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Consolidated results as of 30 June 2016

Video presentation transcript

PHILIPPE DONNET, GROUP CEO

Good morning everyone, and a warm welcome to our first half results briefing.
Our performance has been solid.
While the financial markets and geopolitical uncertainty have been obvious headwinds, we have been able to deliver 2.5 billion of operating profit, and 1.2 billion of net income. We are on track to deliver our promise to increase the remuneration for our shareholders.
How? It is thanks to the fundamental strength of our insurance franchise. In P&C at 92.3% our combined ratio is extremely good, despite the natural catastrophes experienced in the second quarter. And in Life, the careful management of our in-force portfolio and our innovative product offering are delivering benefits. Our new business margin of 25.5% is an indication of this.
Furthermore, our balance sheet is in a sound position: Our solvency ratio is at 188% based on our full internal model, and has proven resilient even with the recent market turmoil.
But while we have produced a solid result in the first half of this year we know that the resilience of our performance should be further reinforced. This challenging environment is creating pressure on our results. We know that we cannot rely on the market to relieve this pressure. We need to act. We need to act decisively to continue to reshape Generali.

As you know, this is an organization that has radically changed for the better in the last few years. We improved governance and managerial effectiveness. We exited non-core operations to focus on insurance. We improved our profitability. We rebuilt a strong and resilient capital position.
And then, with the financial turnaround completed, we explained to you last May our plan to become a more agile, efficient, and innovative organisation.
But compared to May some fundamentals in the financial markets have changed: yields have fallen, volatility is amplified, geopolitical risk and uncertainty increased.
That is why in these months we assessed the market and analysed where Generali is today. We wanted to determine if our strategy is still fit for the current environment. Our conclusion is that what we announced in May 2015 still stands. But, we need to execute faster, and to go faster we have to be very focused on a few key elements which are going to make the difference to our results going forward.
The insurance industry cannot continue as it has done in the past. We are at a turning point. Generali is well placed. We have excellent technical capabilities, a high quality distribution platform and a highly motivated and experienced team who execute with passion. Generali can master these challenges.
In November's investor day we will show how we are executing our simpler and smarter strategy… faster. But, today, let me draw the outline of how we are accelerating our strategy, before handing over to Alberto for our results.

We have identified our two areas of attack and have already started working.
On one side, we will further improve our operating performance. Delivery on this is urgent, the potential is great, and the results will be powerful.
On the other, we will accelerate the way we shape Generali for long term value creation. Let me focus on what these mean.

On operating performance first of all: results have been good in recent years, and also in the first half. But we cannot be complacent, we will keep working with actions around three key elements:
First, the operating machine itself. We have made good progress, but we still have substantial opportunities. There is plenty of scope to further cut out redundant activities, to streamline processes, and to integrate platforms and entities, as has been achieved in Italy during the last three years.
This will have a decisive impact on our performance, but also on costs. The promise we made last May was that we would keep nominal costs flat to 2018, even with the significant investments we are making to transform and modernise the Group. These investments are crucial. But, we will find ways to be more aggressive on savings elsewhere.

Second is about footprint. Our activities are spread far and wide across many countries. Our aim is to be of a relevant size, with good profitability in every market where we play. Where we don’t see any possibility to achieve this aspiration in the medium term, we will release capital and resources from these activities. Those resources will be used to re-inforce businesses where our strengths are already clear and the potential is greater.
Third, we will enhance our core insurance capabilities, our technical excellence. Compared to our peers, we are already performing well on average. But, performances are not consistent across our portfolio and the potential we have in both Life and Property and Casualty is significant. In Property and Casualty we can and have to improve pricing, risk selection and claims management. In Life, besides improving the quality and profitability of our new business, we will explore additional ways to maximise performance of our in-force books.

If we then turn to consider what we must do to secure longer term value creation, we again see three key elements that we will tackle.
First, is the structure of our business portfolio. Our heritage is traditional life insurance. We are managing with great skill and success the challenges this brings thanks to the investment and technical teams, but we need to accelerate the diversification of our sources of profit.
For example, we need to exploit further the opportunities that exist to grow in P&C across all segments. And not blind, undisciplined growth. It will be carefully analysed, profitable growth, in areas where we have the necessary expertise. Health is another area where we see much potential to up our game. Finally, in Life insurance, the shift towards unit linked and protection remains important. We will also increase the amount of fee based revenues we are generating. These fees are less correlated and can help us navigate turbulent times.
Second, innovation and customer focus. We are experiencing a revolution in customer behaviour and technological progress. We will continue to invest to stay on top of these trends. We must be simpler and smarter not only in our internal processes and operations, but also in the way we deal with customers and understand their needs. And not only end customers: Generali has a unique and truly exceptional proprietary distribution franchise. We can maximise the potential of it by increasing their capabilities by giving them better tools with which they can service our customers.
And lastly, our brand. We have a strong brand, built on a rich legacy. We can leverage this great asset much more. To increase its visibility and to fully deploy its power is definitely a “must do”.

Now, all of that sounds common sense and simple. It is common sense and simple. So what will make Generali different?
What will differentiate us is execution. We will do more, and we will do it simpler and smarter. But for us this is not enough, we also need to be faster.
To do it faster, we have made changes to the organisational structure. This new structure allows for a more obsessive attention on efficiency, and ever higher vigilance on performance. For example, we have made changes to the Group Management Committee so that now, all businesses and functions are represented. We have improved the effectiveness of reporting lines, and we are increasing the empowerment, alignment, and the accountability of local CEOs. All of this will accelerate the initiatives I have described and ensure we execute with exellence.

So, let me summarize: our strategy is the right one, and we are going to execute it faster. There are two fundamental lines of attack: operational performance on the one hand, and shaping the Group for long term value creation on the other. I have outlined these for you today. We will have the opportunity to go into the details of these actions, and to give you proof points of delivery, at our investor day in November.
We know what we have to do, and we have the right team to do it. I am fully confident of our ability to execute with exellence. Despite the increasingly challenging environment, we remain committed to our financial ambitions and to our promise of delivering 5 billion euros of dividends in the four years to 2018.
Let’s now turn back to the solid results we are reporting today and for that I pass the word to Alberto.

ALBERTO MINALI, GENERAL MANAGER AND GROUP CFO

Good morning, this is Alberto Minali, General Manager and CFO of Generali. As Philippe has already explained, we operate in times which are undoubtedly challenging for the insurance sector. But, I am pleased to report that our underlying technical performance is extremely solid. And our balance sheet remains robust. Even if the level of profitability is lower due to our prudency in realizing gains, our overall performance is ahead of market expectations.

Key 1H 2016 financials at a glance

Let's look at some numbers. The total operating result of the period reached almost 2.5 billion, down 10.5 percent year on year. Consistently with Q1, you see here the effect of our decision to realise a lower level of gains.

Our annualised operating ROE on a rolling four quarter basis declined by 1.3 percentage points. This was broadly at our target level.

Lower realised gains and higher impairments are also evident in the non-operating result, leading the overall net result of the period down by 9.9 percent to 1.2 billion euro.

Shareholders' equity is up 4.2 percent from year end 2015, to 24.6 billion euro, driven by the increased stock of unrealised bond gains.

The Solvency II ratio remains strong, at 188 percent according to our internal model view.

Operating result by segment

Looking at the operating result by segments,

The Life operating result posted a 3.5 percent decline to just under 1.7 billion euro, but showing an improving trend from the first quarter of the year, which I will explain in a moment.

Property & Casualty showed a 5.6 percent decline, due to lower investment income and to other components, which offset a very strong underwriting result.

The segment Holding & Other Businesses had a negative performance with 102 million euro losses, compared to a 71 million euro profit of last year. This was mainly due to some specific items in the first half of last year, namely the exceptionally strong performance of Banca Generali, and some gains on private equity and real estate funds, none of which was repeated in the first half of this year.

From operating result to net profit

If we now move from the operating result to the bottom line:

Non-operating investment income had a 45 million negative impact to net profits, as compared to the strongly positive contribution of last year. In line with our prudent approach, the first semester experienced 213 million lower realised gains. In addition, weak markets generated 178 million higher impairments.

Non-operating holding expenses increased by 11 percent to 405 million euro, mainly due to 24 million higher interest costs. This increase in interest expenses is temporary, and is linked to the 1.25 billion euro and 850 million euro subordinated bonds which we respectively issued last October and at the end of this May. These are to pre-finance one bond which was called in June and another, which has a call date in February 2017.

Other non-operating expenses decreased by 297 million euro due to some exceptional provisions in the prior year number which did not recur.

The tax rate was 32.5 percent, while minority interests were 66 million euro lower, due to the lower contribution of Banca Generali as previously mentioned, and the presence of realised gains on equity investments in China during the first half of last year, which did not recur in this semester.

Shareholders’ equity

Let us now turn to look at the balance sheet. Shareholders’ equity increased by 4 percent, reaching 24.6 billion euro.
The mark to market of available for sale assets resulted in a 1.4 billion euro gain, driven by the positive impact of reduced interest rates on unrealised bond gains.
The net result of the period contributed for 1.2 billion euro, as you have already seen.
On the other side, we have the 1.1 billion euro cost of the dividend payment in May, as well as other items that were 475 million negative. These derived mainly from the negative effect on our German pension liabilities as a result of the reduced interest rates in the quarter, and from a slightly negative impact of foreign exchange.
Let’s turn to solvency.

Solvency II: Internal Model View – eligible own funds vs required capital

Our solvency ratio remains strong, even if financial markets pushed the number down from the levels seen at year end. This was mainly visible on our Own Funds, which decreased from 41.3 billion euro to 39.6 billion. Then, we also had a slight increase in solvency capital requirement, from 20.5 billion at year end to 21.1 billion at the end of June. This mainly reflects the lower loss absorbing capacity of deferred tax, coming from the lower own funds.

We also show on this chart the view on the current scope of our approved internal model approval, that is the regulatory view. Here, the ratio has also declined to 161% at the end of the first semester.

Solvency II: Internal Model View – capital generation

If we look at the roll forward of the solvency ratio, we see that the contribution of normalised earnings has remained quite consistent at 8 percentage points, i.e. at the same rate as the 16 percentage points we booked for full year 2015. As usual, we accrue dividends when they are declared, i.e. in the fourth quarter, and so there is no impact of dividends in these results.
This positive contribution of normalised earnings has helped to mitigate the sharp negative effect of financial markets year to date, that caused negative economic variances of 22 points, especially driven by the negative interest rate trend, falling equity markets, and increased volatilities.
Despite this negative effect, our solvency ratio ends at a still strong level and far from any threshold where we would need to take action to defend it. Moreover, our ability to create Solvency capital organically will continue to be a strong line of defence, should we encounter further market weakness in the coming period.

Life key financial indicators

Turning now to look at the business segment performance, starting with Life. What I would like to stress on Life is the evidence of the actions that we have taken to improve our product mix, and constrain or eliminate sales of products not meeting our requirements. Therefore, headline measures of volumes are generally somewhat weaker, but the new business margin has been significantly positively affected by these actions, contributing to an overall 38% increase in new business value.

Life Operating result by driver

Let me dive into the single drivers of the life operating result first of all, which overall fell 3.5 percent.
The Technical Margin posted an 111 million euro increase, mainly thanks to higher technical profits on group policies in Italy, but also higher margins on loadings in France.
The Investment result decreased by 226 million euro, despite a growing current income. This is again mainly explained by 931 million lower net realised gains, gross of policyholders share, as well as higher impairments, in contrast to the prior year where we had unusually high levels of gains.

Expenses decreased by 54 million euro, in particular thanks to reduced acquisition costs in Italy and Germany.

Let me make one last comment on the life operating result, which is showing an improving trend if we look sequentially at the quarters. The main effect here is coming from the Netherlands, where we have taken actions on the asset portfolio, for example to lengthen duration. This has allowed us to reverse in the second quarter a provision of around 50 million euro for LAT which we had booked in the first quarter, leaving an overall neutral impact on the first half result.

Life inflows and technical reserves

Turning to net inflows, in the first half we reached a very solid amount, 7.5 billion euro, despite the continued financial market volatility, and our decisions to actively cap or cease sales of some products given the interest rate environment.

These market conditions led to a contraction of the Unit Linked component compared to last year, representing 37% of total net inflows, although improving on Q1, where it was only 30%. I emphasize once more that even the traditional savings products we are selling right now are designed on a prudent and profitable basis, and we will not sell products which do not meet our requirements if the external environment deteriorates, as it has been doing.

Looking at the main countries, in Italy we have stable net inflows at 3.9 billion euro, with reduced outflows which compensate declining premiums. Again, as in the first quarter of the year, and after almost two years of very strong growth rates, hybrid products showed a contraction year on year due to the volatile equity markets.

In France we see positive but decreasing net inflows, from 721 million to 332 million. This latter number is the result of encouragingly positive net inflows in unit linked and protection & health, counterbalanced by strongly negative net outflows in the savings and pension component.

Germany also posted positive inflows but 28 percent below last year. Like in France, the decrease was driven by net outflows of traditional business, particularly as a consequence of the closing of the offer of pure savings products by Generali Leben. In contrast, we saw strong inflows in unit linked and protection.

We are experiencing a similar trend in EMEA, with positive but strongly declining net inflows. That is driven by the deliberate reduction of wealth protection related products in Ireland and by net outflows in savings and pension in most markets, in particular in Austria were we stopped the sale of traditional single premium business.

Lastly, in Asia we experienced a strong increase in net inflows, mainly coming from China and linked to the exceptional level of sales reached through our banking sales partners. As I stated in May, however, this production had been stopped due to the interest rate development, and in the second quarter of the year we experienced a quantitatively more normal and technically sound production.

Overall, the strong net inflows of the Group contributed to a 2 percent increase of life technical reserves over the first six months, to 377 billion euro.

Life new business analysis

Turning specifically to look at the new business, we see similar trends. APE is down 4.5 percent to 2.6 billion euro, mainly explained by the drop of the unit linked component which is down 23.2%, due to the poor financial market conditions.

On the other hand, if we turn to look at new business profitability at the Group level, we see the margin improved strongly by 7.9 percentage points to 25.5 percent. A number of offsetting factors have driven this. The higher level of swap rate and slightly lower swaption volatility – since we are using beginning of period assumptions – contributed to a positive effect of 1.9 percentage points. The change in methodology that was introduced last quarter to, align the calculation to Solvency II principles, added further 60 basis points to this.

But the biggest positive impact, equal to 4.5 percentage points, derived from management actions. Decisions like the closing of product lines which have become unprofitable in this interest rate environment, the launch of new more profitable products, and the further

reductions in new business guarantees have all contributed, and demonstrate our strong proactivity to managing the business in the current challenging conditions.
The overall margin improvement more than offset the negative APE trend, allowing our new business value to grow strongly by 38.4 percent, up to 656 million euro
Looking at the individual countries:
In Italy APEs were overall flat, but as the result of a decreasing production of hybrid products, compensated by traditional ones. The share of Unit Linked on total APEs therefore dropped from 22 percent last year, to a current 13 percent. We confirm nevertheless our strategy to focus on hybrid products and we are already taking actions to reduce the temporary increased exposure to traditional products. We can already see first signs of improvement, with the share of unit linked going up from 11.9 percent in the first quarter of the year, to 14.1 percent in the second. I would also add that even on the savings portion, guarantees have continued to fall sharply, down to only 26 basis points in the first half. This helped contribute to increased margins, up from 22.3% to 28.6% in the first half.
In France we had a 10.7 percent drop in APEs driven primarily by savings business, down 18.2 percent, but also with unit linked posting a 12.6 percent decline. The weight of unit linked is quite stable at almost 20 percent, while there was an increase of the protection component from 30.5 to 35.1 percent.
In Germany we saw a 18.1 percent APE reduction, driven down by the strong reduction in savings component that fell by almost 39 percent. Unit linked and protection sales have correspondingly increased their weight to reach more than two thirds of the total, which had a strongly positive impact on margins.

Life investment performance
Finally, looking to the Life investment portfolio: Life general account investments reached 352 billion euro, up 6 percent from the year end 2015, also driven by positive mark to market performance of available for sale bond investments. A higher balance of investments more than counteracted the decreased investment returns, which fell from 170 to 160 basis points on a non-annualised basis, driven by fixed income current returns. Net of these effects, current income consequently increased by 114 million euro. Current returns on equity instruments showed a substantial increase thanks to dividends from private equity funds, compared to an exceptionally low number in the first half of last year, although with the overall allocation to equities remaining cautious.
In the first half of the year, we invested pre-existing cash, net inflows, bond redemptions and coupons at an average yield of 2.1 percent in the life segment, mainly in corporate and government bonds.

P&C key financial Indicators
Now, turning to look at P&C: Gross written premiums increased by 1.3 percent, on a like for like basis, to 11.1 billion euro. This confirms the recovery trend we have started to see, and in fact the standalone second quarter premiums are 3.9% higher than the corresponding period last year, again on a constant currency view.
The combined ratio improved by a further 0.3 percentage points which was not quite enough to offset the lower investment income, leading to an overall operating result which decreased by 5.6 percent.

P&C Operating result by driver
Looking at the components of the operating profit, we can see a particularly strong technical result at 681 million euro, up 5.6 percent, and a declining investment result driven by lower reinvestment yields. The residual other items line worsened by 57 million euro versus the first half of last year, partially reflecting the payment of brand fees to the parent company and some higher indirect tax items. The prior year was also affected by some minor positive one-offs.

P&C gross written premiums trends

Let's look now at gross written premium developments within our core countries.

Italy is down 3.8 percent, at 2.8 billion euro. Primary motor decreased by 6.1 percent, but mainly due to the cancellation of some large fleet contracts as I mentioned last quarter. Without this effect, the drop would have been 2.3 percent, and therefore on an underlying basis, is on an improving trend compared to that seen during 2015. Primary Non Motor is down 2.3 percent, reflecting the overall weak economic environment.

France declined by 0.9 percent to almost 1.4 billion euro. Primary motor was slightly negative, at minus 0.8 percent, mainly due to continuing pruning activities on the fleet business portfolio, but also as a consequence of decreasing average premiums. Primary non motor decreased by 1.3 percent, due to the competitive market environment in commercial business and the continuation of strict underwriting guidelines and pruning activities.

In Germany premiums fell by 0.5 percent. The reason for this lies in the non- motor segment, down 1.3 percent, where pruning activities in the broker channel and on non performing agencies are still ongoing. Motor business inverted the negative trend of the first quarter, posting a moderate 0.7 percent growth.

CEE accelerated, showing a 2.3 percent growth, while EMEA confirmed a positive trend of 3.1 percent growth.

Combined ratio analysis

Moving to the analysis of underwriting performance, you can see the combined ratio improved by 0.3 percentage points year on year to 92.3 percent. In contrast to the first quarter of the year, the second quarter has been hit by several storms and floods across Europe that affected our P&L by approximately 125 million euro, after reinsurance.

Looking at the single drivers, the loss ratio improved by 0.4 percentage points from the already outstanding result we achieved last year. This reduction has been driven by a 50 basis points lower current year loss ratio before nat cat. Nat Cats weighed for 1.3 percentage points, compared to 1.4 last year, whereas the run-off result decreased slightly. The expense ratio remained stable.

Combined ratio by country

Looking by country:

Italy confirmed an excellent performance with a 88.6 percent combined ratio, driven by the lack of nat-cats, and making it again the best combined ratio of our major countries and regions. We continue to see pressure on the combined ratio in motor, but with the excellent development of non-motor counteracting it.

In France the combined ratio worsened by 90 basis points to 100.1 percent due to a heavy nat cat burden that affected the country for incremental 2.6 percentage points, offsetting some underlying improvement.

Germany experienced an excellent 91.4 percent combined ratio, down 1.1 percentage points, notwithstanding 80 basis points higher nat cats. This is driven by an improving current year loss ratio, as well as by a reducing cost base.

In CEE, our combined ratio increased by 5.4 percentage points, still negatively affected by regulatory changes that were introduced last year in the Polish motor market and a higher level of claims in the Czech Republic.

In Poland we have already executed two tariff increases, launched cost cutting initiatives and plan further tariff increases in the course of the year

In Americas, our combined ratio has improved by 3.2 percentage points, mainly thanks to the strong actions we have taken to restore profitability in Brazil.

P&C investment performance

P&C investments decreased slightly to 39 billion euro, down 2.5 percent from the end of 2015.

Total P&C current returns on a non-annualised basis decreased by 20 basis points year on year to 150 basis points, mainly driven by the fixed income trend.
The average reinvestment rate in P&C during the first half of the year has been 1.4 percent. As well as reflecting the overall interest rate environment, the figure is also explained by the asset classes we invested in during the first quarter, which were mainly government bonds.

Focus on Holding & other business segment
Let me finally turn to our "Holding & other businesses segment", whose overall contribution to the group operating result decreased from a profit of 71 million Euro, to a 102 million Euro loss.
This decline has been mostly driven by the lower profitability of Banca Generali, which was particularly strong in the first half of last year.
In addition to that, the "Other businesses line" benefitted last year from gains on private equity and real estate investments that are not present this quarter.

Conclusion
Let me conclude: Although we could not match the high level of operating and net profit we saw last year, this is mainly due to our conscious decision to realise lower gains.
In fact, I am greatly encouraged at the underlying technical performance the Group is demonstrating. In Life, our discipline on products is showing clear benefits, for example the strong increase in new business profitability despite lower headline volumes and weak markets. In P&C, we have an enviable combined ratio, and with a top line which is starting to show a recovery trend after the pruning actions we took in recent years.
As Philippe has already explained, we will take actions to further strengthen ourselves in the coming period, to combat the external environment which is putting ever more pressure on results. A particular focus for me will be to further streamline the operating machine, and the changes I have made in the General Manager area will facilitate that. We will be exploring opportunities to grow in P&C and Health while never forgetting our strict discipline on profitability. And in Life, we will continue an innovative but careful approach on new business, while also exploring of ways in which we can optimise our in-force books.
Importantly, we will do all of this from a position of capital strength and resilience, which is of fundamental importance in a world of uncertainties.
We are therefore well positioned to deliver on our promises.