Q2 2016 Earnings Call

Company Participants

- Jarmo Salonen
- Kari Henrik Stadigh
- Peter Kristian Johansson
- Torbjörn Magnusson

Other Participants

- Blair Stewart
- In-Yong Hwang
- Jonny Urwin
- Matti Ahokas
- Michael Igor Huttner
- Paul De'Ath
- Sami Taipalus
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Jarmo Salonen {BIO 1860650 <GO>}

Ladies and gentlemen, welcome to this conference call on Sampo Group's January June 2016 Results. My name Jarmo Salonen. I'm Head of Investor Relations at Sampo. And with me, I have our Group CEO and President, Kari Stadigh; Head of P&C Insurance, Torbjörn Magnusson; and Group CFO, Peter Johansson.

As always, Kari will begin with a short summary of the main events in Q2, and then we'll continue with your questions. Let me remind you, first of all, that this transmission can be followed on our website, sampo.com/result, and a recorded version of the call will later be available at the same address.

Now I will 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. Operationally, Sampo reports strong numbers for the first half year. This is best seen in the P&C business combined ratio. Even the positive one-offs booked already in the first quarter, the combined ratio is at an all-time low level. As we don't generally like one-offs and especially we don't like to explain our performance by excluding one-offs, this time, we however do so. As the one-offs are positive, this is also prudent. Without one-offs, the fact is that the combined ratio at 87.1% for the first half year is best ever.

The main reason for the 15% decline in the P&C insurance result is the lower investment income. In 2015, we booked 1.6% investments return. And in 2016, at first half year, we have booked only 0.8% investment yield. The difference of 0.8% in investment income explains more or less the decline in the P&C profit.

Nordea performed well in the second quarter, and the contribution to Sampo profit grew by 5% to €205 million. However, on a yearly basis, Nordea's contribution is still 13% behind 2015 numbers. So there is still some room for them to catch up. The Nordea CEO, Casper von Koskull, commented in his Q2 statement the following. Net interest income has been under severe pressure for many years due to lower interest rates and low volume growth. Net interest income declined 8% compared to the same quarter in 2015.

However, it improved somewhat, and for the second half of 2016, we expect an inflection point with an improving trend for the first time since 2012. This is very comforting and of course very relevant as such. Mandatum saw its premium shrinks by 27%. However, the whole market declined by 38%. So Mandatum Life gained clearly market share.

As you are well aware of, our operations are not managed on the base of market share but profit. Mandatum Life's profit for the first quarter grew by 28%. On top of this, Mandatum Life was able to lower its discount rate to 0.5% for this year, 1% in 2017 and to 1.75% for 2018. With a running yield of 3.1% in the fixed income portfolio, the overall situation seems to be well under control even in this low interest rate environment.

Sampo NAV decreased from €22.09 to €18.83 during the first quarter. The main reasons were the dividend that we distributed during the quarter of €2.15, and of course, the Nordea share price decline which affected the NAV by €1.08. However, with today's share price, more than €1.15 has been recovered as Nordea trades at roughly our book value today.

Finally, our outlook is not much changed, but it's mostly unchanged. However, we narrowed the guidance for the combined ratio from 87% to 90%, whilst showing the strength of our P&C business going forward.

Jarmo Salonen {BIO 1860650 <GO>}

Thank you, Kari. And, Operator, we are now ready to take the questions please.

Q&A

Operator

Thank you. And our first question comes from the line of Matti Ahokas from Danske Bank. Please go ahead. Your line is now open.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yeah. Hi. It's Matti Ahokas from Danske. I guess it's me. Two questions please. Firstly, if for some reason Nordea would have to cut their dividend for this year whatever that might be, is the ambition for Sampo still to grow the dividend and is it possible to still grow the Sampo group dividend in a situation like this?

The second question is that Kari pointed out that the Nordea's NII seems to have recent inflection point at least according to Nordea's CEO as well. What about the If's premium income, how should one look at this? Should we also assume that If's premium – net premiums have also reached the kind of inflection point and what are the kind of key drivers and uncertainties on that line? Thanks.

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

I, of course, cannot comment on Nordea dividends, anything but what Nordea is guiding. And Nordea is guiding slightly increasing dividends for the coming years. However, if we look at the analyst consensus estimates, they are lower than Nordea's guidance. And if we were to use this guidance, these analyst estimates' averages, we would be able to propose to the board an increasing dividend for Sampo. So we are quite comfortable with the present situation.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

When it comes to If's premium development, it's of course driven by completely different mechanisms, one, (07:22) market being the general GDP development which is key and also the competitive environment and that doesn't change quickly with macro factors.

Q - Matti Ahokas {BIO 2037723 <GO>}

So you don't believe that If's premium decline has stopped or has it stopped then – it seems at least that the GDP development seems to be picking up or at least not deteriorating, picking up in Finland and still remaining good in Sweden, so how should one look at this?

A - Peter Kristian Johansson {BIO 4000174 <GO>}

In the sense that you're asking, we have already passed the inflection point because we have a positive development in Q2 for the premium income. But if you give me some GDP growth, I'll give you some premiums.

Q - Matti Ahokas {BIO 2037723 <GO>}

Fair enough. Thanks.

Operator

Thank you. Our next question comes from the line of In-Yong Hwang from Goldman Sachs. Please go ahead. Your line is now open.

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

Yeah, good afternoon. Thank you for taking my questions. They're based on If P&C. Firstly, on the investment income, I think last year you talked about the fact that you've realized much gains there because of the one-off you saw from the Swedish MTPL reserve release. Is it fair to assume that that's still the case in 2Q? I think you saw quite a benign large loss environment in the quarter. And I guess (08:47), should we expect a slightly higher investment going forward if these positive one-offs don't happen?

Secondly on the internal dividends out there and slightly linked to your comment earlier about Kari committing to increase the dividends, you saw last year a step-up in Mandatum Life internal dividends, but If P&C was pretty flat. So is there room to get more out of If P&C since their business is largely ex-growth? Yeah. Thank you.

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

I think that we – our internal dividend payout has not been 100%. So I feel that, if there is no growth, the businesses really don't know – don't need capital for anything else except for segments that covers (09:40) the bank and the insurance business. So – and as you are well aware of, the management (09:45) decide on the dividend. It's a proposal to the board that – sorry, we have – the management is committed gradual increased in our dividend going AGM then finally decides on a different story but we have always said that we like the dividend to grow gradually. That is the goal in our thinking and operations.

On If's investment income, I think that if we booked this year 0.8% return for the half year and we have a portfolio with a running yield of 1.7% then I think that you shouldn't expect higher investment incomes than what we have at this level as long as the interest rates stay as low as they are. But this is – your guess is as good as mine. I only refer the running yield to what we see now.

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

Sure. Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Paul De'Ath from RBC. Please go ahead. Your line is now open.

Q - Paul De'Ath

Hi there. Just a couple of questions from me. Firstly, on the large losses that you didn't see in the quarter for the year - better than expected large losses in BA industrial, how much of that is purely just kind of one-off do you feel, or is there an element of your benefiting from reducing the amount of business that you're selling in the industrial segment, and therefore kind of what the - where should we think of future direction in terms of combined ratio on that business? That's question one.

And then the second point was just on the Mandatum Life business. You mentioned that the overall market premiums are down more than your premiums. Is that largely the level of market volatility that we're seeing that's been driving down the premiums in the market there so is there anything else going on that we need to be aware of? Thanks.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

The large losses in industrial, all of it is one-off, and the reduction from reduced market share for some large clients, that's tiny compared to the overall book.

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

On Mandatum, I think that the market has deteriorated or been shrinking mainly because the insurance wrappers have been under discussion what their tax treatment would be going forward. There has been uncertainty in the press. We haven't seen any changes in the taxation. But there has been a lot of speculation on that. And I think that has been a thing that has affected the life insurance market. Then the other area is of course that given the volatility in the equity market, people have been quite careful and have been investing in less riskier assets.

Q - Paul De'Ath

Okay. Thanks.

Operator

Thank you. Our next question comes from the line of Vinit Malhotra from Mediobanca. Please go ahead. Your line is now open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. So, on the S&P Capital, the excess S&P Capital in the P&C, some used to be a bit higher even after 3Q. And then since 4Q, we are at this €400 million, €500 million range. Is that just going to be built up over the years - over the quarters or the coming quarters or is that the level we should be thinking about? And the reason I ask is I'm thinking have asked (13:58) in the previous period as well, and I was like why you said there was a dividend effect which was one-off, but then now we are sort of at that level a bit more. So that's really my question. Thank you.

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

Vinit, actually we had, last December, when we took a dividend promise, we left a buffer of €200 million. But it wasn't driven because of the rating. It was more driven by how much we needed cash from the parent company. So that's - it's not science, so it doesn't mean if we go below the S&P Capital by €100 million or €200 million in a single quarter, I don't think it would have any rating implications. But we looked both at the S&P Capital, and then we look at the cash needs on the parent company level.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sure. Thank you. Can I ask one question please on Nordea and the book value treatment? So just from the way the book value was and the share price has been, it was last at below the book value in 2011 or 2012, and after that, it's been generally above. And now you're saying it's just about at par. Is that something that bothers you? Is that something you worry about from potential impairments or any such thing? I'm assuming (15:25) just clarify please.

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

It bothers me but it doesn't have any implication on impairments. So it's basically only that (15:37) at year end, we would be below the book value, then we would of course have to do an impairment test. And so we would have to make cash flow forecast. And we basically do that every year even if the share price has been clearly above the book value.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right.

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

Low (15:59) interest rate environment where we are and what kind of risk premiums you would put on assets like this, there is no risk for an impairment. We would do, like Peter says, an impairment test. But the outcome would be clearly positive.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Of course. All right. Thank you.

Operator

All right. So our next question comes from the line Jonny Urwin from UBS. Please go ahead. Your line is now open.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi there. Thanks for taking my questions. Just two for me today. So, firstly, what would you say the reinvestment yield at in H2 for If and Mandatum just so we can get an idea of the pressure that's working through there?

And secondly, have you – can you give us a stir on how you view sort of organic capital generation on the Solvency II? I mean, nothing too definitive, but just any sort of range would be helpful. Thanks very much.

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

I think the reinvestment trade is somewhere between zero and 1% at this moment. It's very difficult to see any short-term change here, especially given the policy of the Riksbank in Sweden, and we are of course a SEK investor as well to a great extent in If. How sustainable it is that you have the growth numbers in Sweden and that low interest rate, that remains to be seen. But at this moment, we are somewhere between zero and 1%.

The second question, could you repeat that one that was on solvency?

Q - Jonny Urwin {BIO 17445508 <GO>}

Yeah. Just we've seen a couple – well, we're getting more and more disclosure from sort of other international peers around the amounts of Solvency II capital they generate every year. On an organic basis, I'd be interested to hear your views on that whether you're ready to share some numbers with us. That'd be great.

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

Okay. Yeah, our position is a bit different because we may look at the group solvency on a conglomerate basis. And there you have of course Nordea at the Basel III treatment and the same goes for Sampo plc, so actually, we calculate the solvency capital requirement for the parent company under Basel III rules.

Solvency II capital generation depends not only on the amount of – on the profitability of the P&C Life Insurance, it also depends very much on how much we want to take investment risk on the P&C and life side. But I guess we have more or less said that we have now more or less maximum risk in the insurance, in the insurance operations what comes to investments. So, basically, the generation of capital that we get through profitability is pretty close to 100% distributable because there is so little growth in the – on the premium side.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thanks very much.

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

And we are over capitalized as you are so well aware of.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you.

Operator

Thank you. Our next question comes from the line of Michael Huttner from JPMorgan. Please go ahead. Your line is now open.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Fantastic. Thank you. Can you – in terms in competition in non-life, it sounds like if it's stable and you quote one word on it, but maybe if you could say a few words, a few more words on pricing in your markets (19:38). And then in terms of the 87% to 90% combined ratio guidance, I suppose I should be able to do numbers. I'm a bit a lazy. I just wondered what does it equate to in terms of ROE? And is there any kind of desire, wish or – in the market that you see for other players being happy with lower returns than you are?

And the final thing, on the excess capital, I took from your answer to Vinit that the there's some flexibility, not a huge amount, to dip your €200 million excess at the year end. And you're willing to dip €100 million or so. That to me is like a €300 million delta. Is that roughly the kind of buffer that one can think about it in terms of offsetting the Nordea dividends (20:32) ever decline? Thank you.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

With pricing (20:37) then, as you described is pricing has been very stable over the past six months to 12 months. Norway is the one area that have competitive pressure, and we have in the past six months seen some of the newer entrants run into more difficulties than previously. So that might be an encouraging sign, but there are no big differences yet. Apart from that, GDP pressure in Finland but no new entrance to any change in competitive landscape nor is there any such thing in

Sweden or Denmark. The 87% to 90% depends, of course, on your assumption on the investment income going forward, but with the present ROE - sorry, with the present return on the investments that would not quite give us the targets did ROE that we're looking for.

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

On the capital side, you said that, like you said, the buffer has now increased on the S&P more from €200 million to €400 million, then how much we take dividends next December or when would want to take the dividend from If that remains to be seen. So there was really no science behind why we left the €200 million buffer. There happened to be €200 million buffer last December when we took the dividend. It was driven more by the actual cash need that we had on the parent company.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

I understand. Thank you very much.

Operator

Thank you. Our next question comes from the line of Sami Taipalus from Berenberg. Please go ahead. Your line is now open.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. Hi. Good afternoon, everyone. Just a couple of questions. First, on If, I know that Torbjörn, you don't like to look at the combined ratio excluding large losses and reserve release but I'm going to do it, try give it a go anyway. It seemed to pick up quite a bit about 2.5 points I think between Q2 this year and Q2 last year. Was there anything specific in there? Anything worthy of note at all? That was the first question.

Second question, in Mandatum Life, the cost and risk result look a little bit weaker in H1 than they've been in the prior year whereas the investment results looks a bit stronger and actually the profit sharing with policyholder looks a bit lower as a percentage of investment income. Is there any sort of shift going on there? Is there anything worthy of note to mention there?

And then finally, coming back to the capital question. Just kind of going back to what Michael was talking about. It seems to me that there's a few more levers than just the S&P excess capital in If leverage might another one. But one that I wanted to ask about was you have quite a big asset liability mismatch in both If and Mandatum Life. Is it possible to get any sort of grasp of whether it would be capital accretive to close that duration gap? What sort of impact would that have on your capital ratio? Thank you.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

Q2 combined ratio compared to last year has really no important change at all whether you look at with or without large losses there.

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

On Mandatum (24:32) and cost result, it is just a normal fluctuation. The cost result is a little bit weaker because of the fee income from the unit linked business. The risk result had some individual items last year. And then we can see also some cyclicality within the year. So I still - my rule of thumb is that they have reached a level where the risk and cost result roughly represents €20 million plus €20 million (25:04), plus minus something on an annual basis. And then the volumes have to increase for them to get to the next level.

A - Torbjörn Magnusson

(25:16) profit sharing that you mentioned, so there is really what looks like we would have allocated more of the investment income to policyholders. But it's more - so it's not - we haven't allocated any bonuses. We have simply lowered this year's second half discount rate down from 100 basis points to 50 basis points. And then we have also increased reserve for next year and lowered the discount rate from 125 basis points to 100 basis points. And 2018, the discount rate has been lowered to 1.75%. So that's why it looks that we have allocated money to the policyholders.

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

I don't think this is at all a moment when one should consider closing any mismatch in duration. That is not - our Chief Investment Officer showed us today that of the best rates has been two years ago, there was an issue of Swiss 50-year government debt at 2%, and the sales price, issued price was €114 (26:31). Today, two years later, it's trading at €195 (26:35). So I think, in this environment, you don't go long on the duration curve, and you don't close any asset liability mismatches.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. The question wasn't really about whether you should do it or not. It was more about what would happen to the capital ratio if you did do it. I mean I guess it's relevant also to - if interest rates did pick up, which hopefully they will do at some point, what would happen to your capital ratio then when you stop closing the duration gap?

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

I have no clue. I think believing in very unusual environments, and I don't want to spend time on considering artificial interest rate numbers now and closing. We are very happy with the way we run it because we have also taken the discount rate in the life company to 0.5%, 1%, 1.75% for the next three years. And our running yield is higher than that. So, for the next three years, I feel no pressure on the asset liability mismatch.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. Okay. And the other thing, can I also go back a little bit to the question about the underlying combined ratio if or the normalized or whatever you want to call it. I mean it does come across as a little bit reckless when you kind of just brush it off as normal volatility or nothing special when it has deteriorated so much and I wouldn't make a point about it if had it been 0.5 or 1 point because we all know that these numbers are not science. I mean there must have been something that you've noticed. Maybe even if for just that you booked the large loss budget in the attrition or who knows, just to be cautious because it's early on in the year. But people are asking about this and wanting to know the answer. So it'd be helpful to get a bit more color there.

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

If you look at the Q2 numbers, did you have - you included also that we have lowered this coverage in Q2 and that burdens this year's numbers by €28 million.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

(28:44) on the deterioration that you see. Which numbers are you comparing this might benefit?

Q - Sami Taipalus {BIO 17452234 <GO>}

So I'm just taking out the obviously all the one-offs out of the prior year. I think to the Finnish discount rate reduction and the Norwegian pensions, then I'm taking out the reserve releases and then I'm taking out or normalizing, sorry, I should say normalizing for large losses.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

Well. We don't seem to have numbers that tally. So maybe Jarmo can help you after the conference with that.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay, nice one (29:15). Easy way out, but yeah, sure.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

(29:19) the way we look at things, we actually have the best combined ratio for Q2 taking out the extraordinaries (29:30) with this year and last year. And there's no – actually, the large loss outcome is quite good this year.

Q - Sami Taipalus {BIO 17452234 <GO>}

Yeah. Yeah. No. I'm not denying that. All right. Thank you.

Operator

Thank you. Our next question comes from the line of Blair Stewart from Bank of America Merrill Lynch. Please go ahead. Your line is now open.

Q - Blair Stewart {BIO 4191309 <GO>}

Thanks very much. Just two questions from me. Just on the lower investment income as it bounced through into the P&C business. I just wonder what actions you might take to try and protect profitability. You've already said that you're unlikely to hit your ROE targets, is there anything you do on pricing or on costs that would help mitigate the prices from lower interest rates or do you just need to take it on the chin?

And, secondly, I think at Q1 you were awarded a credit rating for the sort of HoldCo. I just wonder if you're thinking around possible debt rising. As that HoldCo level has evolved, any act (30:39) to the extent, that you could share that. Thank you.

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

The lower investment income, I don't think that we are going to do any changes in our investment plan at this moment in If. We have an equity weight of 11%. We have a running yield of 1.7%. And, yes, we struggle with the low interest rate environment as everybody else. We are actually – if equities perform, we are going to meet our return on equity targets with this combined ratio.

So let's wait and see what will happen. It's not going to be a smooth ride anyway in the investment market. So it could open up opportunities. This is not the moment to make any big changes in the investment strategy.

Q - Blair Stewart {BIO 4191309 <GO>}

It wasn't really the investment strategy that I was thinking of, Kari. It was more do you try and do more on the underwriting side or the cost side to try and mitigate the impact of the lower investment yields.

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

We are – we have a very demanding investment return climate but still we are very close to our targets. And we will of course always prioritize the return on equity target and continue to work with the costs and underwriting to improve the combined ratio compared to the 87% to 90% that we have in the outlook now.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

And on the rating for the parent company and now we have both from S&P and Moody's. And next year, actually, in February, there is some €500 million senior bond maturing. So, definitely, we will benefit from this extremely low interest rate environment. And also Bank of Finland has been buying some of Sampo plc's bonds from the market. So the intervention on that side that's the small positive from this low rate environment.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. (32:49) any doubt that you can raise that, very cheekly (32:51) I just wondered what your ambitions or relevant refi, if you have any further ambition in that regard?

A - Peter Kristian Johansson {BIO 4000174 <GO>}

So far, no additional plan (33:02). But that is of course one bond that we will finance.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. And would you look to – you can't say too much obviously. But would you look to refinance like-for-like? Or would you take on after qualifying debt instead?

A - Peter Kristian Johansson {BIO 4000174 <GO>}

Not this quarter. We haven't thought about issue. There's no need to issue hybrid Sampo plc level. So we will most likely do a similar-sized senior bond. But no decisions have been made yet.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. If I can just ask one further question, I noticed, if I'm not wrong, the combined ratio and Denmak decelerated year-on-year, I just wonder if you have any color on that. I couldn't really find any explanation in the pack.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

(33:53) exactly what you said. The (33:56) in Denmark.

Q - Blair Stewart {BIO 4191309 <GO>}

The combined ratio in Denmark I think in Q2 you was significantly higher than it was prior year. I could have that wrong. But that was my recollection.

A - Peter Kristian Johansson {BIO 4000174 <GO>}

That's actually (34:07) I think one large loss compared to last year.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Thanks.

Operator

Thank you, and as there appear to be no further questions, I'll return the conference to you.

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

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

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