Q4 2018 Earnings Call

Company Participants

- Lars Thykier, Chief Financial Officer & Member of the Executive Board
- Peter Hermann, Chief Executive Officer & Member of the Executive Board
- Steffen Peter Anker Heegaard, Group Communications & IR Director

Other Participants

- Asbjørn Nicholas Mørk, Analyst
- Jakob Brink, Analyst
- Mads Thinggaard, Analyst
- Per Grønborg, Analyst
- Youdish Chicooree, Analyst

MANAGEMENT DISCUSSION SECTION

Peter Hermann {BIO 20507411 <GO>}

Good afternoon, everybody, and good morning to the U.S.A., and thank you for joining us at this conference call. With me is Lars Thykier, the CFO and Steffen Heegaard, the Group Communications and IR Director. We are holding this conference because earlier today, we published our report for Q4 2018. But before we open to questions, I would like to give the word to Lars to explain a little about our premium developments that has been asked a lot to.

So, I'll give the word to Lars.

Lars Thykier {BIO 16427122 <GO>}

Thank you very much. Sorry to keep your questions at bay. But I'd like to give a few introductory remarks. I do not think that I can teach you these accounting rules in this conference. So, just to give you a flavor of what happens. If you envisage what I would call a normal insurance, we underwrite an insurance in October month 2018, for instance, and this insurance comes into force the 1st of January 2019 and it runs the full year. If this insurance has a premium of DKK 100 (00:01:13) and we expect that claims and expenses and the risk margin will cost DKK 90 (00:01:20), then we'll book a DKK 10 (00:01:22) profit margin at year-end. And then in 2019, as the contract gets shorter and shorter, we'll move this DKK 10 (00:01:33) from the profit margin to the P&L gradually.

If we on the other hand envisage an onerous insurance where we have a premium of DKK 100 (00:01:47), but we expect that claims and expenses and risk margin is DKK 120 (00:01:53). Then the logic says that the DKK 20 (00:01:58) would be minus DKK 20

(00:01:59) on the profit margin. But that is not permitted. We have to pay the DKK 20 we expected loss (00:02:04) by a reduction in premiums.

That means that if we have an insurance with an expected gain, then we'll have this gain in 2019. If we have an insurance with an expected loss, we'll book this loss as a decrease in premiums in 2018. What we see in Q4 in Topdanmark is that we have a substantial increase in the expected combined ratio of some insurances especially illness and accident in 2019 compared to what we had in 2018. This means that we will have to deduct premiums from the P&L – from top line and from the P&L and put this aside as premium reserves to cover expected losses in 2019.

So premiums in 2018 will be lower, the bottom line in 2018 will be lower. In 2019, we will take the premiums we reserved from premium reserves and onto the top line, and use this to pay for the losses we have on insurance. So it'll be neutral (00:03:14) in 2019 while we'll have the losses in 2018. But as I said before, this hits the top line in Q4 and it hit it substantially. That's why the growth in Q4 looks so strange. I hope this would help your understanding of the Q4 account. Thank you. Peter?

Peter Hermann {BIO 20507411 <GO>}

Yeah. So we're now ready to answer your questions. So please ask them one at a time. And operator, may we have the first question, please?

Q&A

Operator

Thank you. Our first question comes from the line of Youdish Chicooree of Autonomous Research. Please go ahead. Your line is open.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Good afternoon, everyone. I've got two questions please. The first one is on your combined ratio guidance. So you are guiding for 89%, 90% for 2019, which is roughly 1 point better than this time last year, and also reflects the efficiency improvements you have made over the past year. So I was wondering whether you can tell us about the efficiency gains you're planning for 2019 and give us a sense of the amount of savings you are hoping to achieve. So that's my first question. And secondly, could you just comment on the pricing environment in private lines and then SME lines separately, please?

A - Lars Thykier {BIO 16427122 <GO>}

I didn't really get when, the efficiency gains, when, in 2020, or...

Q - Youdish Chicooree {BIO 17430923 <GO>}

Well, could you give us a sense of what cost savings you're planning to achieve in 2019.

A - Lars Thykier {BIO 16427122 <GO>}

No, not really. What we are going to do and what we have done the last few years is that we are investing pretty heavily in efficiency gains, but we are not making an exact roadmap for when this efficiency gains are achieved and how big they are. What you can see from history is that in 2017 we launched this concept that we would spend between 0.5 and 1 percentage point on investments and efficiency gains. And nonetheless, we have been able to reduce or keep the expense ratio at the same level. And that's simply because the gains we have got has been at least as big as the investments we have made.

In 2019, we expect this to balance or to move a little, so the gains we have made are a little bigger than the investments we are doing. And this means that that we have changed our combined ratio from expectation from 90% to 91% as it used to be, so it's 90% (00:06:17) as it is for 2019. I do not have the specific figure for the gains we are going to get at a given point of time.

Q - Youdish Chicooree {BIO 17430923 <GO>}

But is it fair to say you have basically harvested the low hanging fruits, and possibly as we move into 2019 or maybe beyond, any gains will be more or less offset by the investments you are currently making?

A - Lars Thykier {BIO 16427122 <GO>}

No. It just means that – the reason why I won't be more explicit about this is it is an ongoing process. And we are finding new ways to improve efficiency all the time and we'll have to make the necessary investments to gain this – or to improve the efficiency all the time. I'm sure that we will be able to improve efficiency very much during the years to come, but I don't have final figure.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Okay, all right, understood. Thank you.

Operator

Thank you. Our next question comes from the line of Jakob Brink of Nordea. Please go ahead. Your line is open.

Q - Jakob Brink {BIO 20303720 <GO>}

Thank you. So the first question is about the Danske Bank deal. It could be interesting to hear, I think, how you got to the roughly 0.5 percentage point impact on the growth in 2019. That was my first question.

A - Lars Thykier {BIO 16427122 <GO>}

I just have to warn you there are some problems with the phone, so I'm not sure I got all of it, but I think you asked why we are forecasting a 0.5 percentage point decrease in premiums due to the termination of the Danske Bank agreement. Is that right?

Q - Jakob Brink {BIO 20303720 <GO>}

Yeah. That is correct.

A - Lars Thykier {BIO 16427122 <GO>}

That is basically that we think the new business we have written through Danske Bank – we don't think, but we have counted in that it more or less disappears in 2019. That is not supposed to be the case and that is not what we have with the agreement with Danske Bank. But that is in our forecast. We have used this amount. This amount should cover the loss of new business and it should cover some of the additional business we have underwritten by the bank. The major part of the additional business that we underwrite with existing customers is not done by the bank but by our sales centers.

Q - Jakob Brink {BIO 20303720 <GO>}

So does that mean that it's around the – is this roughly half of your portfolio, let's say, DKK 1 billion that has been growing 5% and now it won't grow anymore? Is that how you got to 0.5 percentage point or...

A - Lars Thykier {BIO 16427122 <GO>}

No, no, no. Not at all. It is as I said – we suppose that the portfolio will decrease by, say, around 1 percentage point during the year, if we don't get any new business from Danske Bank. The 0.5 percentage points, that is 50% of this, we expect to get some business from Danske Bank, if not, they would not be in line with the agreement we have. But the 0.5 percentage is, in my view, a little bit conservative when we're talking new business. It is probably less than 0.5 percentage point we'll lose in 2019. But we have to see how this is being rolled out, how exactly we make this agreement with Danske Bank. We have worked with them for 20 years and I am sure that we will be able to find an agreement on how to cancel the – or to end this – or terminate this cooperation in a reasonable way.

Q - Jakob Brink {BIO 20303720 <GO>}

And then on 2020, how would it then be, because then the contract will have expired. And I guess, the 10%, you still have the (00:10:43) 1 percentage points drop you talk about is just the retention of around 90%, which I guess would then drop somewhat in 2020 if Danske can start to sell to Turk instead. (00:10:55) So what should we expect then? Is it 1% or is it 2% impact in 2020 or – if nothing else happens?

A - Lars Thykier {BIO 16427122 <GO>}

Again, we have problems with the phone and I hope I answer your question. What we have done is to state that we will receive – or we will reduce the total growth in 2019 by around 0.5 percentage point. In 2020, we won't get any new business from Danske Bank and we'll have the accumulated effect of the premiums we didn't get in 2019 as well. And there may be some impact on retention. That's true. We don't know how big it's going to be, we know that the retention is very high as it is now.

But when we're talking 2020, we are talking about something we don't know much about yet. We will not just let this (00:11:54) distribution channel disappear into nothing. Of course, we'll reallocate our distribution resources and look for other ways to keep the sales at the same level as we used to.

Q - Jakob Brink {BIO 20303720 <GO>}

Okay. And then just the final small question please. What was the discounting impact on the combined ratio in the fourth quarter? I couldn't find it.

A - Lars Thykier {BIO 16427122 <GO>}

Compared to last quarter, it was zero.

Q - Jakob Brink {BIO 20303720 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Asbjørn Mørk of Danske Bank. Please go ahead. Your line is open.

Q - Asbjørn Nicholas Mørk

Yes. Good afternoon from me as well. If I can just go back to the Danske Bank agreement, could you maybe disclose a bit on how will this impact your acquisition costs for 2019? I guess you also see quite a lot of costs from the distribution that you don't get. So what's sort of the impact there? And was there any impact in Q4 from the redundancies that you made in December on the back of this last (00:13:11) distribution agreement?

A - Lars Thykier {BIO 16427122 <GO>}

The redundancies we have made, has, of course, an impact on Q4 but it's very small. The impact on 2019 is too early to talk about. Of course, in the first place, we have not discovered – or we have not disclosed our agreement with Danske Bank. So, we have not told how much we paid Danske Bank for the cooperation. But you're right that it is not an insignificant amount that we used to pay. This will be saved, of course, when we don't get the references from the bank. But again as I said before, everything else is not equal. We are cancelling the cooperation with the bank, but we are doing – or we are putting other activities in place of this cooperation with the bank. So we cannot sack the team and save the money. We'll use the team for other purposes.

Q - Asbjørn Nicholas Mørk

Okay. That's very clear. Is there a sizeable difference in the combined ratio of the Danske portfolio and the rest of – I think you discussed or you mentioned that at some earlier stage. Is that enough to have an impact on your combined ratio for the next couple of years?

A - Lars Thykier {BIO 16427122 <GO>}

Not really. We have stated that the combined ratio of the private lines in Danske Forsikring portfolio is a little higher than the combined ratio of the private lines in the rest of Topdanmark. But the business mix is much different, we have lot of illness and accident, on top of workers' compensation in the rest of the business that we don't have at a comparable size in Danske Forsikring. So I think the best advice I could give to analysts like yourselves is to assume that it's same as the rest of Topdanmark.

Q - Asbjørn Nicholas Mørk

Okay. Fair enough. On your growth, if you look at sort of your private lines growth, if you adjust for the one-offs, you say 3.4% growth to premiums. (00:15:39) like 1.8% of the corporate side, how much is the market growing? Where are you taking market shares?

A - Lars Thykier {BIO 16427122 <GO>}

I think we are talking private lines.

Q - Asbjørn Nicholas Mørk

Yeah, yeah.

A - Lars Thykier {BIO 16427122 <GO>}

We are taking market share especially on accident, I think we're talking market share on the content (00:15:59). We are not taking the market share on motor.

Any addition, Steffen?

A - Steffen Peter Anker Heegaard {BIO 1513480 <GO>}

(00:16:08) in Q4, the market share is almost flat which is the first quarter for a long time that we had kept our market share.

A - Lars Thykier {BIO 16427122 <GO>}

A long time, in a long time. Yes. (00:16:19) We are increasing our market share not very fast, but a little bit in 2018 – or 2019, we suppose.

Q - Asbjørn Nicholas Mørk

Okay, fair enough. And weather claims, you still guide for DKK 170 million on normalized weather claims, it's – I mean if you look at the last couple of years, and I know that this has a tendency to be quite volatile midyear (00:16:45), but still it seems like DKK 170 million is much too high given the circumstance. So, is it just because that's how you've been doing in the past or should we really put DKK 170 million as a weather claim on a normalized basis going forward?

A - Lars Thykier {BIO 16427122 <GO>}

The DKK 170 million is not from our internal model. We have to make a probability distribution about how storms will be, how many storms and how big they will be. And the same goes for rainstorms. You can really (00:17:21) use this as a prediction for 2019. It is very volatile, I remind you that it is 20 years ago we had a very, very big storm of Anatol. And it was in 2011, we had the big rainstorms. So DKK 170 million, that's our best guess on the prognosis we can make on the risk premium we have on cat. (00:17:52)

Q - Asbjørn Nicholas Mørk

Okay. Then just really a final question from my side on the run-off gains, quite high in Q4 and if I add back the Alpha (00:18:01) provisions it's almost record high. Is there anything specific – is this sort of a – should we expect a higher level of run-off gains going forward or is it – I guess you would say no, but is it negatively correlated with investment returns?

A - Lars Thykier {BIO 16427122 <GO>}

I'm sorry to hear you're suggesting that it's negatively correlated with the investment returns. I think that effect disappeared for with the last year though. So this is 4Q for present. (00:18:30) What we have done is that we have looked at what's called this (00:18:43) that is way the Danish government has introduced the process that should make more people who have suffered some kind of accident or illness to (00:18:57) get back to work. And we have increased our expectation on how many will go back to work and how fast they go back to work. This has a small impact on the combined ratio this year but it has a substantial impact on the reserves we have made illness and accident. And that is why illness and accident run-off is so high as this.

On top of this, we had the German development (00:19:22) that the risk on the personal lines seems to be lower than we had expected it to be. And that goes for single accident, it goes for workmen's compensation and illness and accident as well. So that's the reason why it's pretty high this year. We have a very opaque situation for a couple of years because this public body that is assessing workmen's compensation claims has been more or less down for a couple years. So we haven't really seen any decisions since 2013, 2014. In 2018, again, we saw a lot of cases going through and it seems as if risk has come down.

Q - Asbjørn Nicholas Mørk

All right. So no correlation, that's very helpful. Thanks a lot.

A - Lars Thykier {BIO 16427122 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Mads Shinkle (sic) [Mads Thinggaard] (00:20:23) of ABG. Please go ahead, your line is open.

Q - Mads Thinggaard {BIO 15369662 <GO>}

This is Mads from ABG. Thanks for taking my questions. The first one regards to – or relates to claims before one-off, weather, large scale claims, et cetera. We have this uptick of 170 basis points. I don't know if you could kind of elaborate a bit on if that is simply underlying claims coming down to too low levels and that we should expect that to reverse a bit, or if you see any trends here. Thank you.

A - Lars Thykier {BIO 16427122 <GO>}

The long-run trend we've seen is downwards. But I think we spent a lot of effort on 2017 to convince everybody that 2017 was an unusual luck year. And only (00:21:19) our internal model, the basic non-life technical result was among the 3% best results that we could expect in a given year. So 2017 was far too low, coming above 2017 is just what you would expect, and I'll say that the 67.5% we have in 2018, that is below normal (00:21:43).

A - Steffen Peter Anker Heegaard {BIO 1513480 <GO>}

Hi, Steffen here. I can add to that. The reason why the underlying claims trend was better in Q4 was because of fires in Q4 and some additional burst pipes. And as you might recollect this that we have almost no fire in Q4 last year.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. Okay. Thank you. And then the next question on – I mean you have a guidance in the presentation for the life result in 2019 of DKK 200 million and DKK 230 million. I mean, I guess that averaged a bit down from 2018 due to IT costs investments, et cetera. Could you perhaps talk a bit about what you expect on that line in 2020 and 2021?

A - Peter Hermann {BIO 20507411 <GO>}

I think it's fair to say that we are spending a lot of time and also (00:22:44) that means cost on a new system and that's also affecting the prognosis for 2019. Now, we're taking a new system in force and that means that we're also going to do depreciations on the system going forward. So, you could also expect that the result will be (00:23:01) in the same line as have seen in 2019 going forward some years. And then we hope that we can see some efficiency gains from the system, so we also can see the cost result going another way than it is right now, because it's been negative for some years and it will be also the next couple of years.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. So, it's quite distant then that we will get an uptick here.

A - Lars Thykier {BIO 16427122 <GO>}

You will have to wait a couple years before we're dare to forecast an uptick. We think that it has been a very major investment we have made in the new live (00:23:36) system. And we of course hope and expect that the launch will be smooth. But I don't think that it has ever happened that you introduced a system that starts and (00:23:49) everything worked as it should. So we hope it will (00:23:51) have some extra cost in 2019 and 2020.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Yeah. Okay, understood. Thanks.

Operator

Thank you. And our next question comes from the line of Stefan Borg (sic) [Per Grønborg] (00:24:03), SEB. Please go ahead. Your line is open.

Q - Per Grønborg

Hi. Actually, it's me, Per Grønborg from SEB. Two questions from my side. The first, your solvency ratio is coming under pressure (00:24:14) coming down this quarter. Some background (00:24:18) I guess it's the life business, is that correct?

A - Lars Thykier {BIO 16427122 <GO>}

I'll say that the solvency ratio is the same as it was – than it was a year ago (00:24:27), and that's because these small differences are due to (00:24:29) What happened this time is that the – we have had this – what it's called – anti-cyclical (sic) [countercyclical] (00:24:44) buffer on the [ph] equities (00:24:48) has gone down a little which has been positive for the SCR. On the other hand, the losses we have had on [ph] equities (00:24:55) especially has meant that the loss absorption capacity of life has decreased. So the increase in SCR has been a little bigger and the increase [ph] in our funds, (00:25:08) but it is in my opinion very much the same as the last time, it's marginal changes.

Q - Per Grønborg

Okay. When I look at the numbers, solvency ratio last quarter 235%, now you're down to 210% before paying the dividend and you still earned money in the quarter.

A - Lars Thykier {BIO 16427122 <GO>}

Okay. I compare to Q4 2017.

Q - Per Grønborg

Okay. I'm comparing it significantly with euro term (00:25:33).

A - Lars Thykier {BIO 16427122 <GO>}

Yeah, yeah. But let's find – but then you have to be aware that there are – this difference from quarter-to-quarter. And since we have a lot of insurances that comes into force in the 1st of January, these insurances is more onerous in Q1 than they are in Q4. And that means for this reason alone, we'll see a change in the solvency ratio.

Q - Per Grønborg

So no major impact from lower buffers in the life portfolios?

A - Lars Thykier {BIO 16427122 <GO>}

No.

Q - Per Grønborg

Is that correctly understood?

A - Lars Thykier {BIO 16427122 <GO>}

That's right.

Q - Per Grønborg

Okay, perfect. My second question relates to the issue on the loss making sickness and accident, which I understood earlier today from Steffen that that was very much related to the non-life business you sell in connection with your life business. Is that correct?

A - Lars Thykier {BIO 16427122 <GO>}

That is correct, but it's not the full explanation. We have six business lines that hurts us (00:26:42) in this context. Illness and accident is the biggest, it accounts for around 50% of this. But we do put premiums aside on workmen's compensation as well on change in ownership on motor third party liability and a couple of other places. But the big change we have here, that is illness and accident and workmen's compensation.

Q - Per Grønborg

Okay. What I primarily would like to refer to is your normalized return on life insurance. This time you had a slide on page 50 where you include profit from non-life related products. If we revisited that matter (00:27:33) that line would be zero or even negative at the moment. Is that correctly understood?

A - Lars Thykier {BIO 16427122 <GO>}

If we look at the last many years, we have stated that it will become negative in our forecast. But (00:27:51) it has been positive. We have used 100% I think in this normal return and we know it's a small part. I don't expect it to be positive in 2019 to be perfectly clear. I expect it to be negative and disciplined (00:28:09).

Q - Per Grønborg

Any – are there room in the market (00:28:13) for hiking prices or is this just a part of the life selling – life insurance codes (00:28:17)?

A - Peter Hermann {BIO 20507411 <GO>}

Yeah. That is part – this is happening in the (00:28:23) this is how to do business at the moment in the life, that is, it is not giving a surplus selling these personal accident and illness products within life. We see it as a total when we sell a pension scheme looking at both what we can earn on the investment side, and that is both within the life company but also in Topdanmark's own investments company.

Q - Per Grønborg

(00:28:44)

FINAL

A - Peter Hermann {BIO 20507411 <GO>}

So, see it as a whole (00:28:44) if we look at the business. But that's right, it will be in the surplus – (00:28:47) negative, looking at these accident and illness products, but the rest of it will be at a positive.

Q - Per Grønborg

Okay. Thank you.

Operator

Thank you. There are no further questions coming through at this time. So, I'll hand back to our speakers for the closing comments.

A - Peter Hermann {BIO 20507411 <GO>}

Yeah. Thank you for taking the time to attend our conference. As you know, you're always welcome to call on one of us if you have any further questions and then we'll be happy to try to answer them. So, have a good evening or good morning, whatsoever – wherever you are. Bye.

A - Lars Thykier {BIO 16427122 <GO>}

Bye.

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