Q3 2015 Earnings Call

Company Participants

- Alberto Minali, Group CFO

Presentation

Alberto Minali {BIO 16909383 <GO>}

Good morning. This is Alberto Minali, CFO of Generali. I am pleased to report to you this morning our nine months 2015 results.

Generali has continued to perform strongly. Looking at the headline figures, the net result of the period is up 8.7% to EUR1.7b, already surpassing the full year 2014. And the rolling annualized operating return on equity has improved by 90 basis points to 13.9%, well above our target level.

The total operating result of the period increased 4.7% to EUR3.8b, thanks to the positive performances of both the life. And the property and casualty segments.

Shareholders' equity decreased 1.9% from year end 2014, mainly due to a widening of credit spreads and to a EUR623 million negative impact deriving from the final closing of the BSI transaction.

Our strong internal model economic solvency ratio improved further from year end, by 10percentage points to 196%.

Let's now dig into some details, starting with the operating profit by segment.

The life operating result posted a 3.9% increase to over EUR2.3b, despite the less benign financial markets in Q3. As I will come back in a moment, we also had very strong inflows, particularly in unit linked. And a strong rebound in the new business margin in the Third Quarter.

Property and casualty showed a 4.8% increase, confirming a good technical momentum. Underwriting profitability has continued to show a positive development, much more than offsetting the obvious headwind on investment income. And this, despite heavier losses from natural catastrophes and still very competitive markets.

The segment holding and other businesses decreased by EUR32 million to EUR56 million in profits, mainly due to higher operating holding expenses, needed to finance our reinforced head-office functions and regional platforms.

Let's then see the walk from operating result to the bottom line.

Non-operating investment income was positive EUR247m, although around EUR100 million than at the end of last quarter. This difference is mainly attributable to some additional impairments on available-for-sale assets. And in addition, given the market conditions in Q3, we considered it wise to realize a lower level of gains.

Non-operating holding expenses decreased by 8.6% to EUR554m, thanks to EUR51 million lower interest costs.

Other non-operating expenses increased by EUR259 million versus the same period last year. This increase was, as you remember, in fact a feature of the Second Quarter. And linked to the good progression of the German restructuring program, where we already recorded the expected restructuring charges, in addition to some other provisions.

As expected, in the Third Quarter, we did not have these exceptional charges and these other non-operating charges fell back to a much lower level.

Net of taxes at a similar rate to last year, the overall net result increased by 8.7% to EUR1.7b.

Turning now to the balance sheet. Shareholders' equity decreased 1.9% from the year-end level. The EUR1.7 billion positive contribution of net profits has been more than counterbalanced by the negative evolution of available-for-sale assets and, in particular, of bond investments in the Second Quarter and of equity investments during the Third Quarter.

The dividend payment in May has reduced shareholders' equity by EUR934m, while other items were EUR174 million negative. This negative amount was the result of offsetting items.

On the positive side, the development of pension liabilities, deriving from increased interest rates and of currency movements, in particular due to the appreciation of the Swiss franc towards the euro.

On the negative side, the closing of the BSI transaction led to a reduction in shareholder's equity of EUR623m.

Our Solvency I ratio increased by 10percentage point, mainly driven by the 8percentage points positive contribution deriving by the closing of the BSI transaction.

The remaining 2percentage points of growth are the result of a 10percentage points positive contribution from the consolidated result, partially compensated by a number of items. And in particular, the underlying growth of our life business and financial market effects.

The pro-forma view of economic solvency similarly increased, to 196% from 186% at year end 2014. From the end of June, the ratio was relatively resilient considering the deterioration of financial markets, declining by just 4percentage points.

Let me focus now on our business segments, starting with Life.

To summarize our performance, overall life premiums increased strongly by 7% to EUR38.4b, driven by a positive trend of all business lines, especially unit-linked. Life net inflows also continued their strongly positive trend growing 21%. And with more than half in unit-linked.

The life operating result went up 3.9%, reflecting better technical and investment margins.

New business value was down 21% to EUR757m, due to a 5.6percentage points margin contraction, although we have seen a much better margin if we look at Q3 in isolation. I will return to this in a moment.

Let me first dive into the single drivers of the life operating result. The technical margin posted a robust 8% increase, thanks to higher risk results in Germany and increased unit-linked fees in Italy and France. This is a result of our constant effort to gradually shift the life business mix towards unit linked and protection lines.

The investment result increased 6.2%, mainly thanks to the growth of the invested asset base. The contribution from net realized gains was marginally lower than during the corresponding period of 2014. And especially in the Third Quarter. As I mentioned before, this was linked to our tactical decisions and the market conditions which we observed.

Expenses increased by 9.8% mainly due to increased acquisition costs, as a consequence of the growth in volumes. But the overall life expense ratio remained stable at 9.7%.

If we think about the future development of the life operating result, it is closely tied to the amount of assets we have under management. It is, therefore, important to see that we gathered a substantial amount of new assets, totaling EUR11 billion net in the first nine months.

We have spent acquisition costs to generate the new volumes supporting this number. But in the coming quarters, the return on this investment will be visible as operating profits. And with more than three-quarters of the new assets in unit-linked and protection business, those profits will be of a higher quality than the ones generated by the existing book, which is more skewed towards guaranteed-saving business.

Let's look at this EUR11 billion of inflows in more detail. The growth trend has continued, with inflows up from EUR9 billion in the previous year. As I mentioned before, our continuing focus on increasing the share of capital-efficient products is important. And I especially highlight unit-linked, which accounted for 53% of the total.

Looking on a country basis, in Italy, we have a particularly strong increase of net inflows to EUR5b, up 37% year on year. The growth has once again been driven by unit-linked business thanks to the success of our hybrid products that provide us with good margins in this low interest-rate environment.

In July, we also launched a new version of our hybrid product dedicated to the agency network, called Valore Futuro Evolution, where the unit-linked component can be increased up to 70% depending on the client profile. In addition, a biometric risk cover has been added.

In France we reached almost EUR1 billion positive net inflows, driven by strong unit-linked premiums, up 37%. And reduced surrenders.

Also in Germany, after the planned reduction of single-premium savings business in 2014, net inflows continued their recovery showing a 23.5% increase, driven, in particular, by the unit-linked component.

Lastly, the decrease in EMEA is mainly explained by a contraction in the sale of wealth-protection products in Europe through our platform in Ireland. And by increased maturities in Austria.

These strong net inflows contributed to an overall 4.7% increase of Life technical reserves over the first nine months, to EUR363b. It is worth highlighting the positive development of unit-linked reserves, up 7.4%, to EUR72.5b.

Life general account investments increased slightly to EUR328b, compared to the end of 2014.

Total Life current returns are down 20 basis points to 250 basis points for the nine months. As always, this is not an annualized figure. In absolute terms, current income increased by EUR117m, reaching EUR8.2b.

Cash, net inflows, bond redemptions and coupons have been reinvested during the first nine months of 2015 at an average yield of 2.5% in the life segment, mainly in financial and non-financial corporate bonds and government bonds.

Turning to new business, APE is up 1.7% to EUR3.8b, driven by strong performances of unit-linked and protection, up 24% and 21% respectively, while savings business posted a 10% decline. This is good evidence of the success of our efforts to redirect our production towards more capital-efficient products.

Looking at our main countries, in Italy APEs decreased by 5.1% due to a positive Group business one-off in 2014. Net of this one-off, APEs would have increased by 10%.

In terms of business mix, we see a continuing strong performance of unit-linked production, whose weight on APE strongly increased from 10.1% to 21%, thanks again to the continuing success of hybrid products. At the same time guaranteed savings business declined by 17%.

We saw a strong development in France where APEs increased 17%. The biggest contribution came from unit-linked, up 43% and protection business, up 40%.

Germany grew by 2.1%, driven by a 30% increase of unit-linked production. Traditional savings business decreased by 13%, again in line with our strategic decision to continuously decrease the weight of pure guaranteed savings products.

Focusing on profitability, we can say that new business margin experienced a 5.6percentage points decrease, to 20%. The positive impact on the margin of the change in business mix, as well as further reduced minimum guarantees, was much more than offset by a worsened financial scenario.

As you remember, this was particularly an issue in the Second Quarter. Looking at the Third Quarter on a standalone basis, with a more normalized financial scenario at the end of June, we can see a much improved 26.2% new business margin.

Overall, I am very satisfied with the development of the new business and the quality of the mix in the first nine months. And this bodes well for future results. The numbers show that the embedded profitability of the new business being written today is close to double that of the existing book.

Now let's turn to look at the P&C. Gross written premiums are up 0.8%, on a like-for-like basis, at EUR15.8b. But with an accelerating trend in the Third Quarter, which is 2.4% above the same quarter last year.

Primary motor posted a 0.9% decline year to date, mainly driven by Italy and France, as I will explain later. But with a 1.1% increase in the Third Quarter of the year.

Primary non-motor increased by 1.7%.

The combined ratio improved by 0.8percentage points, notwithstanding a 0.4percentage points increased nat cat burden.

The operating result overall increased by 4.8%.

Looking at the components of this operating profit increase, we can see that the technical result is up strongly at EUR981m, 11.8% above the prior year level. This much more than offset a 2.6% decline in the investment result, as a result, of course, of the lower interest rate environment. And the residual other-items line that decreased by EUR9m.

Let's deep-dive into the gross written premium developments within our core countries.

Italy is down 2.9%, at EUR4b, still driven by the highly competitive environment of motor. Primary motor decreased by 8.4%, mainly due to reduced average premiums.

However, as you know, the non-motor segment has a bigger weight than the motor one for Generali in Italy. In non-motor, premiums are up 1.1%, driven in particular by the employee benefit segment.

France declined slightly, by 0.9% to EUR2 billion due to the competitive market environment and the continuation of strict underwriting guidelines and pruning activities.

Primary motor continued its negative trend with a 5% decrease driven by an ongoing pruning of unprofitable fleet and garage-related contracts and by a still soft retail market. But with continuing positive signs in terms of number of contracts in the retail segment.

Non-motor reverted the trend growing 1.5%, continuing the recovery in personal lines and the re-launching, on a technically sound basis, of some commercial lines.

In Germany premiums grew by 1%. The growth rate of motor business, up 1.3%, is still distorted by the ongoing shift from the main renewal date from January to other months of the year and should improve in the last quarter of the year, benefitting also from relatively good market conditions, with average portfolio premiums still rising. Non-motor rose by 0.8%.

Moving now to the profitability analysis, the combined ratio improved by 0.8percentage points year on year to 92.7%, despite 0.4percentage points higher nat cats. The main nat cat events were storm Mike and Niklas, affecting mainly Germany. And storm (Anton), which caused losses in Italy between March and April. And also the storm (Siegfried-Thompson) that affected Continental Europe in July.

Looking at the single drivers, the loss ratio improved by 1percentage point, driven by an improved current-year result. Slightly higher prior year run-off results counterbalanced the increased nat cat burden.

The expense ratio increased by 0.2percentage points.

In Italy our combined ratio deteriorated slightly. But still is at an excellent 89.4%. I think this is a very good result in the light of nat cat losses that were worse by 1.3percentage points. And of course, the still very competitive motor market. Here, we see that improving combined ratio in the non-motor business is continuing to compensate for the margin erosion we have seen during the year in motor.

In France the combined ratio improved significantly, by 6.1percentage points to 99.3%. Of this, 3.2percentage points is due to the improvement of the combined ratio excluding natural catastrophes. And reflects the first signs of success of our turnaround efforts. In addition, natural catastrophe costs were 2.9percentage points lower than in the previous year.

In Germany the combined ratio decreased by 1.9percentage points, despite 1.6percentage points higher nat cats, thanks to an improved current year loss ratio.

CEE confirms its outstanding profitability levels with a 86.5% combined ratio, despite nat cats weighting for 1.3percentage points.

Overall P&C investments remained stable at EUR39b, with respect to year-end 2014.

Total P&C not annualized current returns declined by 20 basis points to 250 basis points.

The average reinvestment rate in P&C during the first nine months of the year has been 2.1%.

Let me finally turn to our holding and other businesses segment, whose overall contribution to the Group operating result decreased from EUR87 million to EUR56m.

The positive contributions of financial businesses that posted a EUR27 million improvement, in particular from Banca Generali. And of other businesses, up EUR8m, have been more than compensated by increased operating holding expenses, which increased from EUR290 million to EUR358 million year on year.

This is reflecting the reinforcement of the Group head office structures started in 2013 and further developed in 2014, including the transition to the new Solvency II regime, as well as the development of regional offices aimed at leading, coordinating and controlling the key business areas for growth prospects, as in the case of Asia.

So let me now summarize. Generali has continued to perform well in the nine months. The strategic reshaping of the Group that we have executed in the past, to refocus the business on our core insurance roots. And to restructure and strengthen our balance sheet, are having tangible benefits today.

Indeed, it is in this context that we see as entirely logical the Financial Stability Board's decision to remove Generali from the list of Global Systemically Important Insurers.

Our life insurance business continues to grow operating profits, despite the weaker financial markets. And our sales and new business margins reflect the success of our efforts to refocus product mix, which will benefit the future profitability.

Our P&C combined ratio remained excellent. And has even further improved. It is stable or improving in all of the Group's major regions. And has much more than compensated the impact of low interest rates.

Consequently, our net profit amounted to EUR1.7 billion at the nine months, already surpassing the level we made in full year 2014. We therefore expect significant year-on-year improvement for full year 2015, barring any exceptionally large natural catastrophes or financial market events.

And all of this is on a solid base of capitalization, with our internal model economic solvency ratio growing by 10percentage points from year end, to 196% at the end of September.

Thank you very much for your attention.