Tryg – Q1 2015 results

Audio cast and Q&A 15 April 2015

Transcript

Presentation

Lars Møller, Head of IR

Good morning everyone here is Lars Møller from Tryg. I am the head of Investor Relations. We are here to present our Q1 results and with me today I have our CEO Morten Hübbe and our CFO Tor Lønnum and with this short introduction over to you Morten.

Morten Hübbe, CEO

Thank you Lars and we kick off on slide 3 where we show a somewhat mixed bag of results in Q1. If we start on the positive side, we have an increase in the pre-tax result of a bit more than 10 % Y/Y. We have reduced the cost ratio 0.3 % Y/Y. We have a return on equity of just above 20 % for the quarter. And we have improved the trend on the top line with a positive top line in Private and Corporate lines. On the negative side, we see a reduction in the insurance technical result of DKK 94 million impacted largely by DKK 120 million higher weather claims, mainly due to the storms that have hit across the Nordics and a larger number of house fires as a consequence of winter in the Norwegian market. Also we see a negative impact of some DKK 56 million from interest rate level. That is due to of course both discounting and technical interest having a negative impact when interest rates are lower. And I guess it is fair to say that weather usually hits Q4 and Q1 more than the other quarters whereas the lower interest rate level will continue to have a negative impact on the future quarters as well.

If we move to slide 4, it is the first time we report on our three customer targets that we announced on the Capital Markets Day. Bear in mind, very importantly, that none of these three customer targets have the focus of chasing new customers. Rather they have the focus on increasing loyalty and product coverage amongst existing customers. As we know, that is a significant driver of stability and bottom line. We see that the NPS, the customer satisfaction, where the ambition is to double within 3 years, we have already increased from 11 to 16 %, which is a bit more rapid than we had expected, mainly driven by Private lines and also claims in Denmark. We see the more than 3 product coverage has increased by 0.2 % where Denmark is the main driver and we see the retention rate has also increased 0.2 % where Commercial is the main driver but also a somewhat positive impact from Danish Private.

If we move on to slide no. 5, we list the most important news in the first quarter. First of all, we have introduced a new car product. There is no doubt that car is the area where competition is the highest and where we have seen a lower price in recent years. We have now come with a more structural solution with a completely new product in the Danish market with significantly higher price differentiation and stronger risk selection and a structure where the product is less of an all inclusive and more of a basic coverage with the opportunity to select add-on coverage, which has been well received in the market within the last weeks. Then we have announced Viking as the first Nordic procurement agreement where we can see that clearly elevating from national procurement agreements to Nordic procurement agreements has taken down the cost significantly and also will increase the customer experience. And then we saw on the AGM the decision on the DKK 29 dividend, which has been carried out. The stock split which will be carried out and the semi-annual dividend, which will start this summer. And then we have taken a new beginning of the new efficiency programme of DKK 750 million with this first quarter and then you probably all of you have seen that our 60 % shareholder has decided that they will introduce a membership bonus where they will pass on most of their dividends and buy back proceeds to the Danish customers.

On slide 6, we elaborate on the Combined Ratio development in the various business areas. We see a significant improvement in Corporate from 98.7 % last year to 92.9 % this year. Clearly driven by lower large claims but also a significant improvement in the cost ratio. In Private lines we see a higher Combined Ratio increased by 3.8 %, negatively impacted by some 4 percentage points from weather and some 0.4 percentage points from interest rates. On the other hand, positively impacted by a lower cost ratio and an improvement in the underlying claims ratio of 0.7 %. In Commercial we see an increase in the Combined Ratio of 2.7 % with a negative impact of some 2.4 % from weather and some 10.8 % from large claims, one particularly large claim. But also on the positive side, some 9.3 % on run-off gains, 0.3 % lower on the cost ratio and an underlying improvement in the claims of 1.8 %.

If we move on to slide 7, we show the beginning of the new efficiency programme of DKK 750 million, which will run until 2017. On the Capital Markets Day in the autumn we showed that the ramp-up of this programme – as you saw on the previous programme there was also a ramp-up with a lower beginning and a higher ending, but it is also the case for the new programme with a DKK 150 million impact this year, DKK 225 million next year and DKK 375 million in 2017. While this should come as no surprise, and this will be a main positive driver for the next three years, clearly it means that the run rate is lower in 2015 compared to the ending of the 2014 impact in the old programme. One of the current focus areas is clearly on outsourcing where we have made the most progress currently in IT and finance.

When we move on to slide 8, we show the development in cost and head counts. As I already mentioned, cost ratio has improved 0.3 % Y/Y. Bear in mind that Q1 is usually the highest cost ratio quarter of the year due to commissions and therefore the Y/Y comparison is the most relevant. We have reduced head counts by a bit more than 50 people. As you can see from this graph, we have reduced nominal expenses in all four business areas. And then we should remind you that on the Capital Markets Day we announced that we expected to see some one-off costs during 2015 in order to achieve the 2017 programme. We previously expected to announce that in Q2, but now the expectation is to announce that in the third quarter results.

And then over to you, Tor.

Tor Magne Lønnum, CFO
Thank you, Morten. I guess, first and foremost if we look at slide no. 10 the top line and the technical result you can see that there is a slightly improved trend in terms of the top line. There is a negative development of 0.4 % in local currency, which is a significant improvement compared to last year. You see that there is actually a small positive trend in the Private lines which of course is a strong improvement compared to the same quarter last year. And then there is a bit more mixed picture on the other

areas. I guess that also highlights the fact that if we look at the Swedish business there is a significant improvement in terms of top line development. In terms of the technical result, I won't go further into that since Morten has talked a bit about it earlier.

If you move on to the next slide and look at the development in terms of average premiums, you can see that there is a negative development in average prices for motor and house in Denmark. In particular, this is reflecting a low index and also motor-competition in the Danish market. As Morten mentioned earlier, the new car product that has been launched in March should mitigate some of the effects going forward and we think in particular sort of introducing a better structure in the motor products should, as I said, mitigate some of the effects. If you look at the Norwegian average premium, you can see that there is a positive development on average prices in Norway both for motor and house, but we also can see some increased competition due to the economic downturn. There is a relatively low effect of price measures in motor which is particularly due to increased emphasis on the efficiency programme and an increased competitive position. There is a slightly higher level of price measures in 2015 and thus average premium will continue to stay low in 2015 but should grow in 2016.

If we move on to the next slide and look at the customer retention, there is a positive development in retention levels in Denmark. Private is actually up to a level of 89.7, which is relatively good. There is a stable development in retention level in Norway, Commercial at 88, but a slightly lower level in Private. We do think primarily due to some seasonal pattern.

If we move on to the Combined Ratio and claims side, you can see that there is an underlying improvement in claims ratio – 0.1 % - which is relatively low and reflecting a mixed underlying development in the business areas. You can see that Private underlying continues to improve and it is 0.7 % for the quarter. Commercial at 1.8 % for the quarter, whereas there is some negative development in Corporate and Sweden. I think first and foremost it is important to note that when you look at the relatively low underlying improvement in the quarter it reflects that some of the measures related to the efficiency programme or the procurement programme that Morten mentioned will have a lower effect here in Q1, but it also reflects that there is some underlying inflation in terms of the claims side both in Denmark and Norway.

If we move on to the next slide and look into the large claims and weather claims, you can see that there is a reduced impact of large claims which is at 3.5 % and more or less in line with the annual expectation. Weather claims are slightly up at 5.4 %, which is up 2.6 % from last year. It is also more or less in line with expectations and I will give you – I will elaborate a little more on the weather claims. Run-off at 7.8 % continued to be at a relatively high level. It reflects still a strong reserve position but also of course that there is a relatively high impact of low frequency claims in this quarter, both due to weather and large claims.

If we elaborate a bit more on the weather claims, you can see here – we have tried to show that there are weather claims as I said more or less in line with expectations and patterns for the last 6 years show that there are significant variations for Q1 and you can say that this year we had a combination of storms Nina and Egon, which hit both Denmark, Sweden and Norway in January and that gives a total effect of slightly more than DKK 90 million after reinsurance and in addition as Morten mentioned there has been a frequency of medium-sized fires in Norway which is in the area of DKK 60 million above last year's level. As I am sure you have all observed, particularly here in Denmark it has been – besides the effects I have mentioned – relatively benign weather in Q1.

If we move on to the investment side, there is a relatively strong return on the free portfolio, overall of 2.2 %, primarily driven by high return on equities at 7.7 %. The key driver to that performance is particularly that we have a tilt towards stable equities and also that there has been an overall rate of European equities in the period. You can see that there is some return on match portfolio in the quarter and the main driver is the falling interest rate levels. We have no material changes in the portfolio and of course the low interest rate level will reflect on the expectations in terms of performance of the portfolio going forward.

If we move on to the slide related to the capital structure, the capital buffer increased in the period to 55 % driven by returns in the period but also additional inclusion of DKK 300 million on the subordinated debt. We said at the Capital Markets Day that the time frame for giving information about new subordinated debt would be in the Q3 announcement but it is most likely to be postponed until later in Q4 due to pending approval of the internal model. And finally on this slide I would highlight the fact that the equity level is significantly reduced to last year but it is due to how the dividend distribution was actually pre-quarter in 2015 whereas it was after the quarter in 2014.

And with that I leave it back to you, Morten.

Morten Hübbe, CEO
Thank you Tor and we end our presentation on slide 20 where we reiterate our 2017 targets, which is to have a return on equity post tax at or above 21 %. To have a combined ratio at or below 87 %. Bear in mind that it is a full-year target and not necessarily a target for winter quarters and then also a 2017 target to have a cost ratio at or below 14 % and then we have mentioned of course the 3 customer targets on NPS retention and number of products and no doubt the new 750 million programme will be a main driver of the value creation for the coming 3 years with a ramp-up which is less of an impact in 2015, more in 2016 and the peak of the programme in 2017. I think with that we are ready to take your questions.

Questions and answers

Jakob Brink – *ABG*
I have two questions, please. The first one is regarding premium growth and competition. I think, Tor, you mentioned that you are expecting average premiums to come up in 2015 or into 2016 and also you are expecting premiums to grow in line with GDP in 2016. How do you see this when also we are seeing your smaller competitors like Alka and Lærerstanden talking about sort of very high growth ambitions the next 4-5 years? I think Lærerstanden was also talking about a 13 % cut in house premiums, is this not going to impact you and the larger competitors at all? That is the first question. And then secondly you mentioned in the report that you have potential to issue subordinated debt of DKK 1.2 to 2.2 billion. As far as I can see that must be including 10 % CoCo's And also assuming that the natural perils pool will still be treated as equity. Could you confirm that please? Thank you.

Tor Magne Lønnum, CFO

Yes, Jakob. First and foremost in terms of the last question, you are quite right, there is no doubt that the variation in terms of the subordinated debt when we say between DKK 1.2 and 2.2, the 1 billion in difference is related to the natural perils fund as you indicate. In terms of the full potential there is, you are right that there is a possibility to utilise up to 10 % of the core capital for subordinated purposes or CoCo's as you indicate.

Jakob Brink – *ABG*

But if the perils pool is treated as tier 2 then you are down to 1.2 or around that level but then it would basically mean that you would have to issue CoCo's in order to increase the level of subordinated debt. Are you willing to do that and then basically utilise the full potential or how aggressive will you be on that?

Tor Magne Lønnum, CFO

I am not prepared to say how aggressive we will be in terms of the subordinated debt, that is really why I said that we will sort of come back to that announcement in Q4 and as I said in the presentation it is really important to understand that whereas we said Q3 on the Capital Markets Day and I am now saying Q4 it is really because there is a time frame related to the approval process related to the FSA that creates some disturbances for us in terms of time frame and that is why I am saying some time in Q4 because it will, as I said, be dependent upon that decision, on that approval.

Morten Hübbe, CEO

I guess we just proved yesterday our application for the internal model to the FSA, a 3000 pages long package and I guess the FSA will now have to evaluate that across the companies applying for the internal model and we need their final approval in order for us to make our final decision on the capital composition.

Jakob Brink – *ABG*

What about the approval or the treatment of the natural perils pool in Norway? I thought they said by March 2015 they should have a conclusion but I guess they haven't done that yet. Anything new on that?

Tor Magne Lønnum, CFO

No, unfortunately there is not and we have actually been trying to set up a meeting with the Ministry of Justice in Norway as well and haven't been able to do that so far. So I think I have been relatively cautious on that before as well, trying to put pressure on the authorities is never a good idea, so I think I will just say that we are in a positive dialogue and that we will just have to wait and see. And then I guess if we move on to the competition question that you raised, there is no doubt that you see some announcement related to the pricing as indicated, Jakob, but I guess first and foremost what I tried to indicate was that there will be price effects across the portfolio later in 2015 which primarily will have some effect on the 2016 numbers and I think, keep in mind that when we said the next level of price differentiation as one of the effects going forward of course that means to be more selective and more granular in terms of the pricing and that includes price effects beyond the index in Denmark. On the other hand there is no doubt, as I tried to indicate in the presentation as well, that we do see slightly more competitive pressure and I think we have said for some time in particular sort of in Motor and this is something that I would highlight again and you have heard me say this before, there is an extremely important position to have as market leader to make sure that we are not driving the development and thus it will always be a balancing act where we need to try to maintain a position where we are not a price leader and we are not going to be a price leader but we should be sort of in the range in the middle of the pack, perhaps, in terms of prices.

Morten Hübbe, CEO

When you mentioned, Jakob, you mentioned Alka and Lærerstanden, to be honest I don't think Lærerstanden is large enough to make any significant difference in the market but clearly Alka is a bigger player. We have seen Alka being, it is not new that Alka is fairly aggressive on growth and pricing, they have been that for the past three-four years, they have also had a significantly larger branding spend than the three other large companies almost put together. I think, to be honest, that their growth has been limited on the back of that, also we see that our competitive disadvantage there has been on our price differentiation being too weak, not on the average price, and the best indicator of how it impacts us currently is on the retention rates and on the current sales, and we can see that our group retention rates are actually increasing, 0.2 % in this period and also we see that our sales are slightly higher than they were in the same period last year. So of course we do concern ourselves with the question but we don't see any significant impact to the market as of now.

Jakob Brink – *ABG*

Okay. Thanks a lot for the answers.

In-Yong Hwang – *Goldman Sachs*

Hi, good morning, two questions from me. So the first one is on the customer development model, which has obviously now been improved. So are there any plans on how these will be distributed so for example you could I guess have a system where customers get it if they have more than three products like you have in the customer target to help with that sort of things and do you have any kind of projections on how it will impact your premiums going forward? And the second question is on the interest rates, the impact of a low interest rate in Denmark. Do you set aside any kind of provisions for further cuts in rates, which could potentially happen with the Central Bank's commitment to defend the peg. Thank you.

Tor Magne Lønnum, CFO

Yeah, I guess the last question is relatively simple, the answer is no. So of course that has an impact. Keep in mind, where we also mentioned the interest rate in terms of comparison to Q1 last year but keep in mind that when we have announced both the previous targets and these targets, we have not taken the interest rate level into consideration, i.e. we are saying that these are long term targets and they should stand despite the fact that the interest rate level has been coming down. So we stay committed to the long term targets despite what has been happening on the interest rate. So the mentioning of the interest rate this quarter is just for comparison purposes to Q1 last year.

Morten Hübbe, CEO

I think on the first question on the bonus model, I think it is important to bear in mind that the entity that has decided and will be paying the bonus is our 60 % shareholder, it is not us. So to that end it will not be sort of an integrated part of our customer loyalty programme and we are not the designers of the bonus model, but having said that, of course we have a dialogue with the 60 % shareholder on how the practicalities will be handled and they have said that they expect to be paying out somewhere between 5 and 8 % of annual insurance premium as a bonus to the Danish customers, and undoubtedly we see that as a positive loyalty argument, we also see it as somewhat of a sales argument but at the same time we do not expect that to be sort of major game changer of the market but clearly something that will contribute to our efforts to keep customers staying with us longer and buying new products.

Tor Magne Lønnum, CFO

Just to elaborate a bit on what Morten is saying, one of the things that we are looking into is whether or not we can utilise the dividend model to actually encourage customers to sign up for electronic distribution and also to get their bank account numbers which of course would streamline other processes internally even further so that is about as far as we go in terms of trying to hook up to the new process for internal purposes as I speak.

In-Yong Hwang – *Goldman Sachs*

Great. Thank you very much.

Gianandrea Roberti – *Carnegie*
Yes, good morning from me as well. I actually have three questions and I apologize, the first one I am going to throw you quite a bit of numbers in there. I was trying to look a little bit on the underlying developments in Q1 2015 versus last year, right, and I can see that the sum of larger weather claims is around DKK 50 million approximately worse this year versus last year and then you have runoff which are roughly 50 million higher this year so the underlying seems to be 35 million worse and then interest rates have an impact of around 90 bips on the combined, negatively, which is around 40 million so in total I am calculating a negative development of 75 million which is approximately 170 bips. But then I am wondering what has happened to the around 350 million savings of run rate which Q1 2015 should show versus Q1 2014? I think it is a little bit surprising the number that you are putting so unluckily I am failing to grasp what are we missing here if we are missing something. I don't know if it is easy for you to reply but it would be quite interesting. The other two questions. One is actually what you just commented upon, Morten, you are mentioning that the falling rates year-to-day doesn't affect the targets going forward. Should we take this that if rates then move then your need to increase prices are what? Because I mean 90 bips, it is not insignificant the amount on the combined. And then lastly on the retention rates, I can see it is up 20 bips already and you have a target of increasing it 100 bips, I don't know if you would top 20 bips for any specific seasonal situation but it just seems quite a bit of a jump compared to your overall target. Thanks a lot.

Morten Hübbe, CEO
I think I can start off with the second question, Gianandrea, of course you are right that the falling interest rates need to be refinanced somewhere and of course that is a bit of a juggling act because we are trying to figure out what will happen to interest rates from now on and until 2017. I think the optionality we have, of course, is to push harder on the efficiency side, to push harder on prices and to push harder on the differentiation and selection. But I think the strongest commitment you need to hear is that we are not using lower interest rate as an excuse to change our financial targets. So we will just make sure that we push the other three areas hard enough to make sure that we compensate for lower rates and then I guess your guess is as good as ours on what will rates look like from now on and until 2017. So I guess the jury is still out on that.

Tor Magne Lønnum, CFO

In terms of the retention rate, Gianandrea, I guess it is at least fair to say that if you look at the mix, the customer mix particularly sort of in the private lines, we see that the number of one-product customers have been reduced whereas three-plus customers have increased and of course that will give some effect on the retention levels. Will it be a stable effect going forward I think is really difficult for us to say, I mean keep in mind that a quarter is a relatively short time span to evaluate that effect. And then I guess not getting into the plusses and minuses that you made in your calculation and in principle what you are asking about is the effects of the savings programme. If you look at sort of the development in terms of the underlying and I guess it is fair to say, and that goes back to the comment that I made earlier, if you look at sort of there is some competitive pressure in terms of pricing, the overall price effects on the portfolio are less than what you have seen in the previous years and there is some claims inflation in terms of the various products and of course that means that significant parts of the effects are not shown in the underlying.

Gianandrea Roberti – *Carnegie*

Okay. Thanks.

Jonny Urwin – *UBS*

Hi there, thanks, I have only got one question left and that is just to hear a bit more about the dynamic between these pricing movements and also the movement in claims inflation. Obviously the trajectory of pricing increases is slowing in Norway and the deterioration is sort of picking up in Denmark, could you just give us a bit more into how claims inflation has developed over the same period and what the sort of underlying movement in the margin is as a result? That would be great, thanks.

Tor Magne Lønnum, CFO

Yeah, just to give you a flavour you can say that if you look into the building index for Denmark for instance last 12 months it was 1.7 % and the price measure in the product is 0.2 % and if you look at sort of the development in the average premium that I commented on earlier you can see that it is actually a negative development due to portfolio mix, due to pricing pressure in the market, so I guess that is the two main components that give that picture. Naturally, if you could look into the inflationary development in the Norwegian market it will be higher and I think if you look into the Norwegian house product it was 3.5 % on the building index for the last twelve months. So just to give you a flavour of…

Morten Hübbe, CEO

But there are no doubts, though, that the sort of acceptance and market ability to handle slightly higher price increases is easier in Norway than it is in the Danish market so clearly in Denmark we have to work harder on the claims procurement and on the risk selection and price differentiation and I think the new motor product in Denmark is a good example of that because in reality we have to solve market competition in pricing of motor with higher discounts short-term and now we are substituting that with a completely new product where we see that if we are successful enough in selling add-on coverage then actually we should be able to enhance or improve our managing of the slightly lower pricing in Danish motor. So still somewhat of a difference between Denmark and Norway.

Jonny Urwin – *UBS*

Great, thank you.

Christian Hede – *Nordea*

Yes, good morning, this is Christian from Nordea in Copenhagen. Most of my questions have been answered so I just have one which is more of a follow-up as well I guess on the one-off costs. Could you give us kind of some indication of what we are talking about what is your best estimate at the moment? I understand that you haven't finalised anything. And also with the announcement in the Q3 report you said, as I understand it, is that all going to be in the Q4 numbers then for 2015? Is that correctly understood? Thank you.

Tor Magne Lønnum, CFO

Yes. To the latter, yes. In terms of the one-off I think it is fair to say that both Morten and myself have been given some pepper so to speak from the organisation about announcing numbers about FTEs and one-off to the market before it is announced to the rest of the organisation. So I guess that is one of the reasons why we would be a bit reluctant to actually sort of state something, but keep in mind that when we talk about 250 million in additional cost savings, of course that is primarily related to FTEs and that means that we are talking about a relatively significant amount of FTEs and that will be the main driver in terms of one-offs. So I do appreciate, Christian, that I am now answering with a potato in my mouth but, you know, I am trying to be a bit subtle about it.

Christian Hede – *Nordea*

That's fair. Thank you very much.

Per Grønborg – *Danske Markets*

Yes, good morning, it is Per from Danske. Your large claims, your weather related claims, can you put some geographies on it, how much of that is in Denmark, how much of it is in Norway?

Tor Magne Lønnum, CFO

Yeah, in terms of the weather related claims, it is fair to say that on the gross side related to the storms etc. it is slightly more than DKK 100 million and I think I mentioned something about the frequency of medium sized claims in Norway. In terms of large claims there is one particular driver related to large claims which is the hotdog factory here in Denmark as I am sure you have read about in the papers a large portion at least of the large claims is related to the Danish portfolio.

Morten Hübbe, CEO

So the entire increase in commercial large claims is in Denmark.

Per Grønborg – *Danske Markets*

Back to the weather related claims you said DKK 100 million was related to Norway, was that correctly understood?

Tor Magne Lønnum, CFO

Yes. Slightly above on the gross level.

Per Grønborg – *Danske Markets*

On the gross level?

Tor Magne Lønnum, CFO

Yeah.

Per Grønborg – *Danske Markets*

Okay, thank you.

Lars Møller, Head of IR

Thank you very much, operator. It is Lars here again just to thank you all for participating in the call this morning here and I just want to remind you that we will be around and you can see the roadshow plan on the slide currently so we are looking forward to seeing you around there and have a nice day to all of you. Thank you.