Q1 2016 Earnings Call

Company Participants

- Jarmo Salonen, Head-Investor Relations & Group Communications
- Kari Henrik Stadigh, President, Group Chief Executive Officer & MD
- Peter Kristian Johansson, Chief Financial Officer
- Ricard Wennerklint, Deputy Managing Director, If P&C Insurance Holding Ltd

Other Participants

- Blair Stewart, Analyst
- Christian Hede, Analyst
- In-Yong Hwang, Analyst
- Jonny Urwin, Analyst
- Matti Ahokas, Analyst
- Niccolò Dalla Palma, Analyst

MANAGEMENT DISCUSSION SECTION

Jarmo Salonen {BIO 1860650 <GO>}

Ladies and gentlemen, welcome to this Conference Call on Sampo Group's January-March 2016 Results. I am Jarmo Salonen, Head of Investor Relations at Sampo. With me here in the studio, I have our Group CEO and President, Kari Stadigh; Group CFO, Peter Johansson; and Deputy CEO of P&C, Ricard Wennerklint.

We'll start with Kari's introduction into the Q1 development and afterwards take your questions. Let me start by reminding you that this transmission can be followed online at sampo.com/results and a recorded version of the call will later be available at that address.

With these words, I'll hand over to Kari. Kari, please.

Kari Henrik Stadigh {BIO 1504152 <GO>}

Thank you, Jarmo. Welcome to the conference call on my behalf as well. The insurance business within the Sampo Group continued its solid performance also in the first quarter. Nordea's contribution to our result was down 30%, as they had already reported earlier. Also, the effect of a weak investment environment can be clearly seen in our mark-to-market numbers.

As we have so many times before communicated, one quarter numbers in P&C insurance are not very informative. This time, even more so, as If reports a combined ratio of 83%, including a €72 million non-recurring reserve release from the Swedish Motor TPL reserves. This following the review of mortality tables by the Swedish Insurance Federation.

Excluding this one-off positive item, the combined ratio would have been 89.8%. And if we then continue and correct this item with the negative outcome in large claims, we are back to or actually below our combined ratio in the corresponding quarter last year. So really, not very informative and too many one-offs or corrections to my taste. But all in all, a very strong insurance result and, of course, as planned. Based on this strong performance, we have adjusted our guidance for the full year combined ratio to 88% and up to 91%, excluding the positive non-recurring reserve release.

Nordea. Nordea reported weaker numbers than in the corresponding quarter last year. However, given the lower interest rate environment, combined with the difficult investment market in the two first months of the year, an operating profit of over €1 billion is still a solid sign of the strong position the bank has in the Nordic countries.

When analyzing Nordea short-term communication to the market, our reading is, one, net interest income will at best be flattish. Two, costs will grow roughly up to 3% in local currencies. Three, credit quality largely unchanged in the coming quarters. And summing up all these is actually fine, given the goal to gradually increase the dividend year-after-year.

The big agenda in Nordea is, of course, very different. Simplification of the operations and IP (04:07) massive investments in Nordea, as well as diversification of the legal structure. All this targets, of course, to significantly increase shareholder value in the coming years.

Our life business, gross written premiums were significantly down in the first quarter, but the whole market was down even more. However, the profit before taxes was up 36% and on top of that, we were able to lower discount rates even further. Now they stand at 1% this year, 1.25% for the next year and 2% for 2018.

In the parent company, the net debt is now at €1.4 billion, this is after €1.2 billion we paid in dividend in early May. So, also our capital position is very strong indeed. I can't say anything else, but safe sailing as such.

Jarmo Salonen {BIO 1860650 <GO>}

Thank you, Kari. Operator, we are now ready for the questions.

Q&A

Operator

Thank you. And our first question comes from Christian Hede from Nordea. Please go ahead.

Q - Christian Hede {BIO 18642300 <GO>}

Yes. Good afternoon. This is Christian from Nordea in Copenhagen. I have a couple of questions. One is on your rating uplift from S&P – one is on your lift – the rating uplift on S&P, can the rating become too high for you, and what is the benefit of the level you have now? Would you like to take it down again, so to speak?

And then also, I would like to ask some questions on the growth in Denmark and Norway, where in Norway you have negative organic growth, as I see it for the second quarter in a row now. What should we expect going forward from here? And on a more positive note, the growth in Denmark seems to be positive for the first time in many quarters, is there anything changed there or this is more of a coincidence? I think that will be my two questions. Thank you.

A - Peter Kristian Johansson {BIO 3902189 <GO>}

Here (06:18) I can take the first one on the rating. No, we don't want a higher rating and we have clearly also communicated with S&P that we don't need a higher rating. The reason was that we wanted them to look also on the parent company, and they're – basically to get a rating for Sampo plc. In the past, we only had a rating from Moody's.

Q - Christian Hede {BIO 18642300 <GO>}

Thank you.

A - Ricard Wennerklint

Growth, I think we start with Denmark (06:47) (06:48) growth for the last couple of years, so that is unchanged. And you could actually see volatility from large contracts, mainly in industrial, so that that is what changed year-on-year.

The Norwegian market is still affected by premium pressure, especially in the commercial and industrial segment. Well, that will continue or not, your guess is as good as mine.

Q - Christian Hede {BIO 18642300 <GO>}

But that doesn't sound reassuring, I would say. I'm sorry, that was joke. Maybe on the last question, the investment results so far in Q2, can you comment on that in any way, shape or form?

A - Peter Kristian Johansson {BIO 3902189 <GO>}

From which side, you mean, P&C or life?

Q - Christian Hede {BIO 18642300 <GO>}

I was thinking on the P&C business.

A - Peter Kristian Johansson {BIO 3902189 <GO>}

On the P&C, because we knew already in February that we will get this huge reserve release in Swedish Motor, so we decided not to realize any gains in March because – when the market turned positive, so we wanted to maintain the same positions. And then there was also minor impairment losses in If in March, so some €15 million (08:12). No impairment losses in life insurance.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

But then (08:15) you must of course be prepared for low investment returns in If, because the equity weight is only 13% and our running yield is 1.5%.

A - Ricard Wennerklint

1.8%.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

1.8%, sorry, and then, of course, when we invest in new bonds at this moment, it's anything between zero and 1%. So, I think that it is evident that we have to adjust our thinking to low investment yields in If in this environment.

Q - Christian Hede {BIO 18642300 <GO>}

Thank you. That's very clear.

Operator

Thank you. The next question comes from In-Yong Hwang from Goldman Sachs. Please go ahead.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Hello. Two questions from me. Firstly on the Mandatum Life solvency ratio, without the transitional measures, it looks like it's below 100%. Does that worry – cause you worry for you (09:12) or the regulator, probably more importantly? And the second question is on the premium development fund then, I think has had a (09:19) quite sharp decline in the first quarter, is that just a one-off effect or is there kind of pricing cuts there (09:25) (09:27)? Thank you.

A - Peter Kristian Johansson {BIO 3902189 <GO>}

On the Mandatum solvency ratio, so it's no concern that we are below the solvency requirement excluding the transition rules, because the Finnish FSA has clearly communicated what they follow is the transition rule solvency. Because in practice, with profit businesses in run-off (09:55). And also, we haven't used any of the hybrid capacity that we have.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

On the gross written premiums, they were down, however, the market was down even more. The investment market wasn't very attractive in the two first months of the year. It was not the market where you were able to sell any risky product to our client. So, I would say that the volume development reflects very well the uncertainty in the investment market.

Going forward, I would expect that as long as this uncertainty continues, the premium levels are not going to be as high in the market in general as – in Finland as they were last year. As you are very well aware, we have own direct sales and then we sell through Danske. This time it was especially the retail market through Danske which suffered of the general environment. Our own sales were roughly at the same level than the previous year, 2014, but Danske was even below that.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Sorry, apologize. I didn't make myself very clear. I was asking more on the P&C side, but that was very useful color as well. Is there any comment you make (11:25) on the P&C side, sort of the prices minus 3.9% (11:28) in the first quarter in Finland?

A - Ricard Wennerklint

You were asking about the Finnish premium?

Q - In-Yong Hwang {BIO 18784369 <GO>}

P&C, yeah.

A - Ricard Wennerklint

Yes. Okay. Finnish premiums is affected by, first of all, the downturn in the Finnish economy. Secondly, we had a one-off one (11:49) product that we basically discontinued, which is around 1% of that bit (11:57) more than 3% that we were down in the first quarter. And thirdly, of course, you have in Finland, a significant part of our industrial business, which have had a downturn throughout the Nordics due to mainly premium pressure coming from new and existing players in the industrial market.

Q - In-Yong Hwang {BIO 18784369 <GO>}

All right (12:21). Thank you.

Operator

Thank you. The next question comes from Matti Ahokas from Danske Bank. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes, good afternoon. It's Matti Ahokas from Danske. A question on the Swedish P&C business. You continue to show very nice premium growth altogether, but could you a bit, Ricard, elaborate on which parts of the market this growth is coming from, i.e. private, commercial, industrial, and is this a function of increasing volumes or higher prices or both? Thanks.

A - Ricard Wennerklint

Growth in Sweden is within the retail business, private business, but also commercial business, not so in industrial. And large corporate, there's actually a decrease. To some extent, premium increases but mainly increase number of customers.

Q - Matti Ahokas {BIO 2037723 <GO>}

Does this reflect some kind of more aggressive marketing or how come – what is the reason for the increasing number of customers?

A - Ricard Wennerklint

Increasing number of customers are twofold. One is continued increase in car sales in Sweden, which of course effects our business. The second is the improvement in the underlying business and also sales through Internet and the Nordea channel is important.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks a lot.

Operator

Thank you. The next question comes from Blair Stewart from Bank of America/Merrill Lynch. Please go ahead.

Q - Blair Stewart {BIO 4191309 <GO>}

Afternoon. It's Blair here. I've got three questions actually. Firstly, just looking at the movements year-on-year in the combined ratios across a few of the countries. If you adjust for the reserving, Sweden was down quite nicely, I think about 6 points or 7 points combined ratio improvement year-on-year, Denmark about the same and Finland was actually the other direction, up about 6 points. Is that just normal year-on-year volatility or is there anything more fundamental going on there with the combined ratios in Q1?

Secondly, Kari, you made a comment about we need to adjust our thinking to cope with the low yield environment. Just wondered what you meant by that. Is that thinking on the underwriting side or thinking in terms of being a bit more innovative (14:55) perhaps on the investment management side?

And thirdly, possibly for you, Peter, you talked about hybrid capacity, I think, in relation to the life business, so just wondering if you're prepared to comment on what you think the hybrid's capacity for the group might be? Thank you.

A - Ricard Wennerklint

If we start with combined ratio development year-on-year, if you exclude one-offs, if you exclude large claims, run-off and look at, in lack of better terms, sort of underlying profitability, it's been fairly stable year-on-year. So most of the volatility is from large claims and reserve changes.

Q - Blair Stewart {BIO 4191309 <GO>}

Thank you.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

On the investment side, I meant exactly what I said, I meant that in a low interest environment I'm surprised that how many people are finding out now that fixed income is not returning anything. So for me, it's obvious that in a low interest environment with the duration we have and so (16:01) fixed income yields are low.

Q - Blair Stewart {BIO 4191309 <GO>}

So, does that just simply mean lower returns, Kari, or are there ways you can mitigate those impacts is really what I was meaning?

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Well, we have given a combined ratio guidance, and you know that our cost ratio will go 1 decimal point down every year, and then – so then the only lever we are now talking about is that the investment yield will be lower on fixed income. So, what it means is that the equities have to perform; if they don't, then the investment yield is low.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Understood. And you've also got a large stop (16:42) of unrealized gains, the fair value reserve is a significant number. Is that something that you look to utilize over time? I know it changes quarter-on-quarter, but it does tend to be a significant number.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

I was talking mainly mark-to-market now.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Then of course we have unrealized gains which we can treat any way we want.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. Okay. And on hybrids?

A - Peter Kristian Johansson {BIO 3902189 <GO>}

Yeah, Blair on the hybrids, if you look – theoretically, if you (17:10) of course, have a huge hybrid capacity, but then (17:14) to make it sensible, so that also the rating regencies will give credit. For the hybrids, maximum in life insurance would be €300 million, because they have to take into account also that it is gradually running off the liability. So that means also the SCR is coming down.

If, I would say, it's probably in the region of €400 million to €500 million. And on the group level, if we would use hybrid capacity also Sampo plc , which we have only used when we bought out the other shareholders from If, you could add another €400 million to €500 million. So, in the region of €1.2 billion, €1.3 billion.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

And today the hybrid that we have issued is mainly owned by the parent.

A - Peter Kristian Johansson {BIO 3902189 <GO>}

Yes.

Q - Blair Stewart {BIO 4191309 <GO>}

Yes.

A - Peter Kristian Johansson {BIO 3902189 <GO>}

€10 million is outside the group.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

And how much we sold by the parent?

A - Peter Kristian Johansson {BIO 3902189 <GO>}

€350 million.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Which we could sell tomorrow in the market if we wanted to have a quick fix for something.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. Very clear, gentlemen. Thank you.

Operator

Thank you. And the next question comes from Niccolò Dalla Palma from Exane BNP Paribas. Please go ahead.

Q - Niccolò Dalla Palma

Hi, good afternoon. If I may follow up on the hybrid question. Could you tell us, Peter, at what point would you trigger an issuance of hybrid at the level of Mandatum? Is there a precise action plan or is it just when the – when and if the regulator asks you to do so? So you will try not to use that capacity. If you could say something on that. And maybe also on the on the holding loss, excluding Nordea, can you just explain to us what drove that quarterly volatility this quarter? Thank you.

A - Peter Kristian Johansson {BIO 3902189 <GO>}

Hybrid on the life from time to time we talk about it, but we haven't made any decisions yet, because actually, the dividend flow from Mandatum has been enough to fund our own dividends. But we could of course at some point also take an extra dividend and put in some hybrids, but we haven't made any decisions on that.

The volatility on the holding company, most of the volatility comes from FX. So if you – and last year in Q1, we also had one-off gains from dividends from Swedbank (20:06) shares and also some sales gains from Swedbank (20:10) shares. So it was an exceptionally high. And also we had a positive FX result in Q1 last year. And Q1 this year, we had €3 million negative FX results. So if you take out the €3 million from the minus €12 million, then it's a pretty normal quarter, but due to the FX volatility, it always bounces back – slightly back and forth (20:36).

Q - Niccolò Dalla Palma

Okay, thank you. And if I may follow up with another question and sorry, it may be a bit basic, but on the mortality tables changes in Sweden, is the impact on the Motor TPL reserves coming from, basically, less expensive annuitizations? And if so, does it actually mean that the new mortality tables mean that people die quicker than in the previous tables? Sorry, for the basic questions, just trying to understand the mechanics.

A - Ricard Wennerklint

On the mortalities. The mortality table is actually largely unchanged but it was better than what we expected, so we could release some reserves and it all (21:25) comes from the Motor TPL reserves from the reserve for annuities.

Q - Niccolò Dalla Palma

Okay so you had a more conservative table than the one that was finally adopted, so that's...

A - Ricard Wennerklint

Exactly.

Q - Niccolò Dalla Palma

Okay.

A - Ricard Wennerklint

We affected a larger change done like that... (21:41)

Q - Niccolò Dalla Palma

Okay.

A - Ricard Wennerklint

...but one that we're finally on the table when the analysis was done.

Q - Niccolò Dalla Palma

Okay. That's very clear. Thank you.

Operator

Thank you. Next question come from Jonny Urwin from UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi. Good afternoon, everyone. Just one follow-up question from me, please. Just thinking about Mr. levers, (22:01) Blair, who was asking about – I mean just thinking about the combined ratio, I know we've got guidance for this year, which is very helpful, but just thinking about the sort of future years. I mean, I guess the cost ratio is what it is and it'll track down gradually. But is there anything you can do around the loss ratio to get that any lower from already impressive levels? I mean, is there anything you can do on claims management, on pricing, on risk selection? I mean, maybe thinking about especially in the (22:29) digital world, where capability is increasing everyday for risk selection. And just maybe some more broader comments around the combined ratio and loss ratio in particular going forwards would be great. Thank you.

A - Ricard Wennerklint

Cost ratio is where it is, yeah, but we still expect to improve cost ratio with at least 0.1% or 0.2%, or even 0.3% year-on-year, based on more efficient operations and change buying patterns from clients, mainly clients going to more automatic digital services, so that is the change. On pricing, there are a lot of things changing in pricing almost on a daily basis, of course, the question is how much of that we give back to the client and how much of that means a change in combined ratio. And as you can see from our outlook, we don't really expect to change the combined ratio target, as of now.

Q - Jonny Urwin {BIO 17445508 <GO>}

And what about sort of claims management and risk selection and things like that?

A - Ricard Wennerklint

That supports things that we work on all the time, things that we have to improve and change when our knowledge change or when we can use new data and improve pricing and also, of course, improve risk selection, but it doesn't necessarily mean that we target a lower combined ratio all the time. And currently, that's not the case.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thank you.

Operator

Thank you. And the next question comes from Anna of RBS. (24:20) Please go ahead.

Q - Jarmo Salonen {BIO 1860650 <GO>}

Hi. Sorry. One follow-up question on Denmark. Not sure even if you (24:25) covered this, you have 3.7% premium growth while all of your peers have been facing some pricing pressure. So could you give more color on that, please?

A - Ricard Wennerklint

We face the same market as everyone else in Denmark, however, we manage to take on some more clients especially in the small commercial and the private segment. In addition to that, we haven't really lost any of the large corporate business that we have seen in other markets. I don't think we face a different market than the rest of our competitors in Denmark but we have done better these quarters, simple as that.

Q - Jarmo Salonen {BIO 1860650 <GO>}

Okay. Thank you.

Operator

Thank you. And as there are no further question, I hand the conference back to you, speakers.

A - Jarmo Salonen {BIO 1860650 <GO>}

Thank you. Ladies and gentlemen, thank you for your attention and have all a very nice evening. Thank you.