S&P Capital IQ

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Allianz SE DB:ALV

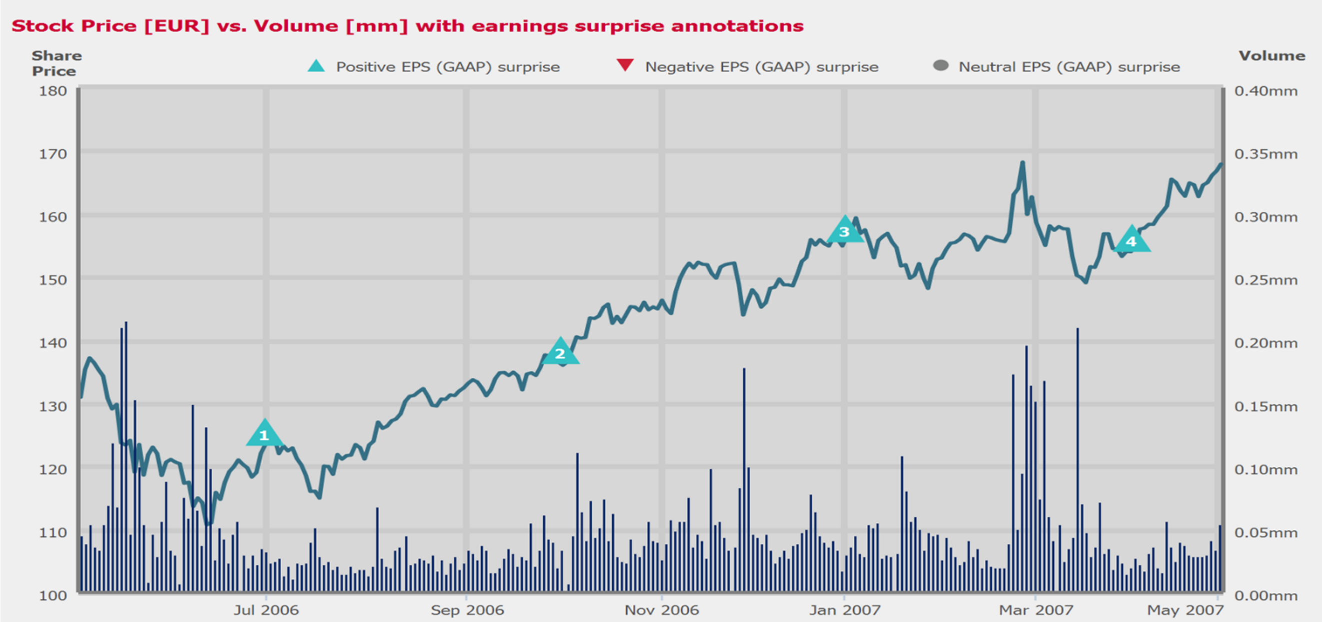
FQ2 2007 Earnings Call Transcripts

Friday, August 10, 2007 12:00 AM GMT

S&P Capital IQ Estimates

	-FQ2 2007-			-FQ3 2007-	-FY 2007-	-FY 2008-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	4.60	4.85	▲5.43	3.73	18.24	18.98
Revenue (mm)	24874.25	24300.00	▼(2.31 %)	-	101192.60	104617.78

Currency: EUR
Consensus as of Aug-08-2007 2:30 PM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2006	3.82	5.62	▲1 47.12 %
FQ3 2006	3.25	3.93	▲2 20.92 %
FQ4 2006	3.10	3.20	▲3 3.23 %
FQ1 2007	5.92	7.34	▲4 23.99 %

Call Participants

EXECUTIVES

Helmut Perlet
Deputy Chairman

Michael Diekmann
Chairman of Supervisory Board

ANALYSTS

Anthony Silverman
CFRA Equity Research

Brian Shea
BofA Merrill Lynch, Research Division

James B. Quin
Citigroup Inc, Research Division

Marc Thiele
UBS Investment Bank, Research Division

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Unknown Analyst

William Hawkins
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Michael Diekmann
Chairman of Supervisory Board

Well, good afternoon, ladies and gentlemen. Welcome to the Allianz Conference Call. As always, I'm here with our CFO, Helmut Perlet, and some of our financial experts, who will offer their support in case Helmut and I run out of answers. We have some 90 minutes for the call, and in order to not waste time, let us start right away.

These days, everybody talks about risk. Well, we want to talk about profit, about operating profit to be precise. Helmut, the floor is yours.

Helmut Perlet
Deputy Chairman

Yes. Good afternoon, ladies and gentlemen. A warm welcome from my side as well. I'm happy to report that the good start we made in Q1 has been continued in Q2, with an operating profit in excess of EUR 3 billion. To be precise, close to EUR 3.3 billion.

And let's just look back for a moment. Over the last 3 years, we have delivered what I think is an excellent result: 22% CAGR, which is -- again, is quite an excellent achievement. As I have been saying consistently in our previous discussions, this has been achieved by maintaining our focus on disciplined underwriting. And I always would like to -- also would like to reinforce that you are all familiar with our group initiatives, which we remain confident will help us to deliver on our 3-year outlook that we gave you in February. With that in mind, let's step into the usual presentation.

On Page 2, you see that year-on-year operating profits have increased by roughly 18%. As you will see when we go into the details, this is mainly driven by margin improvement but also to some extent by gross. Net income would be a return, EUR 2.1 billion of profit. That is 6% lower than last year. This has been always subject to some comments, as I have seen over the tickers. Just to put this in perspective, you should remember that in 2006, we had huge capital gains, EUR 800 million or EUR 900 million more than we have this year. And this, of course, explains the slight deviation by far.

Now with that in mind, let's move on to growth, turning to Page 4. In Q2, revenues are up with an internal growth of 1.7% or roughly EUR 420 million over prior year, with strong growth particularly in Asset Management and Banking. The revenue split, I think, contains some notable features. One is foreign exchange. We had a negative impact of roughly EUR 330 million as basically all foreign currencies got weaker versus the euro.

In Life, we have reported 0.3% internal growth. You will recall that the revenue shortfall in the U.S. was EUR 1.1 billion in the first quarter. It is now, on a quarter-on-quarter basis, EUR 400 million, including a EUR 100 million negative FX effect. And this narrowing is in line with the expectations as Q1 '06 was at a very high level and was followed by a slide throughout the rest of last year. As I've pointed out to you already in February, I only expect growth in the U.S. on a quarterly basis starting with Q3.

In P&C, internal revenue was 1.8%, and I think very much in line with our strategy, managed gross and disciplined underwriting.

Turning to operating profit. Again, it was an outstanding EUR 3.3 billion, the highest mark ever we've achieved. Of course, that kind of contrasts with the 7.2% growth in the first quarter. But given the seasonality of our business, you should always look at operating profit development on an average basis. With approximately EUR 6.2 billion of operating profit year-to-date, I think we are well on track to achieve our full year target of EUR 11 billion.

Again, I'm very satisfied that all segments contribute to this strong performance. Property -- P&C and Asset Management have contributed additional earnings on top of a already very high and attractive level of profitability. Life and Bank contributed, as forecasted, the major point of the total improvement. So if I put this in an analogy, our engine, I think, is running on 4 strong cylinders.

Nonoperating, minus EUR 90 million in Q2. That is some EUR 300 million worse than last year. There is some notable deviations. I've already commented on realized gains. The Q2 number includes EUR 230 million from the sale in our stake of Hana Bank, and the rest basically is a number of positions, more positions resulting or as a result of a our day-to-day portfolio management. And this is what we expect for the rest of the year as well, that will be on the capital gains stemming from day-to-day transactions and portfolio management.

We have an additional expense which is related to the AGF transaction: EUR 74 million bridge financing. That is why interest expense from external debt is somewhat higher. And there's another one-off item in the acquisition-related expenses which goes also back to the AGF transaction: EUR 52 million due to the AGF minority buyout, which are related to the changed accounting for the still outstanding stock options for AGF employees. Effective Q2, we show this plan as a cash settlement plan -- or we have to show it as a cash-settled plan instead of an equity-settled plan, and that is why it's in the expenses rather than part of the acquisition cost.

Now if we turn to net income. And pretax income is basically made up by operating profit, EUR 3.3 billion. Pretax income for the first time also clearly in excess of EUR 3 billion, EUR 3.2 billion. You see that we have, of course, higher income taxes stemming from the breakdown of the pretax income. It's basically all operating profit which is fully taxable as opposed to the high level of capital gains in Q2 '06. That is somewhat compensated by lower minority interests following the buyout in Italy and in France.

Now if we move on to shareholders' surplus. When you see that compared to year-end 2006, shareholders' surplus is down EUR 2 billion or 4%. You have a breakdown of the move -- or the movement analysis on the right-hand side of the slide.

Let me just point to 2 or 3 major items which explain the difference. The combined net effect of minus EUR 2.8 billion from transaction between equity holders, which you see at the very bottom of the upper box, resulted mainly from the minority buyout at AGF, to a much, much smaller extent also to Allianz Leben and Taiwan. The most important impact, EUR 2.7 billion out of this EUR 2.8 billion, is related to AGF and is simply based on the fact that we netted off the goodwill from that transaction. That was close to EUR 6 billion against our shareholders' equity.

Now on the other side, the unrealized bank position has decreased by EUR 2 billion. Those EUR 2 billion are explained by the fact that we, of course, have harvested some gains in the first 6 months, which previously, were included in unrealized gains.

And we see also a higher unrealized loss position in our debt securities. It's now minus EUR 1.6 billion, down from EUR 300 million at the end of last year. So that is nothing more than change in market value of our fixed income securities based on the higher interest rates we have in the markets. To be very clear here, as we all know, this is basically accounting driven and accounting volatility because our assets are mark-to-market, whereas the liability is basically reported at cost. From an economic point of view, the impact on shareholders' equity would be plus EUR 500 million instead of minus EUR 1.9 billion.

Now with this kind of level of capitalization, Page 9, our solvency ratio is, at the end of June this year, is 170%. This is very much in line with what we have indicated to you in our previous discussions.

And if we move on to Page #10, then you see what is not yet -- a, on the left-hand side, you see the impact from the AGF minority buyout. This is just as a reminder because we have had intensive discussions and detailed presentations about these implications in our Q1. Disclosure on the right-hand side. And please keep this in mind, the solvency -- the ratio of 170% does not yet reflect the further implications from the squeeze-out of 4-point something minorities. Once this is factored into the numbers, and that's illustrated on the right-hand side, our solvency ratio will slightly decrease to 166%.

Now moving on to the segments. In P/C, we are back on a growth track which applies to the top and the bottom line. And we were able to improve the already outstanding profitability level of last year by another 2.7%. In terms of operating profit drivers on the right-hand side, you'll see that underwriting is down by

EUR 68 million. That is a consequence of a combined ratio, which is basically 1 percentage point higher than in 2006, while the loss ratio improved slightly by 0.2 percentage points. The expense ratio went the opposite direction, and I'll come back to that in a minute when we are discussing the combined ratio.

What you see is that our operating investment income has improved by EUR 130 million. That is basically a consequence of 3 factors: a, the assets under management have increased; b, we have higher yields, run rates from both dividends, as well as interest income on our fixed income portfolio.

Now with that, if we move on to P&C growth, we'll see that we have 3.1% total growth. That, of course, is positively influenced by the acquisition of ROSNO, that makes up for something like EUR 190 million. On a negative side, there's some FX impact of EUR 66 million. And that leaves us then with internal growth of 1.8%, which, I think, if you look at this internal growth over the last 3 years, which is around 1.5% to 2%, is what you really want to achieve in kind of a difficult market environment where we are committed to bottom line profitability, but still trying and proving to successfully that we are able to grow.

If we break this internal growth down, then the price impact on the whole portfolio was minus 0.5%, which then -- and that was in line with expectations. As I have always told you, we do not see major implications from soft markets on our portfolio. So having said this then, the volume as we added 2.3 percentage points to our in-force business.

I think if you look at the left-hand side, and this is very much in line with this managed growth, we have quite attractive growth in many markets. We hold back where the prices, we think, are not sufficient. And that goes in particular for our large account business in our industrial portfolio, AGCS. I think it's also important to keep in mind that we already see some signs of heightening prices, for example, in the German Motor business, where negative pricing impact is only half of 2006.

And we expect to see stable prices really for the next renewal round against the background that the German market is running in excess of 100 combined. And so the need -- this kind of breaks some level of tolerance, and people are certainly ready to react. The same what we have seen and observed recently goes for the U.K. motor market, where we also see clear signs for a turnaround in pricing.

Now let's have a closer look on the combined ratio. Combined ratio on a quarterly basis, 92.9%. That is again, in terms of loss ratio, slightly favorable. And we come to the details on the next slide. In terms of expense ratio, at a first glance, that doesn't look pretty nice. The expense ratio has gone up from 26.8% to 28%. But you will remember that when we talked about the 2006 numbers, the major part, approximately 1%, comes from reclassifications which again, we already discussed more extensively at the 2006 closing and which we will encounter throughout the individual quarters on 2007. With that being said, more or less on an apples-to-apples basis, the expense ratio stays flat at around 28%.

Now having said this, there is 2 offsetting components: point #1, on a run rate, we see already, as expected, positive influence in the order of magnitude of some EUR 60 million-plus coming from our sustainability initiatives and from the German reorganization. But this is somewhat compensated or more than compensated by the fact that our stock-based compensation plan and the related expenses is, of course, included in the expense ratio. And thanks to the performance of the Allianz stock in Q2, this liability had to be reevaluated, and that added another EUR 70 million to our expenses.

Now what I think to what I find interesting, if you look at the left-hand side of this slide, that with the exception of France and the U.K., all our markets are at or significantly below 94% combined ratio, which is, as you know, the target ratio for the whole group.

Now in terms of loss ratio, on an accident year basis, Page 15, you see that the loss ratio is stable with around 68.3%. We had basically, in terms of NatCat, we had about the same amount, or we suffered the same amount from NatCat in Q2 '07 as in Q1. It was more or less EUR 110 million, and that was a number of smaller events: storms, floods and hails in Germany, in the U.K., in Australia and some other places.

Runoff ratio has more or less a stable pattern compared to 2006. And I think all I can say here is that we have stable runoffs all over the organization and all over our operations.

Next page, investment income. I think I have more or less covered already.

Then let's move on to Life. Operating profit continued its dynamic growth. It's up 44% while nearly all Life companies improved over previous year's Q2 results. The strongest increase is coming from France and the United States. If we look at the profit drivers, you see that we have higher investment margins. Higher investment margins is basically a result of 6.6% higher assets under management. And we also slightly increased the shareholders' share in the total profit pool, that does explain the EUR 133 million.

And on the other side, we have on the expense margin, that's up EUR 100 million over Q2 '06. That development benefits from higher asset management fees in our unit-linked business and from the fact that in '06, we had some significant expense overrun in the United States based on the unexpected shortfall of the production, which our colleagues in Minnesota have managed to successfully address so that there is no more expense overrun in this year.

On the growth side. Premiums, top line is more or less flat, but there is mixed picture if you look down to the operations. I think with the exception of the United States and Germany, if you look at the numbers, most markets performed very nicely. If I leave out these 2 countries, the internal growth is around 10.9%. We are particularly pleased with the development in Italy, where we benefit from strong sales and gross across all channels, proprietary channels as well as our bancassurance channel. In the United States, we have at least reversed the trend, the downward quarterly trend, and I come back to that in a minute. There's a separate slide about the United States.

In Germany, in an essentially flat market environment, our premiums were 9.7% lower in Q2. There is, in particular, one impact. We have a shift in our business mix. We lost new business in single premiums, but we had a significant increase in recurrent premiums. And this is, as we will see in a second, also one of the reasons why the present value of new business premiums written, as well as the new business margin in Germany increases quite nicely.

Nevertheless, we do expect for Germany for the second half of the year to improve significantly our top line and product innovation, stronger marketing efforts and increased sales via Dresdner, all supposed to contribute to this increased growth in the second half of this year. And we do believe that for the full year 2007, our growth rate should be around 4.5% to 5% in Germany, which of course, together with the expected upturn in the United States, should give us a very different picture if we talk next year in February again about the Life business.

Now on Page 20, you see what I have just briefly introduced with respect to Germany, the new business margins and some embedded value information. New business value increased 16% over 2006 to now, and this is on a 6-month basis, to now EUR 506 million. You see the breakdown, that of course, a major impact comes from the change in minorities. Business impact is EUR 13 million-plus if you adjust for the EUR 7 million FX impact.

And the reason why business impact is not higher than this FX-adjusted EUR 20 million, really, if you go into the table on the left-hand side, you see, and that shouldn't come as a surprise to you, that based on significantly lower production, there is a much lower value in the United States, where we have EUR 75 million of new business value compared to EUR 116 million new business value last year. The real good message is, I think, that with the new business margin at 3.1% shows pretty nice consistency with the overall result for 2006, where we had also new business margin in excess of 3%. And on Germany, I've commented already, there's an increase in new business value of EUR 22 million.

And later on in the back half, I think on Page 41, you have also a breakdown of all the various details across the various markets. And you see that the present value of new business premiums in Germany has increased by roughly 5% over 2006, which of course, gives a totally different picture than just the statutory premiums.

In the United States, as you will see on Page 21, we have been successful to manage the downturn, to stop and turn it around. We have USD $4.6 billion of gross premiums written, and we still do believe that we can achieve the $11 billion by the end of this year, based off all the measures I have repeatedly explained to you during the 2006 closure and during the first quarter discussions.

What I would like to add here is really that in terms of operating profit, as of today, I would like to slightly revise the forecast downward from $600 million to $550 million. The reason being, really, we have observed, or we had to record, in the first 6 months, accounting volatility of some $120 million. If this accounting volatility or this number stays around for the rest of the year, it's reasonable to assume that we're not going to make the $600 million.

Page 22, investment income. A lot of details for your models, but I think pretty much self explaining. There's nothing really exciting I would like to point to, so let's move on to Banking.

On the Banking side, with the strong improvement in operating profit, I think it kind of demonstrates that Dresdner Bank is also -- is able to show sustainably good profits also against a somewhat normalizing level of loan loss provision. Where does the improvement come from? Point #1, we have higher productivity, i.e. higher revenues; and we have lower expenses, also in absolute terms, which are the main drivers of this increase in profitability.

Let me just draw your attention to Footnote 1. You might remember, or you certainly will remember, that we had a lot of discussions during 2006 about the treatment of own shares in the banking accounts. You will remember that we have to eliminate any revenues from own shares trading in Allianz shares from our accounts. All this has to be -- has to go against equity. Now we have taken the opportunity, and this is what we are doing from 2007 onwards, that we no longer make this adjustment regarding own shares in Banking other what we directly netted against the Dresdner results. And for that very reason, we have also restated the 2006 numbers.

Now if you please have a look at the Footnote 1, you will see that this is now window dressing of the numbers. It's just a shift between Q1 -- sorry, between Q2 and Q3, but has no impact on the full year results and numbers for Dresdner in 2006. And we think it's the right way to look at the Dresdner numbers because this is exactly, in line, how they do contribute to the group results.

Now our next page, operating revenues. Operating revenues are up 8.7% at now close to EUR 1.8 billion, and you see that there's contribution from all revenue categories, strong contribution from net income, which is mainly driven by higher margins and volumes in the deposit business, but also by structured finance transactions, in particular hex-oriented [ph] structured products. We have higher net fee and commission income, which particularly comes from increased income from certificates and higher fees from M&A and advisory.

On net dealing, we have to make some distinction. Trading revenues on the operating side, i.e. the investment bank, is lower than it has been last year. That is based on the fact that we have positioned ourselves pretty conservatively and therefore, had lower revenues from equity and credit derivatives. But this shortfall has been made up by the corporate segment. The corporate segment benefits from this already mentioned technical effect on shares, but also shows significantly higher revenues from all the treasury activities, that is, the revenues related to assets -- of assets which do back the equity in the bank.

In terms of expenses, cost-income ratio is down, 72.4% on the quarter. Year-to-date, it's 69.4%, and significantly lower than last year, already almost 10 percentage points. Now what I -- and that improvement goes for worse personnel expenses as well as non-personnel expenses. What I really do like is the right-hand side of this slide, actually, my favorite slide in this presentation. What we've shown here, our 12-month rollings for the bank in terms of revenues, expenses and cost-income ratio. And what you can see, that the 12 months rolling cost-income ratio is coming down from 91.4% by the end of 2005 to now 74.6% by the end of June this year. So that is to say that within 18 months, we have improved the cost-income ratio by 17 percentage points, and I think this is a pretty remarkable result. And it, first and foremost, stresses and underlines again that this is a sustainable development, and that the trend goes in the right direction because with this 74.6%, of course, we are not yet satisfied and we are working hard to approach the 70% mark.

On Page 27, you can see that the net loan loss provision, while they are still significant -- or still significantly below expected loss numbers, what they are approaching slowly but surely a more normalized level of EUR 62 million. And I think if you look at nonperforming loans and coverage ratio, there is really, I should say, business as usual.

Now finally, Asset Management. Profits are up 9.4%. FX-adjusted, this increase would have even been 15.6%. We still have significant growth in our revenues, which is facilitated by a strong asset base, and still growing asset base, by solid net inflows driven by innovative products and services and strict pricing discipline and effective cost management, which I think is clearly illustrated by our stable cost-income ratio at 59.2% despite the fact that we have made investments in future growth i.e. for AGI Europe distribution and also in our operations in Asia-Pacific.

This, of course, is against the background of ongoing strong performance and now both in our fixed income as well as in our equity performance.

Fixed income performance, Page 30. On a rolling 3-year basis, 83% of our assets under management do outperform their respective benchmarks. Now also, our recent fixed income performance in the first 6 months of this year is below our expectations. Let me just point out, this was not because our colleagues made kind of undue bets, all funds are well within their tracking error budget. But as you know, PIMCO is a long-term investor. PIMCO has, I think, pretty early in the process, flagged some concerns about the developments in the U.S. Mortgage market, and they feel now well positioned based on their longer-term strategy to generate alpha, strong alpha, in the months ahead of us.

Talking about equity performance, we have now managed to also deliver a strong 3-year rolling performance track record. 76% of the equities under management are outperforming their respective benchmarks. There is not quite enough evidence in the net flows. Let me just give you 1 or 2 examples. I mean, for example, in Germany, the mutual fund market overall has seen significant net outflows in the second quarter 2007. In Germany, top ranking in terms of net flows, our money market products and certificates. And another example where improved equity investment performance has not yet translated into superior net flows, for example, is Nachem [ph], Nicholas-Applegate, who has significantly improved their performance to more than 90% of outperforming assets on a 3-year basis. But there is -- clearly, they are positioned to benefit from further developments.

Now finally, what you see assets under management on Page 32. Based on flat FX development, and that was our assumptions for making this 10% growth assumption, year-to-date, we are at 5.3% gross, again I think on good track to achieve our annual target.

Now before I turn to the summary, let me make a few comments and updated information on the whole subprime issue in the United States. Just to put this in a broader context, and I know you are all familiar with this, but I think it's just important to repeat. As an integrated financial services provider with the universal bank in our portfolio, we are one of the largest institutional investors in the world. We are in the origination of credit business, and we do provide solutions for our clients to support them with all kind of structured finance transactions. As an institutional investor, our portfolio is broadly diversified across all asset classes and all those categories.

In credit and solutions, I think I can say we do require highest standards regarding ratings and collaterals. If, for example, the quality of a collateral deteriorates, we promptly require additional collaterals or execute the position. All these activities on investment side, as well as on the credit or the trading sides, are governed by clearly defined rules with regard to risk management processes, with regards to underwriting capacities, with regard to limit, and are supported by what I think are very highly sophisticated risk models.

Now to translate this into figures. If you look at Allianz in total, then we have EUR 1,030 billion of assets under management, i.e. investments and receivables, respectively, loans. Of this EUR 1,030 billion, we have EUR 35 billion of asset-backed securities, including CDOs and CLOs, which we have announced last Friday. Now of this EUR 35 billion asset-backed securities, and I will come to that later on, 50%, roughly 50%, is accounted for under available-for-sale and 50% under trading. Of the EUR 35 billion -- and the EUR 35 billion, to make this clear, is not just related to the mortgage market in the United States. We do have mortgage issues or mortgage-based securities in the U.S., EUR 11 billion in available-for-sale. This is basically mortgage-backed securities held by Fireman's Fund and AZ Life, and there is no subprime exposure in network. We have EUR 2 billion mortgage-backed securities in mark-to-market.

Why have we now -- or let me put this into context. Last Friday, there were some requests from various medias. What is our exposure in CDOs and CLOs? Now as always, and as usual, if you give out some information immediately, there's the next request and the next request was for asset-backed securities, and that is why we are now giving all those -- also that breakdown for asset-backed securities. So again, what I'm trying to say was the EUR 35 billion, EUR 13 billion of that is related to the U.S. mortgage market. The rest is all kind of receivables, credit card receivables, automotive receivables and what have you.

Now of this EUR 35 billion, we have EUR 1.7 billion subprime exposure, the EUR 700 million we announced on Friday related to CDOs and CLOs, and EUR 1 billion related to mortgage-backed securities. This EUR 1.7 billion translate into 0.16% of our total assets under management. Of this EUR 1.7 billion, 99.5% are investment grade, with the bulk being in AAA and only a few percentages in BBB.

Now having said this, I think 0.16% exposure to the subprime market by all standards is a very low and very reasonable numbers. You can also, if I may add to this, you can see or take some comfort from the fact that if you look at the development of our risk-based capital both from a group perspective as well as from a bank perspective, if you look at risk-rated assets or at value at risks, all these numbers are going down or are flat at least, like the risk-rated assets on the banking side.

What I have also said tomorrow -- this morning in the press conference call after a variety of questions, I've done what I usually don't do, I commented on some July numbers because the question obviously was, "What is the development in the meantime in the last 4 weeks? What do you expect, et cetera?" Let me put this into some context. We had, as you know, end of June, there was EUR 70 million impact from the sole CDO, CLO stock which we have reported in our Q2 and covered in our Q2 results. Now this is not to say that there is already a shortfall, because credit worthiness of the underlyings is lower or what have you. This is just based on mark-to-market valuation. Because again, of that EUR 35 billion asset-backed securities, 50% is mark-to-market and you have to valuate that mark-to-market regardless of what the longer-term value of the security is deemed to be.

Now if you tell me, "How does this whole position impact your overall results in the third quarter or for the rest of the year?" It's kind of speculation because we all don't know what is the spot price at the 30th of September or at the 31st of December. But what I can tell you is that as of yesterday, based on mark-to-market, out of the EUR 17 billion trading assets, the impact would have been an additional EUR 100 million. And I think an additional EUR 100 million, given the size of the portfolio and given the size of the profit pool of Allianz, is a number which should give you some comfort. At least it does us give a lot of comfort and we have analyzed all that stuff very carefully that we don't see any indications for an alarming sign in our business.

And this is why -- and that gets me now to the summary page. This is why we still confirm our target, namely the operating profit of EUR 11 billion for the full year 2007. And in addition to that, we have given some guidance on net income, where we expect to come out at EUR 8 billion. And this increase in EUR 8 billion -- or to EUR 8 billion is based on the assumption that there is only little, if any, capital gains to come in the second half of 2006. And basically, the difference to the year-to-date EUR 5.4 billion net income is made up by additional operating profit, which we expect to come through in the second half of the year.
Well, with that, I look forward to your questions.

Question and Answer

Operator

Our first question comes from Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I had several questions, if I may, one on the EUR 1.7 billion. You said 95% investment grade. Could you break it down precisely by category, BBB and AA and all these things? And also, is this all -- you said 50% is mark-to-market. Is the whole EUR 1.7 billion mark-to-market, or is it just 50% of that mark-to-market? So that would be the first question. The second question is within the other kind of CDO, CLO, what is the status as regards leverage finance? And do you have any exposure to the stuff which -- how much do you have exposure to the stuff which was issued this year? And which leveraged loans which will fall on and I think we're still sitting on? The other thing is can you -- as I understand it from the number you said, EUR 60 million is a synergy number. Now I wasn't sure whether that was just a Q2 number and whether that's a number which is developing or that's it for the year. So that would be EUR 240 million for the year? And on the matter of combined ratio, you said Germany is above 100%. And I just wondered whether you could say what your figure is now in Germany. And then in terms of loss ratio, I noticed that in Q1, there was nice development, this accident year loss ratio, excluding NatCats, fell by 1% relative to Q1 previous year, and Q2 this year was actually flat. So I'm just wondering whether there's -- we should expect a trend here.

Helmut Perlet
Deputy Chairman

Your first question. What I've said is that we have 99.5% investment grade, not 95%, 99.5% investment grades in CDOs, CLOs. Now we have about 55% AAA, 31% AA, 13% A and 0.5% BBB. Now the other question you had, the 50% I mentioned of -- one step back, the EUR 1.5 billion -- the EUR 1.7 billion subprime is all mark-to-market. The 50% I mentioned was related to the total EUR 35 billion of asset-backed securities. We have EUR 35 billion asset-backed securities, of which EUR 17.6 billion are held under available-for-sale where market changes are go right through equities, and EUR 16 billion, EUR 17.3 billion or EUR 4 billion, which are mark-to-market.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Just that -- sorry, the percentage you gave for AAA, AA, et cetera, that's the whole of the EUR 1.7 billion?

Helmut Perlet
Deputy Chairman

Right. And then with respect to leverage finance, we do monitor the market and our positions very closely and continuously, and we are managing all those positions very actively on the risk side, as well as on the business side. Syndications are fully working, and the total we have on our portfolio is significantly less than 2% of our total loan portfolio. Now the EUR 60 million, and that refers to sustainability, et cetera, was a Q2 number only. So there is, of course, more to come, and we should expect that this number is increasing over the course of the quarters going forward. Our combined ratio in the Motor business in Germany in the first half of 2007 was around 102%. And then you had one question, and the accident combined ratio was less in Q2 when last year was slightly better.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Q1 was slightly better.

Helmut Perlet
Deputy Chairman

Was slightly better. I mean, I think we have to see that there is obviously always some changes depending on the profile of how the claims come in, et cetera. I would think that one percentage point up or down is well within a normal range. And if you look at page, you know the slide in the P&C presentation, I think 19 or -- no, 15 it is, you see that over the last 9 quarters, with the exception of this one NatCat, we are well within the range of plus and minus 1.5%. So having said this, we still don't see any signs of worsening with respect to the comp through the loss ratio.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

May I ask if you think that's a lot [indiscernible]? And where's the offset to the Motor?

Helmut Perlet
Deputy Chairman

Pardon me?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Where is the offset to the Motor? If Motor is higher, where's the rest -- where is it so much better?

Helmut Perlet
Deputy Chairman

What offset Motor is just Germany. Our Motor business in total is running at 93.9 for the Allianz Group.

Operator

Our next question comes from James Quin from Citigroup.

James B. Quin
Citigroup Inc, Research Division

My first question is just on the Dresdner admin expenses, which came down from EUR 1.4 billion in the first quarter down to EUR 1.33 billion in the second quarter. And I was just wondering if there's anything that you would see as exceptional within that sum, or whether the EUR 1.33 billion number is a fair rate going forward. The second question is just on PIMCO. And really, if you could give us any sense of whether any particular -- or rather any individual PIMCO funds that had a material proportion of assets in the subprime, or which had any leverage positions in CDOs? And any sense of whether you could have any exposure to, for example, being called in to support those funds at any point?

Helmut Perlet
Deputy Chairman

Well, I think on the admin expenses at Dresdner, there is nothing unusual in this number. It's a result of our continuous efforts to improve efficiency, and we are well on track with our program, Neue Dresdner Plus. So our expectation clearly, is that we do see further improvements going forward. Of course, what is fair to say that if you look at the result of the investment bank, the investment banking result is lower than it was in the last year, and therefore, you see some impact on the bonus side performance-based compensation as well. That, of course, is a volatile number in line with the operating profit of the investment bank, but this bonus is very much tied to EVA. And therefore, I mean, we are happy if this number is going up, because then, we are making more money also for the shareholder on the investment banking side. On PIMCO, I mean, it shouldn't come as a surprise to you if this guy said "significant exposure in the subprime business," as Bill Gross [ph] was always out in the market and arguing that there is some concerns. I think maybe the background of your question is the most recent development and announcement of AXA. There's nothing on the table where we are aware of that there is any kind of similar development on the PIMCO funds.

James B. Quin
Citigroup Inc, Research Division

Okay. Just as a quick follow-up to that, has there -- and obviously, it's very early days, but I mean have you seen any impact in terms of the net flows into PIMCO reflecting any of the sort of ups and downs that we've had? And any sort of well, not collapse, but any change in investor confidence around that?

Helmut Perlet
Deputy Chairman

Well, I think the PIMCO guys are very confident that, as I said, that they can take benefit of this whole development. They are positioned very conservatively and they see rather opportunities to go forward to generate alpha. Because obviously, if we do see repricing of credit risk with some people in a need to restructure all their positions, there is all kind of opportunities out there to buy cheap.

Operator

Our next question comes from Marc Thiele from UBS.

Marc Thiele
UBS Investment Bank, Research Division

I have 3 questions, if I may. Firstly, can you give us the exposure the bank has to any kind of CDOs, CLOs in terms of the revenues and any potential impact you would expect in terms of the revenues going forward? Then secondly, have you some indication in terms of the embedded value? You gave some -- your business profit numbers. I was wondering are they based on the macroeconomic environment, i.e. higher interest rates as of the end of June? Or is it still based on the end of '06 assumptions? And can you give us some indication of what the in-force value has done over the same period? And then thirdly, can you give us an update on the German tax situation? Are you still happy with the numbers you provided us with some time ago? And will that show up in the third quarter?

Helmut Perlet
Deputy Chairman

Yes. Your first question, exposure to CDOs, CLOs as far as revenues are concerned. All I can say at that point in time, I mean, if the market stays where it is, you should expect that revenues on the investment banking side from this kind of business might slow down, are lower than they were in the first 6 months, but this is really hard to predict going forward. In terms of embedded value, I don't have the in-force value with me. I do have a presentation in front of me for the whole operations, but unfortunately, there is no summary of the in-force business. But we do have the number, Marc, and Oliver is coming back to you. But I just don't have it out of the top of my head.

Marc Thiele
UBS Investment Bank, Research Division

Are the assumptions based on end of June, or?

Helmut Perlet
Deputy Chairman

Assumption's based on the end of June. And then in term -- your last question, impact from the tax reform in Germany. I think the numbers I've given you in the past are pretty stable. So to repeat this again, we do expect based on our outlook, that for 2008 and 2009, our tax expenditure in Germany will go down by EUR 150 million, respectively, EUR 200 million. We will see, in the third quarter, some one-off impacts from the revaluation of deferred tax liabilities and tax assets. There, we do expect a one-off impact on net income of -- yes, that should be a high double-digit million number, and also a number of roughly EUR 80 million to EUR 100 million of one-off impact which goes straight to equity.

Operator

Our next question comes from Nick Holmes from Lehman Brothers.

Nick Holmes
Lehman Brothers Holdings Inc., Research Division

I had 3 questions. First one is, wondered whether you could update us on the situation with the class action lawsuit in Minnesota, where I think you recently lost your appeal. Second question is back on German Motor. Wondered, do you have a sense that there's a big change in the mutual's view of motor pricing and that we can expect prices to really start to rise next year? And then the third question is just coming back to subprime. Just wanted to check, you said EUR 1.7 billion of subprime. I wondered, could you give us the split between insurance and banking?

Helmut Perlet
Deputy Chairman

Okay. Subprime, EUR 1.7 billion. It's EUR 1.6 billion banking and EUR 100 million insurance. On the German Motor side, as I've said, we have seen -- if we look at the first 6 months in 2007, we see half of the price reduction we've had in 2006. We do expect that we're going to have stable prices for the renewal rounds in this autumn. Thus, that indicate that the prices go up in 2006, probably yes, but it's a long time to go. And then just let's wait and see how we go through the next renewal round. In terms of an update for the class action situation in the United States, what I can say to you is that we have now -- we have 5 of the class actions being certified. Allianz Life still denies any wrongdoing of the company. And also, we think that we have always complied with all applicable laws and regulations. We rather think that we are in the forefront in terms of suitability. I mean, that does not rule out that any court comes to the conclusion there is more to be done going forward. What this, then, is more market issue than it is an Allianz Life issue. So I think all I can say at this time, we are very confident in our legal position on this matters because we believe our business conduct was proper. Again, our procedures are beyond what is required by law. I think -- and I guess, Nick, you have -- there is some estimates in your house, there is a very high number. I think it's way too high of what you will appreciate -- I hope you will appreciate that I cannot comment on a pending litigation.

Nick Holmes
Nomura Securities Co. Ltd., Research Division

Can you make any comment on the fact that the appeal has been turned down for the Mooney case in particular? Is there anything further you can say about that? I mean, what the next step would be in terms of the legal process?

Helmut Perlet
Deputy Chairman

From our point of view, there is no impact. But there is really no further comment I want to make on that one.

Operator

We have a question from Brian Shea from Merrill Lynch.

Brian Shea
BofA Merrill Lynch, Research Division

I just have one question on U.S. life insurance. For several quarters now, we've had, I think, very competent updates on the numbers, but it's been a while since we've had a strategy update on the numbers. It does seem that things are turning the corner, but it also seems that you've been having to tone down your own expectations. Could you just say what are you doing to get the revenues fixed, just really an update on what you've told us previously? And are you confident that you will have the right platform, having done your organic fixing?

Helmut Perlet
Deputy Chairman

Well, I think in terms of what we have done, it goes in 3 directions, that is improve our products, improve the quality of our services and get a new setup on the distribution channels. We have made significant progress in all of the 3 areas. I think the FMOs are selling better now. We are leveraging on our connections with AGI in the U.S., which should give us some leeway with respect to banking and wire houses, and we see already some first progress. We are now ahead of in the -- I think, maybe -- I don't even know whether I can address this, but what we are going to make some promotions of new products, where we think those are going to be very successful, less complex, more attractive for the customers. So that should get us back to a level of EUR 6 billion to EUR 6.5 billion of production in the second half of the year so that we are able to achieve the EUR 11 billion. I think the key issue really is that we have now better products, that we have been able to revitalize the FMOs, which traditionally have been the strength of Allianz Life. But of course, there is still, call it, some tough times or rough weather as long as this litigation issues are going around, and that is also why it is in our utmost interested -- interest to get these resolved as soon as possible.

Brian Shea
BofA Merrill Lynch, Research Division

Okay. Well, it sounds like there's a lot in improving the product, the service, the distribution. That doesn't leave much health. I mean, it's such a wide-ranging fix-it program. I just -- are you confident that organically, you're going to get to where you need to be?

Helmut Perlet
Deputy Chairman

I think we are confident that organically, we can grow this company significantly further. And we can grow the company in, say, double-digit numbers, which should be possible to bring us, in particular, in variable annuities, to a reasonable market rate. Today, we are number, I think, 14 or 15, and we are comfortable that we can grow pretty quickly among the top 10 players in the market.

Operator

We now have a question from William Hawkins from Keefe, Bruyette, Woods.

William Hawkins
Keefe, Bruyette, & Woods, Inc., Research Division

I'm sorry, I just wanted to clarify a couple of points on the subprime issue. And I was scribbling, so forgive me if I missed this. But the EUR 70 million, can you just flag where predominantly in Dresdner Bank that number's being taken? I mean, is it all the trading results or is there another line that we should think about? More importantly, the EUR 100 million that you said would have happened if you were marking to market your trading book as of last night. Can I confirm you said that, that was on all of the EUR 17 billion of ABS that some -- in your -- being marked as trading and not just on the CDO portfolio? Because without professing to be an expert on this at all, it strikes me that's a remarkably low number in the context of the loss of you've already had on the CDO book alone.

Helmut Perlet
Deputy Chairman

Well, to start with your last question, yes, I do confirm the EUR 100 million is all on the EUR 17 billion we have on mark-to-market. And the EUR 70 million Q2 was -- almost all of that was in revenues in the trading. And I think we had, if I'm not mistaken -- no, we had some EUR 6 million or EUR 9 million on the P&C side on our ART business.

William Hawkins
Keefe, Bruyette, & Woods, Inc., Research Division

Great. May I also please check. In AZ Life, the EUR 120 million that you called accounting volatility, is it reasonable to assume that's ever going to be reversed therefore, if it's accounting volatility, or is this kind of accounting volatility that's not going to come back...

Helmut Perlet
Deputy Chairman

No, it's reasonable to assume that it's going to be reversed.

Operator

Our following question comes from Michael Huttner from JPMorgan.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

I had 2 follow-up questions. You said you maintained your EUR 11 billion target now. You just earned EUR 6.158 billion in the first half, so if I -- assuming all this is run rate stuff and if it would be, we'd get to EUR 12.32 billion for the full year. So effectively, you're saying that you're either keeping aside or you think there's a risk on somewhere around EUR 1 billion. And given that the synergy numbers first accelerate a bit. And at this stage, I mean, it's hard to predict the future, the charge for share-based compensation may not go up that much more. What are the moving pieces? I mean, the only ones I can think of were EUR 300 million for dividends in the first half and EUR 400 million for reserve releases or reserve runoffs, whatever which normally thus tend to be skewed in the first half. But there's still something there, which is...

Helmut Perlet
Deputy Chairman

I think -- yes, fair question, Michael. I think there's basically there's 3 key reasons. Point #1 is we always get the dividends in the first half of the year, and in particular, in the second quarter. So we are talking here around about EUR 500 million, which are not going to recur in the second half of the year, point #1. Point #2, as we all know from history, there is always a clear difference in operating profit contribution from the Bank side in a sense that the second half of the year does produce and contribute always much lower numbers than in the first half of the year, which is kind of a seasonality of the banking business. And not just true for Dresdner Bank, but goes for many of those companies. Third point is that year-to-date, the runoff is in excess of what I would expect for the full year.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Right. Okay, but you -- would you expect the runoff to go backwards?

Helmut Perlet
Deputy Chairman

Well, I think I still like to stick to my guidance where I said I would expect runoff anywhere between 2% and 2.5%. For the first 6 months, we are at 3.3% or 3.4%.

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

Yes. I see. Excellent, and that's very helpful. And then just another question on subprime. You must be kind of fed up with this, but -- yes, I can imagine. And this comes from my banking colleagues. I don't know, I just read it out.

Helmut Perlet
Deputy Chairman

Who?

Michael Igor Huttner
JP Morgan Chase & Co, Research Division

My banking colleagues. My bank's analyst colleagues. They say the issue is not CDO. If all, it was subprime overall, it's CDO subprime mezzanine. They said this would get wiped out, whether if it's normal leveraged stuff, and that would look very good. Do you have subprime mezzanine?

Helmut Perlet
Deputy Chairman

No.

Operator

Our next question comes from Tony Silverman from Standard & Poor's.

Anthony Silverman
CFRA Equity Research

It's Tony Silverman, Standard & Poor's Equity Research here. I just had one question, there's -- sorry, 2 questions. There was -- so you mentioned the charge from the mark-to-market subprime. And I was wondering what would be the equivalence of the EUR 100 million for the -- of the EUR 17 billion -- sorry, of ABS securities which will go straight to the balance sheet? And the second question was you mentioned an economic impact of market movements, I'm not sure I quite caught this correctly, which was plus EUR 1.9 billion compared to a minus EUR 500 million number. And I was sort of unclear whether we're talking equities or fixed income there, whether it's an impact you generated from the Life segments or the non-Life segments or elsewhere. I wonder if you could expand and explain a little bit on that, please.

Helmut Perlet
Deputy Chairman

Okay. I think with respect to your first question, I don't have a good number for you at that point in time. We do not really evaluate available-for-sale assets on a daily basis. So please, I ask for your understanding on that one. With respect to your second question, economic impact. What I was referring to was entirely the market movement of our fixed income portfolio available for sale. So based on the interest rate changes, the market value of our fixed income portfolio which we report the bulk of this on available for sale, was decreased by roughly EUR 1.9 billion from end of 2006 to the end of June this year. That is the real market movement. Now what is not reflected on our balance sheet view is a corresponding reduction of your liabilities on the books, because the liabilities, almost all of them are discounted at a fixed predetermined rate and not discounted at market rates. As our -- we have a very strict asset liability management and our portfolio, to a large extent, is duration hedged. Economically, we do not suffer from an interest rate movement. Where we do benefit from is that the present value of our future profits, in particular in the Life business, is increasing based on interest rate increases. And that of course, is also not reflected on our financials. And that made the EUR 500 million, I said in economic terms. If you were to measure the fair value of our equity, that would have increased by EUR 500 million instead of decreased by EUR 1.9 billion based off this more accounting-based treatment.

Operator

Our next question comes from Ian Haylock [ph] from Elgin [ph].

Unknown Analyst

I heard you talking about the EUR 1.7 billion. But did I read this morning that you had EUR 5.8 billion exposure to super senior CDO tranches?

Helmut Perlet
Deputy Chairman

That's what we published last week, and that is true, yes.

Unknown Analyst

Okay. Is there likely to be any sort of impairment in there at all?

Helmut Perlet
Deputy Chairman

No.

Operator

[Operator Instructions] We now have a follow-up question from Stephan Kalb [Oppenheim Research].

Stephan Kalb
Oppenheim Research GmbH

I have another question also on the subprime issue, namely the connection between the EUR 1.4 billion in CDOs you have published and the EUR 1.7 billion today. And then could you give an indication about the possible damages from the flood in the U.K. now in July and compared to June also, and the several fires in southern Europe at the moment?

Helmut Perlet
Deputy Chairman

Yes, subprime. Last Friday, we said, and this was the background of -- this was related to a question regarding CDOs and CLOs. We had EUR 1.4 billion of CDOs, of that is 1 -- sorry, EUR 0.7 billion related to subprime. The additional EUR 1 billion subprime exposure is related to asset-backed securities other than CDOs. That is the EUR 1.7 billion in total. U.K. flood, we had about EUR 25 million already booked by the end of June. That was the floodings we had in end of May and early June. Now obviously, the floodings in July are not covered by the results, cannot be covered. We do expect another EUR 35 million to EUR 40 million in terms of claims out of this flood. The fires in southern Europe, I don't have a good number right now on that. And I don't know yet if and to what extent we are impacted by that one.

Operator

There are no further questions at this time, so I would like to turn the call back over to you for any additional or closing remarks.

Michael Diekmann
Chairman of Supervisory Board

Yes. Ladies and gentlemen, thank you very much for joining our conference call. We say goodbye to everybody and wish you a very pleasant weekend. Goodbye.

Helmut Perlet
Deputy Chairman
Thank you. Bye.