Q2 2016 Earnings Call

Company Participants

- German Egloff, CFO
- Gert De Winter, CEO
- Martin Wenk, Head of Asset Management

Presentation

Gert De Winter {BIO 19720616 <GO>}

Ladies and gentlemen, I'm delighted to present to you the highlights of the first half of 2016.

We are very satisfied with our operating performance during the first six months of this year. Our underlying profit rose significantly. The combined ratio was below the target range of 93% to 96%; and equity is higher than it was one year ago.

This financial stability means that we can actively manage our business. We are equipping Baloise for future challenges by strengthening reserves in the German non-life business; and adding a substantial amount of over CHF250 million to technical reserves in the life business.

Overall, the Baloise Group generated a profit for shareholders of CHF223.6 million for the first half of this year, which constituted a year-on-year reduction of 10.4%.

This drop, however, was due to the addition of CHF54.8 million to reserves in the German non-life business. If it had not strengthened its reserves, Baloise would have generated an operating profit of CHF261.5 million, which would have equated to an increase of 4.8%. However, by taking this one-off action we are putting the German business on a sound footing.

In addition to this measure, the business mix in Germany is undergoing a significant shift away from industry and towards SME and retail business.

Finally, new approaches to promoting sales are helping to boost growth in profitable target segments. We expect these to stabilize the financial performance of our German business.

Baloise net combined ratio was a healthy 92.5% and only just above the prior-year level. But if reserves had not been strengthened in Germany the ratio would have been 88.7%.

EBIT in non-life business went down. But would have been up by 0.5% year on year if the effect of the steps taken in Germany and the ongoing portfolio optimization are excluded. Overall, the volume of non-life business expanded by 3.1%.

In our life business we were able to continue with the planned switch to capital efficient risk and unit-linked products. As a result, our investment-type premiums increased by 18.5%, whereas traditional business declined as planned.

Turning to our investments, we can see that asset management has been very successful in adapting to the environment of low interest rates and the uncertainty surrounding currencies. The net return of 1.8% was 0.2percentage points higher than in the prior-year period. We also used the prevailing conditions to end the share buyback program earlier than planned.

I'll now hand over to our CFO, German Egloff, who will talk about the individual operating segments in more detail.

German Egloff {BIO 4782831 <GO>}

Many thanks, Gert. I'd now like to review our operating performance in the first half of 2016 with you. I'll start with slide seven and our non-life business. Later on, I'll go into more detail about the strengthening of the reserves in Germany that Gert mentioned just now. What I'm about to say ignores this effect for now.

Overall, the results for the non-life segment were very encouraging. The volume of business grew to over CHF2.1 billion in the first six months, which was a rise of 3.1%.

In Switzerland there was a slight slowdown in growth, due to the ongoing review and restructuring work. And to a selective underwriting policy in accident insurance and daily sickness allowance business. All other national subsidiaries generated a positive level of growth.

The business mix also improved because growth was particularly strong in our highly lucrative target segments. The investment income was up by 13.6% year on year. This is proof positive of how well we have responded to the difficult investment environment by reallocating investments.

Both claims and costs were slightly higher than in the first half of last year, which I will now explain on slide 8.

At 92.5% the net combined ratio was just about on par with the excellent ratio reported for the first half of 2015. If reserves had not been strengthened in Germany, the ratio would have been an outstanding 88.7%. Whichever way you look at it, we were below our target range of 93% to 96% for the first six months.

There was a small increase in the expense ratio, which amounted to 31.9% in the half-year period. This can mainly be attributed to DAC write-downs in Belgium. And to project costs in Switzerland.

Continuing the trend seen in recent years, the prior-year claims development was positive, reducing the claims ratio by 2.6percentage points.

The adverse impact of large claims increased slightly compared with the first six month of last year, amounting to 3.6percentage points in the reporting period. This was the result of natural disasters and individual large claims.

Adjusted for large claims incurred and profit on claims reserves, the underlying claims ratio was a very good 59.6%. This figure underlines the high quality of our non-life portfolio.

On slide 9, we can see the changes in the combined ratios on the individual countries. The combined ratios for Switzerland and Luxembourg were excellent, with both countries improving on what had already been outstanding ratios in the prior-year period.

Switzerland reported a ratio of 78.4%, which constitutes a reduction of 6.5percentage points. The reason for this is a relatively favorable claims environment in all sectors and the improved business mix. What's more, the profit on claims reserves benefited the claims ratio.

Our international markets of Belgium and Luxembourg also exhibited a very high level of operational profitability. As in Switzerland, we have a strong market position in these countries. In Belgium, the combined ratio was a very good 94.1%, even though the claims ratio was adversely affected by two major events.

By contrast, there is potential for improving the technical profitability of the German non-life business. I'd like to look at this briefly on slide 10.

In Germany, we have repeatedly been confronted with losses on claims reserves over the past few years. Furthermore, the low interest rates mean that it will become necessary to strengthen reserves for annuities in the liability insurance business.

That is why. And because we want our resources in Germany to be focused on the future, we strengthened reserves in the German non-life business by around CHF55 million. Specifically, we have lowered the discount rate for annuity reserves by 0.75%.

In addition, the claims reserves were strengthened by an amount that means that future profits in Germany will no longer be impaired by legacy issues. This had an adverse impact on the combined ratio in Germany of around 15percentage points, taking it to 116.3%.

Without this one-off negative effect, the ratio would have improved year on year. On a positive note, the expense ratio in Germany went down.

The initiatives to reduce headcount are proceeding to plan. We are confident that by taking these steps, we have laid the foundations for holding the net combined ratio below the 100% mark in the coming years.

Let's now move on to slide 11 and the life business. The slight contraction in the volume of business was a consequence of deliberately scaling back new business, particularly in traditional single-premium business, in view of the interest rate situation. As a result, the business mix shifted further towards innovative capital efficient insurance solutions.

This is highlighted by the strong growth of more than 160% by our semi-autonomous pension solution, Perspectiva. And by the marked rise of almost 20% in investment-type premiums.

Moreover, this very encouraging improvement in portfolio composition is reflected in the Group's new business margin, which was actually slightly higher than at first half of 2015, despite a further decline in interest rates.

At CHF46 million, profit in our life business was lower than in the prior-year period. But this is explained by the substantial addition of over CHF250 million to strengthen technical reserves, in view of the interest rate situation.

By the reserve strengthening, we make the balance sheet more robust and further reduce the average return required to meet guarantee obligations.

Overall, earnings in our life business have thus proven pleasingly resilient, despite significant headwinds from the level of interest rates, which have fallen sharply, again, in both Switzerland and the European Union, following the Brexit vote.

I'd like to finish on side 12, by taking a look at equity. With equity of CHF5.4 billion. And a carrying amount per share of CHF116.5, Baloise remains strongly capitalized.

This can also be seen from the confirmation from Standard & Poor's of our credit rating of A with a stable outlook. The rating agency thereby acknowledge Baloise's very healthy AAA level capitalization, high operational profitability. And robust competitive position in its profitable core markets. Standard and Poor's also rated our risk management as strong.

The share buyback program that we had started in 2015, with the aim of acquiring 2% of the registered share capital, was ended earlier than planned, by the end of July 2016. As a result of this program, more than CHF100 million was returned to shareholders in total.

Having given you a summary of our excellent set of key figures for the first half of this year, I would now like to hand you over to Martin Wenk, who will talk in more detail about the good gains that we made on our investments.

Martin Wenk {BIO 4193573 <GO>}

Thank you, German. It is my pleasure to present the investment result.

Our asset allocation stayed largely the same. The minimal changes are the result of changing market values. Higher bond prices increased this position and decreased most of the others, for example, the equity position by 0.2percentage points.

Nevertheless, it is difficult to maintain the exposure in certain asset classes, namely real estate and mortgages. We therefore hired some more professionals for our real-estate department. While, for mortgages, our tried and tested collaboration with Baloise Bank SoBa, is protecting our excellent position in this market.

Let's have a look at the investment result. My comments pertain to both the life and non-life slides.

The market started 2016 turbulently and ended the half-year in the same way, due to the unexpected result of the Brexit referendum. This led to even lower interest rates in developed markets.

Despite that effect, we were able to maintain our current income at the levels of the prior-year period. We achieved that by switching bonds in all bond portfolios and carefully expanding our US dollar segment, which generates higher yields, even when fully hedged, than the Swiss franc and euro segments.

We always decide on the basis of risk capital adjusted returns and maintain our high quality standards. However, we worry about the ever-diminishing liquidity of the interest rate markets, both the underlying bond market and the derivative market.

Banks losing their trading appetite and central banks monopolizing certain bond markets make it difficult to invest. 80% of bonds issued in Swiss francs are trading at negative yields. It is a real challenge to find the golden opportunity in the remaining 20%. So it is even more important that rental income and mortgage payments provide a stable base for current returns.

The bond switches mentioned before generated gains on fixed income investments. And our long-standing portfolio of swaptions returned additional revaluation gains that can be used to strengthen our technical reserves and will lower the necessary yield for future reinvestments.

Some small impairments were necessary on equities. But were offset by gains realized on our hedging program. We carefully revaluated our real-estate portfolio and adjusted only modestly.

The equally erratic currency markets left no trace on our income statement. This was due to the absence of any position in pound sterling. And our extensive hedging program. The effects, you see in the table, are purely hedging costs.

All in all, the investment result in the life segment reached CHF779 million, an increase of 9.4% compared to last year's result for the first six months; and the net return of 1.7%, up from 1.5%.

The corresponding figures for non-life were CFH150 million, an increase of 13.5%. And a yield of 1.6%, up from 1.4%.

I'll now hand back to Gert De Winter.

Gert De Winter {BIO 19720616 <GO>}

Many thanks, Martin. Ladies and gentlemen, Baloise demonstrated its financial stability once again in the first six months of this year. It is, therefore, underpinned by very strong foundations. And is fully prepared for the next strategic phase.

For our customers, we plan to simplify our structures and be more than an insurance Company, with our future focus on the ever-changing demands in the digital age.

For our employees, we want to create an environment that encourages entrepreneurship. While, for our investors, our aim is to maintain a consistent attractive dividend policy. Our current objectives, therefore, remain unchanged.

At the strategy day on October 26, we will present the core aspects of our long-term strategic direction.

Thank you for watching.