quarter last year.

Turning over to Page 8, the loss ratio decreased by 8.6 percentage points to 64.4%. Although this was somewhat helped by lower large losses and higher enough gains, this was primarily due to improvement in the underlying frequency loss ratio. The underlying profit -- profitability improvement for motor in Norway returned to a good level, thanks to the effective measures we have put through over the past several quarters. We also benefited from better weather conditions in Norway, which had a significant impact on the property insurance lines in the second quarter of last year. Denmark generated stronger underlying profitability compared with the second quarter last year on the back of improvements in commercial property lines and adjustments of claims portions relating to the first quarter.

Our Baltics operations showed a slightly improved underlying frequency loss ratio. Sweden delivered on par with the second quarter last year. We maintain a strong focus on implementing profitability measures in all our operations outside of Norway.

Let's turn to Page 9. We recorded NOK909 million in operating expenses in the quarter corresponding to a cost ratio of 14.9% and 14.2%, excluding the Baltics, both down 0.2 percentage points from the second quarter of last year. The improvement is a result of continued cost discipline across the whole group and our focus on simplification of processes, automation of internal operations and further digitalization. We see considerable opportunities from further operational efficiencies, particularly in Sweden and the Baltics.

A few comments on our Pension operation on Slide 10, the pretax profit came to NOK39 billion, more or less in line with the second quarter of last year. Continued growth in our customer base resulted in higher net operating income. This was partly offset by lower financial income driven by lower returns on property investments. Annualized return on equity came to 17.6%, assets under management remained at NOK34 billion at the end of the quarter, reflecting the exit of SKAGEN as a consequence of Storebrand's acquisition. The ratio of shared customers on the general insurance business is high. At the end of the second quarter, 68% of the customers in our pension business were general insurance customers as well.

Moving on to the investment portfolio on Page 11, the investment portfolio yielded a return of 0.9% in the quarter, reflecting the market conditions in the quarter. The total investment portfolio amounted to NOK 57 million at the end of the quarter.

The match portfolio yielded a positive return of 0.5% on a portfolio of NOK35 billion. A large part of the match portfolio consists of bonds at amortized cost, which yielded a return of 0.9%. The running yield in this portfolio was 3.7% at the end of the quarter and the average reinvestment rate for the quarter was 3%. Unrealized excess value amounted to approximately NOK0.9 billion.

The free portfolio, which amounts to NOK22 billion, yielded a return of 1.5% in the quarter. All asset classes contributed positively in the quarter.

Looking at our capital position on Page 12, our capital position is very strong. The solvency margin according to approved internal model as at the end of the second quarter was 242%. Our own partial internal model showed a solvency margin of 289% both well above our target range of 135% to 200%.

The margin based on both models were down compared to the first quarter due to an increase in capital requirement and a reduction in the eligible own funds. The capital requirement for market risk increased as a consequence of a slightly higher exposure to equity and property, whereas the underlying growth in the insurance book increased the underwriting risk.

Several elements impacted eligible own funds, resulting in a decline compared to the level of the end of the first quarter. Retained earnings contributed positively while changes in interest rates, planned run-off gains and technical adjustments in the calculation of the risk margin contributed negatively. We will continue to balance our capital structure in a disciplined way in order to support the targeted return on equity while at the same time allowing us some leeway for further bolt-on acquisitions and securing high and stable regular dividends.

I will then hand the word back to Helge.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Jostein. To sum up on Page 13, we delivered a strong second quarter result and we have succeeded in implementing significant price increases in combination with changes in terms and conditions both in the private and commercial segments in Norway.

I'm particularly pleased to see the motor insurance line has again reached a good profitability level, a level we will seek to maintain also going forward. And I am pleased to see the portfolio quality in the commercial segment being solid. We will continue to focus on retaining our strong and unique position in Norway. Our achievements in the private segment gives us more flexibility to ensure an optimal balance between profitability improvements and volume growth going forward.

For the commercial segment, we still see considerable need to raise prices. We are very pleased with the progress in Denmark so far this year. We remain strongly committed to increase profits from our operations outside Norway expecting the results to becoming increasingly evident towards 2022. As we implement measures targeting both the top lines and operational efficiency.

And finally, with our strong capital situation, we are well positioned to act upon potential attractive growth opportunities. As mentioned earlier, we will give ourselves some time to explore different M&A opportunities in our marketplace. Hence, we do not plan for paying out any special dividends this year. However, I can promise you again, we will stay disciplined and rational and return excess capital to our shareholders over time if good opportunities do not arise.

I will now open for the Q&A session.

Questions And Answers

Operator

(Question And Answer)

Thank you, sir. (Operator Instructions). We will now take our first question from Jonathan Denham, Morgan Stanley. Please go ahead.

Q - Jonathan Denham {BIO 19972914 <GO>}

Thank you so much. I'm sorry if I missed this in the release. Could you quantify the benefit of the adjustment of the claims provisions in Denmark relating to the first quarter on the second quarter results? And then just secondly, the retention in your loyalty portfolio fell slightly again, but do you think it's now bottomed or do you expect pricing action continue to close at full further? I guess your cushion somewhat buys the dividend, but would love your view there. Thank you.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

I can maybe take the last question first, and Jostein comment the Danish situation. We have actually acted just according to our plan; and as you have heard before, we have a clear priority to improve profitability. You have lost some customers and the customers, you have lost, they have lower customer score meaning the overall portfolio quality is gradually improving.

Price increases have had an impact on volume as expected. However, as I said, the trend has shifted into a positive direction during the quarter. New sales in private picked up significantly this quarter and motor churn is down compared to Q1, but if you look at churn 12-months rolling, it's opposite, but what I commented was the trend shift in the second quarter.

A - Jostein Amdal {BIO 19939645 <GO>}

Can take the Danish questions regarding claims.

Yes, we have not quantified the amount of that effect. There will always from quarter-to-quarter be some adjustment related to the previous quarters, and if it's within the year it will be an intra-year runoff in a way, and you won't see it, and if it's crossing the year-end line it will be recorded as runoff gains or losses. It's not -- if it had been really significant, I think, we'll probably disclose the exact numbers, but it does affect numbers, but not to a really significant effect.

Q - Jonathan Denham {BIO 19972914 <GO>}

Okay. Thank you.

Operator

We will now take our next question from Kevin Ryan from Bloomberg Intelligence. Please go ahead.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thanks very much. I just like to ask about the reunderwriting of the portfolio in Denmark and Sweden. Could you let us know if that's complete now and where you expect premium levels to go from here in terms of volume? And secondly, could you comment a little bit about your automated straight through claims processing, which you mentioned is at 16%. Can we expect that to climb further this year and what's the outlook there, please? Thank you very much.

A - Jostein Amdal {BIO 19939645 <GO>}

Yeah, I'll start on the re-underwriting. As we commented, we think that kind of the reunderwriting and repricing part is in Denmark is more or less finished. If you look at the profitability now, it's at quite good level. There will always be pockets of the portfolio that needs to be reunderwritten and you'll have some kind of short-term volatility And some customers, small and large, leaving us, but by and large, I think for Denmark we are where we want to be.

In Sweden, the situation is a bit different. There's still need for measures in the portfolio to improve the quality there. That might mean that the portfolio still will shrink somewhat, but remember that -- when we're looking at kind of year-on-year comparisons, you have one year of accumulated effects that gives us the 13% decline in measured in local currency. so quarter-by-quarter is much less.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Regarding the automated tariffs and claims straight through processing. As you remember, we launched these KPIs at the Capital Market Day last year, and when it comes -- automated tariffs within 2022, it should be 100%. And as you remember first quarter, it was low, 2.8 or something like that and we jumped up to 30% due to property and motor in private in Norway that will continue gradually up to 100%. And the target for claims straight through processing is 64% in 2022 meaning that we have to improve this KPI quarter-by-quarter towards 2022.

Q - Kevin Ryan {BIO 1814771 <GO>}

Thank you.

Operator

(Operator Instructions). We will now take our next question from Jan Erik from ABG Please go ahead.

Q - Jan Erik Gjerland {BIO 5346031 <GO>}

Hey, good morning. Jan Erik from ABG here. You mentioned that you reduced your strong profitability to get back on track on the sort of private segment, but you still has some more to go on the commercial side and pricing. So will you start to use your sort of underlying now below 80% combined ratio in the product lines to fight back on your --for those starting to lose market share situation so that it will start to increase again. And have you actually fought back on the need to? You said that it was a little bit less going out the book here than last quarter, just to clarify that?

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Thank you, Jan Erik. The latter is right. The first quarter, we lost more customers to Tryg related to NITO agreement compared to second quarter and that's typically what's happened when you change agreements like that.

When it comes to combined ratio targets, pricing and profitability, it's as I said we think we have a strong profitability level on the motor insurance. Now. So Going forward, it's about being smart, it's to increase prices in line with the claims inflation; as you heard, we have lowered the targeted claims inflation going forward, 3% to 4% before we set 4% to 5%. So it this is to continue in a balanced and smart way going forward, but as I said, clear priority it's to have the right profitability level and we are really pleased that we reached that level this quarter.

Q - Jan Erik Gjerland {BIO 5346031 <GO>}

Okay. Thank you. Just a follow-up on the commercial side then. What kind of levels do you expect now? you had 8% premium growth the last quarter and 6% this quarter, and you said that the renewal from 1st of July was very strong. Is it so that we should expect higher than 8% or below 6%?

A - Helge Leiro Baastad {BIO 5865247 <GO>}

No, when it comes to commercial, the main batch of renewals is 1st of January and this is typically related to large corporates, where the need for price increases has been the highest. So, it's no slowdown in efforts or ability to put through price increases. We will continue going forward for large corporates and certain other segments. So -- and at 1st of July, 60% of the renewals are behind us.

Q - Jan Erik Gjerland {BIO 5346031 <GO>}

Okay. Perfect. Thank you.

Operator

(Operator Instructions). We will now take our next question from Matti Ahokas, Danske Bank. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes, good morning. Two questions please. Firstly, you previously talked about the impact of the weather obviously a negative impact in previous quarters. How much would you say was the positive impact of the weather in Q2? And then Helge, you mentioned earlier that the profitability of the motor insurance is now at an adequate level if I understood you correctly. What would that be in terms of a combined ratio in Norway? Thanks.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

The last question, I think Jostein will comment on this. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

The first one the weather effects. The second quarter of last year, we reported NOK150 million to NOK200 million effect of what this was extraordinary weather effects meaning that there were difference from the average for the previous seven years something like that. This is no exact science, but I think that was a fairly okay estimate. This year, I think we've seen a very normal weather pattern in terms of claims history. So, it's -- yes, it's an average year, I would say, this year.

And the profitability in motor, we don't disclose any CR targets for any specific products like that. As Helge mentioned it's we are now based on accumulated effects of not just pricing, but also the changes to terms and our internal processes, we're happy with the profitability level that they have in motor meaning that they only need to price in line with expected inflation going forward, yeah.

Q - Matti Ahokas {BIO 2037723 <GO>}

All right. Great, thanks.

Operator

We will take our next question from Vinit from Mediobanca. Please go ahead.

Q - Phil Ross {BIO 20618440 <GO>}

Hi, good morning, a couple of questions from me, please. Firstly, I think you said in the past that you don't expect the portfolio in Norway to return to the sort of supernormal profits that you earned in the past. I guess I just wondered how much the results this morning that can be changed or reassesed there whether it still stands. And then secondly, the comments that new sales in private have picked up. I just wondered why you think that might be. Is it that your price increases are lower than peers' or do you think people are attracted by the customer bonus more than in the past? Thanks.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Maybe just a comment on the last one before Jostein take the first question; we as I said, we experienced strong competitiveness in the market and we typically meet the main players now. Tryg is the new front end but we assume competitors have stepped up price increases also, and you have seen some comments from our competitors regarding hybrid cars and electrical cars typically some months after we commented that the first time. So, it's a combination I think. We started price increases earlier. We will price in line with expected claims inflation going forward. We have done also lots of changes with our tariffs and terms. So, it's not only price increases. This is a set of measures actually. And of course, competitors have stepped up price increases also, so it's a combination.

A - Jostein Amdal {BIO 19939645 <GO>}

Okay. If one quarter has made us change our previous statement that we will not return to the extremely good profitability we had back then I think it was around 2014-15 and we see that net profitability is in single lines -- single product lines can be extremely profitable from time-to-time, and -- but looking at the overall profit now in private, it's extremely good. And as we said, we really see some need to price up certain segments within the commercial book; otherwise, we are quite happy with the profit levels that we are at.

Q - Phil Ross {BIO 20618440 <GO>}

Sure. Okay. Thanks.

Operator

It appears there are be no further questions in the queue. I would like to turn the conference back to the host for any additional or closing remarks.

A - Mitra Hagen Negard {BIO 3974076 <GO>}

Thank you. We will be starting our road shows in August with London, Thereafter the west coast of Norway, Bergen and Stavanger, Copenhagen and Helsinki followed by Munich and Amsterdam in September.

Thank you very much for your attention, everyone. Have a great summer and goodbye.