Q3 2018 Earnings Call - Second

Company Participants

- Kjetil Ramberg Krøkje, Head-Investor Relations
- Lars Aasulv Løddesøl, Group Chief Financial Officer
- Odd Arild Grefstad, Chief Executive Officer
- Trond Finn Eriksen, Head of Economic Capital Management

Other Participants

- Ashik Musaddi, Analyst
- Matti Ahokas, Analyst
- Peter D. Eliot, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, and welcome to Storebrand Analyst Conference Call. My name is Anna, I will be your coordinator for today's conference. During this call, you will be on listening only. However, in the end of this presentation, you will have the opportunity to ask questions. I will now hand you over to Head of Investor Relations, Kjetil Krøkje, to begin the call. Thank you.

Kjetil Ramberg Krøkje

Thank you. Good afternoon, ladies and gentlemen. Welcome to Storebrand's third quarter 2018 conference call. My name is Kjetil Ramberg Krøkje, and I'm Head of Investor Relations at Storebrand. Together with me, I have group CEO, Odd Arild Grefstad; CFO, Lars Aa. Løddesøl; and Head of Economic Capital, Trond Finn Eriksen.

In the presentation today, Odd Arild will give an update on the developments in Q3. CFO, Lars Løddesøl, will give an overview of the financial developments and dig into some of the more technical elements in the quarter. The slides will be similar to the analyst presentation released this morning and are available on our webpage. After the presentation, the operator will open up for questions. To be able to ask questions, you will need to dial into the conference call. I will now leave the work to Storebrand's CEO, Odd Arild Grefstad, who will start the presentation on slide 2.

Odd Arild Grefstad {BIO 5483351 <GO>}

Thanks, Kjetil. A warm welcome to our third quarter presentation, which happens to be on the same day as the United Nations Day. The United Nations' 17 Sustainability (sic)

[Sustainable] (01:45) Development Goals provide a clear direction as to what future society we wants to move towards. Reaching its goals will demand massive investments in the years to come.

In Storebrand, we firmly believe that there is good money in sustainable investments. That's why we invest in the companies that best meet these criterias and are best positioned to create value going forward. Storebrand Global Solution is an investment fund that exclusively invests in companies contributing to the UN Sustainability (sic) [Sustainable] (02:23) Development Goals. The firm has performed well and manages NOK 2.6 billion to date.

Then let's move to slide number 3 and the highlights from our third quarter. It is with great satisfaction that I can announce a result of NOK 853 million and an operating profit of NOK 685 million. This is a 15% increase from the corresponding period last year and in the year-to-date results of NOK 2.6 billion. The result is primarily driven by solid growth in savings, combined with strong risk and insurance results and low operating costs. The underlying solvency margin is strengthened with 3 percentage points in the quarter to 166%. Including transitional rules to traditional rules, the solvency margin is 169%.

Following our improved capitalization and earnings generation, we were also pleased to see a rating upgrade of Storebrand Life to A minus in the third quarter.

Then let's move to slide 4. At our Capital Markets Day in May, we introduced this picture to illustrate our strategy. This is a continuation of our strategy for the last five years. But (04:02) to reflect that we now have a strong balance sheet and are positioned for capital released from the back-book in the coming years.

Growth within occupational pension and private savings drives the growth within asset management. In addition, asset management growth is strengthened by winning external mandates based on our good performance and administration and our position as a leading asset manager on sustainability.

With that, let's move to slide 5. With our strategy in mind, let me start by addressing our guaranteed back-book and its largest product paid up policies. It is a fact (04:47) that the regulation in place today for managing paid up policies only (04:52) leads to loan risk-taking and long returns of these culture of contracts.

On behalf of the Ministry of Finance, our working group recently proposed a set of changes to these regulations in our report that partly explores several possible regulatory improvements. We are very pleased with the proposal allowing for individual profitability per contract and the proposal allowing for more flexibility in the buffers to cover negative returns. This may enable higher pensions per contracts already under payment and increased risk capacity for some contracts. These are good proposals by the working group, but our stance is that there are good reasons to go even further in the regulatory senses (05:46) to ensure better pensions for all policyholders.

Let's move to slide 6. We see that the strong growth in the Savings segment continues. Our core product, Unit Linked, which includes occupational defined contribution pension in both Norway and Sweden, grew by 18% compared to the third quarter in 2017. We also see good returns in these segments relative to our competitors and sales are good. Asset under management continues to grow by 16% since the third quarter last year. Growth within insurance continues to be low, but the profitability is very good. Steps have been taken to increase sales going forward. Our bank has had a positive development with 11% volume growth in retail loans during the past year. These loans have been booked under life insurance balance sheet.

Moving to slide 7, the pace of the excess (06:57) development in Skagen is good. Skagen are launching an extended version of their equity savings account platform ASK, with the widest health offering in the Norwegian market, with a total of 600 funds. The offer is strengthened by recommending our shortlist of 20 to 30 funds selected by our award-winning selection chief. With this, Skagen is perhaps providing the strongest and most customer-friendly ASK platform in the market.

Moving to slide 8, one of the best firms in this platform is our very own Storebrand Multifactor, our factor firm that systematically tracks for well-known documented factors. The firm's asset under management has grown to over NOK 20 billion and had shown (07:51) to a yearly outperformance of 1.3%. In 2017, Morningstar named it the best Norwegian global equity firm.

And finally, slide 9. Our digitalization is continuing with undiminished strength. A good example of this is the newly launched chatbot in SPP Gajda. Gajda is a chatbot that provides businesses with a tool to communicate pension in a charming and engaging manner to the employees. Recently, the Swedish Pensions Authority awarded Gajda with the award for the most innovative solution for providing information on pension.

And with that, I give the the word to Lars

Lars Aasulv Løddesøl

Thank you, Arild (08:43). Starting on page 10, key figures. The group result of NOK 853 million and operating result of NOK 685 million reflects a good quarter for Storebrand. The results includes two items that reduced the reported costs by a total of NOK 40 million. The first item is linked to reversed performance dynamics (00:09:07) caused by weak relative performance in some of our largest funds.

I do have to point out, however, that the fourth quarter looks far better so far, and the final performance fees to the group and to the portfolio managers would be concluded at year end. The other item that reduced the costs in the quarter is the disruption compensation – distribution compensation that reduced the costs within P&C Insurance. This is a one-off item. The two elements are classified as special items and sum up to NOK 40 million. The financial items and risk results life are good and are supported by satisfactory returns in the company portfolios and a good risk result from paid up policies.

Earnings per share are down primarily as a consequence of higher tax charges in the quarter. I will revert to this in a moment. Solvency has been further strengthened and we have continued to be the first to be able to handle potential market volatility.

Moving over to page 11, three main factors explain the development in the solvency ratio in Q3. Every year in the third quarter, we have a true (10:17) revision of our assumptions, both operational, financial and actuarial. There are a number of smaller assumption changes that sums up to the negative 1.4 percentage point.

The main contributor to the change is a downward revision of the assumptions for paid up policies to convert to any policies with investment charges. Second, interest rates of approximately or increased interest rates of approximately 15 basis points in Norway and Sweden is a main contributor behind the 3.2 percentage point increase from market movements, decreasing the value of liabilities more than the value of the assets. In addition, strong equity markets have increased the buffer capital.

And third, the results for the third quarter have been good and contributes with another 2.8 percentage points to the solvency position before deduction of 50% of the result to future dividends. So that means 1.4% in the table (11:19).

Moving over to the following page, the most significant change for the last quarter is that we no longer have any effect from the transitional rules on technical provisions. This is due to increased interest rates and decreased value of liabilities in the Solvency II balance sheet. It is important to remember that if interest rates were to go lower again, Storebrand will automatically turn into the transitional arrangement for technical provisions.

Hence, the solvency position, including transitionals for the interest rate sensitivity, on a 50 basis points interest rate drop, is largely unchanged. For all other sensitivities reported here, we do not expect sufficiently large effects to trigger the transitional arrangement for technical provisions again. The sensitivities are more or less of the same magnitude as reported last quarter.

And then over to page 13. The growth in fee and administration income was 5.8% year-to-date, adjusted for the acquisition of Skagen and currency movements. As you're well aware, the Guaranteed Products are in long-term runoff. Therefore, the growth in the actively sold products must make up both for margin pressure and rental (12:37) products. The growth in actively sold products from the premises was 9.3% year-to-date on a comparable basis.

There were somewhat lower trading revenues from asset management in the third quarter, partly explaining the flattish development in revenues between the second quarter and the third quarter. We expect these revenues to pick up towards the end of the year.

The insurance results are still good with a combined ratio of 81%. We see overall low tranche and some runoff gains, primarily from improvements in Disability.

I mentioned of the key figures that we have reversal of cost amounting to NOK 40 million in the quarter. Furthermore, the third quarter has seasonally lower costs due to the summer and lower marketing. Nevertheless, we still see strong underlying cost control at (13:33) delivery on our ambitious cost targets.

The finance items and risk result life are strong. This is lifted by an unusually strong Disability result from paid up policies at NOK 91 million in the quarter. Going forward, we expect the contribution from paid up policy risk result to be in the order of NOK 50 million per quarter, up from NOK 0.00 historically.

For the third quarter, we have a calculated tax charge of 30%. Year-to-date, the tax charge is estimated at 21% in line with our previous guidance. The higher tax rate in the third quarter is caused by periodic effects and technical factors. We continue to expect the tax rate around 20%. The taxes are non-payable due to large tax loss carry forwards.

And with that, I conclude my part of the presentation and give the floor back to you, Kjetil.

Kjetil Ramberg Krøkje

Thank you. The operator will now open it up for our Q&A, please.

Q&A

Operator

Thank you. And we do have one question that's coming through already, and that's from Peter Eliot from Kepler Cheuvreux. Please, go ahead. Your line is now open.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thanks very much. I have three questions, please, if I may. First one is on insurance. You commented that the result benefited from some runoff gains. Just wondering if you can quantify those and say where they came from? And the second thing was on solvency sensitivities, I mean, as you say they are not very different quarter-on-quarter but compared to last quarter, they do seem less symmetric, and the upside in the with ratio has disappeared, especially on the sort of interest rate sensitivity. So, I mean, if I look at that sensitivity and the upside on the with seems to disappear, whereas the without now 4.9 points (15:37) drop from 6 points. Just wondering if you could explain what was happening there?

And maybe thirdly, I was interested in Gajda and your comments there as well. Is that chatbot now sort of fully up and running? And I'm just wondering whether you can share with us any sort of financial implications? I mean, it's probably maybe too small and too early, but any comments would be useful. Thank you.

A - Lars Aasulv Løddesøl

Okay. Let me start with insurance. On the runoff gains, we typically don't give you an exact number of this, because this is a number of different product lines and we have certain runoff gains and we also have certain runoff losses in other lines. But, as I said broadly, the development in Disability has been positive and when we have a positive development in Disability, you have three basic effects.

You have one effect that the number of disabled person in the quarter is less than you expected previously, so you have a gain from that. Secondly, when you have an improvement in the economy like we have in Norway now, people that were disabled in the past that are getting well again and get back into the workforce, you can release some of the reserves set aside for their disability, that's called reactivation. And thirdly, when you look forward, you expect somewhat lesser disability and put aside less reserve for the future, because you see this positive trend. So, these three elements give a positive impact in the quarter and in the year-to-date, but it's difficult to quantify exactly what is unusual and what is the normal variation.

A - Trond Finn Eriksen {BIO 17132188 <GO>}

Hi, Peter. When it comes to the sensitivities, I think, yeah, most of the sensitivities, with the exception of interest rates going down, it's more or less the same level as the previous quarters. What we have seen is that the sensitivities to interest rates without transitional rules have changed a bit over time. The reason this quarter is somewhat technical and are attached to risk margin. I'm not going in details on that. The other element is what Lars had said was assumption change that we have had a revision of how many that are converting from paid up policies to paid up policies with investment choice. And taking that assumption down, that gives us somewhat deduction (18:19) sensitive to the interest rates going down again.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay. Thank you.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Okay. And talking about Gajda, I think most importantly with Gajda is that we chose that expertise (18:31) when it comes to the transition in the market. And we can also see that, as we'd have an effect in the Swedish market, whereas the key on gaining market share is very strong growth in the sales and transfer balances compared to last year.

Saying that, Gajda in itself is now taken up by, very short time by more than 15 (18:58) customers, and there is – well, some more payments for using this because it's employer that shows this to the employees, so they are using this as a tool of making pension being more transparent. But I don't think we will expect to see these numbers coming very much through in the results. That's more about the total competition in the market, whereas to be a really (19:25-19:30).

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you, Odd. Could I come back quickly just on the solvency? I mean I guess, I mean, it's being commented before on calls that we've seen a bit of a trend of negative modeling and it features sensitivities as well, just wondering are you able to give us any numbers about what your assumptions are on the conversion of the paid ups?

A - Trond Finn Eriksen {BIO 17132188 <GO>}

Yeah, the assumption also revised downwards from 1% of the reserves annually to 0.5 percentage point or 0.5 percentage annually in conversion.

A - Lars Aasulv Løddesøl

Just remember, Peter, that we had the revision on all the different assumptions in the model, so this was but one of them. So we can hardly go through all of the different assumptions and models, but this was the most important one in making the difference in this quarter.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Sure. Okay, thank you very much.

Operator

The next questions come from Matti Ahokas from Danske Bank. Please, go ahead. Your line is now open.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes, good afternoon. Two questions, please. Firstly, on the cost side the nominal flat cost target towards 2020, should we assume this would be kind of the cost in the different business segments would be at the same levels or how will this move, in your opinion, towards 2020? Are we going to see cost increases in some segments and decreases in others? And then the other question is regarding Lars mentioned that Q4 looks better. The markets have been super turbulent in Q4. So, I was bit wondering and how come that looks better and, also, as an outsider, is there any way of kind of tracking some of the funds? How could we kind of assume that if you can – if you will be able to book the profit, profit share in the fourth quarter, what are the sensitivities there? Thanks.

A - Lars Aasulv Løddesøl

I'll start quickly on the cost side. We guided on roughly 950 a quarter as nominally flat cost for the group, that is excluding any lags, lag settlements (00:21:50) from profit sharing if there is a superior return in Skagen or in the management that needs some bonuses. And then, when it comes to – on a segment base level, there it's not on a segment level. We will probably still see costs in the Guaranteed business go down over time and somewhat more cost can be allocated to other areas.

I think it's important to just like emphasize that having flexibility in cost allocation and redistribution of resources in a company like ours, and any other company as well, is a key competitive factor. I mean if you want to stay competitive, you need to develop with the market and you need to reallocate resources to where you have profitability and growth or where you want great growth. So, it's very important to say that this is not static, but we work within a total limitation set by the objectives set out at the Capital Markets Day.

Second, on performance in the fourth quarter, I did not say that the fourth quarter markets are such fruit bearer (22:58), because you certainly interpret them (22:59). I said that performance in the main funds looks better so far in the fourth quarter. And if you go into Skagen funds (00:23:08), you can follow the performance on each one of the funds on a daily basis, both on absolute terms and relative terms, and that will give you an indication as to the development.

Q - Matti Ahokas {BIO 2037723 <GO>}

So, basically you're saying, Lars, that the Skagen fund, the absolute performance has been great, but the relative performance has been better in Q4?

A - Lars Aasulv Løddesøl

That's correct.

Q - Matti Ahokas {BIO 2037723 <GO>}

Thanks.

Operator

Next question comes from Ashik Musaddi from JPMorgan. Please, go ahead. Your line is now open.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Hi, good afternoon. Just one question on Skagen again, I mean, you mentioned that fourth quarter relative performance looks okay and in the first three quarters, I think you mentioned outperformance of 1.5% or something. So, I mean all together, how should we think about the fee revenue that – additional fee revenue that you'd be booking at one go in fourth quarter? So, any thoughts on that would be great.

And secondly, if I look at your capital generation, it used to be around, say, 1.5% in past net of dividend and in this quarter it was 1.4%. So, how much of this is just rounding error and how much of that is some drop quarter-on-quarter?

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Well, maybe I should start on Skagen. I think, first of all, last year you saw that Skagen had a performance quite closer to the real premium basis and that gave – I believe it's given the result of around NOK 200 million in the last quarter. This year it's been underperformance in the main incomes (25:03) so far, and a quite significant underperformance in the third quarter, leading to a situation where we reduced the cost for the PMs in the third quarter. And if we have to close the group cap at third quarter, that would be a total of NOK 53 million in performance fees. So, that gives you so much range here. While I must say bad quarter when it comes – or bad news so far when it comes to performance, a NOK 50 million in performance fee will be good.

And then you have the range up to, well, quite a normal situation than when you have a performance like (00:25:46) indexes, and you'll have NOK 200 million of cut cost (25:49) if you can really perform as we intend to do out far (25:55). On top of that, going forward, you will have absolutely also an uplift from that level. It's not what we expect for the portfolio.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

On solvency generation, we have said that we expect to create 10 percentage points from operational earnings each year before dividends. With 1.4% after dividends, we're a little bit higher than that level with approximately 12 percentage points run rate a year. So, I guess we are broadly in line with the guidance given.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. Perfect. Thank you.

Operator

Ladies and gentlemen, there's nobody to queue at the moment. Thank you. There is no further questions coming through, so we'll hand the call back to you. Thank you.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

We just want to say, thank you for everyone for joining the call and also, please feel free to reach out to us if you have any further questions. So, with that, we would like to wish all a nice afternoon. Thank you.

Operator

Thank you for joining today's conference. You may now replace your handsets to end this call. Thank you.