TRANSCRIPT

Conference Call Transcript

H1-2016 Preview

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Operator

Ladies and gentlemen, welcome to the Coface conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a Q&A session. As a reminder, this conference call is being recorded. Your hosts for today's conference will be Mr Xavier Durand, CEO, and Ms Carine Pichon, CFO.

I am now handing over to Mr Xavier Durand. Sir, please go ahead.

Xavier DURAND, CEO, Coface

Thank you very much. Good morning to all and thank you for joining the call. I guess by now, you all have seen the announcement that we made last night. This call has the purpose of giving you some colour around this announcement and obviously to provide you with the opportunity to ask any questions you may have. Just in terms of the announcement, as we mentioned in Q1, we have seen risks rise in developing markets over the past quarters and we highlighted how this was centred around some sectors: in particular, sectors such as commodities, metals and trading. We now have the benefit of one more quarter, as we end Q2, and we have been updating our understanding of the situation and getting more visibility over the rest of the year.

So, in summary, what we've just announced is that our loss ratio for the second quarter of 2016 is looking like it's going to be around 67%. Behind this number is the fact that we're seeing higher risks in developing economies than we anticipated. Of course, this hits the policies written in these parts of the world, but it also affects the policies written for companies in mature markets that are exporters to these emerging markets. At the same time, in these markets and these developing economies, we're seeing larger files than we have seen, on average, in the past. Structurally in these markets, the payment delays are longer and the time to recover these debts is increasing. In other words, recoveries are slower than in the past. So, with these trends going on in the portfolio, we have taken adjustments to our reserve and risk-management policies. As such, we see our loss ratio for the total of the year being in the range of 63–66%.

As we discussed on the prior call last quarter, we have taken strong measures to adjust our risk exposures, in 2015 in particular, around Asia and Latin America. We discussed these adjustments at length during the last call. We still expect to see the positive effects of these actions taking place over time this year.

You have also seen some of the announcements that we've made. We are continuing to strengthen our global risk infrastructures and underwriting teams. We have announced a new CEO for our Asia-Pacific region, coming on board in September, with Bhupesh Gupta, who is a senior financial services professional. He has a very strong risk track record of over 20 years, in the risk space in Asia. We have also announced a new Group Risk Director with Thierry Croiset, who also has strong risk experience both in Europe and in Asia. We think he is going to be a strong asset to help us strengthen our risk management framework around the company.

These are the core points behind this announcement. As you know, we are working on our strategic plan and we will, as discussed in the first quarter, provide details of these during the investor day on September 22nd. We will also give you some highlights at the end of this month, when we publish our Q2 results.

What we're doing, of course, is adjusting our plan to take into account the reality of the markets that we're facing today, with increased risks in emerging markets. This means that we'll adjust our risk underwriting, as much as our cost structure and our growth strategies, around the reality of these markets.

So that's basically what I have to say as an introduction. What I'd like to do now, is turn it over to you. We will be happy to take your questions.

Operator

Thank you. Ladies and gentlemen, if you wish to ask a question please press 01 on your telephone keypad.

Our first question is from Guilhem Horvath, from Exane.

Guilhem HORVATH, Exane BNP Paribas

Hello, good morning. I have three questions. The first question is: can you speak a little bit about the type of claims which triggered this profit warning, in terms of frequency, severity and what you are you seeing, actually? The question on that is, obviously, with the risk action plans you have put in place in these countries, shouldn't they have tackled these kinds of 'over-border' problems?

My second question is a more high-level question. What do you think about the underlying profitability of Coface in 2016? What is the profitability excluding these exceptionals and on what basis should we forecast for 2017 and 2018?

And my last question is on dividends. Obviously you have a 60% official pay-out policy and applying this pay-out policy to the revised net income for the year will lead to a much lower DPS. Could we have, in a way, a DPS decreasing less than the EPS for the year? Is that possible, from a capital perspective? Thanks.

Xavier DURAND, CEO, Coface

Okay, thank you. Well, I'll start with the type of claims. As I said, we're seeing a rise in claims in the emerging markets of Asia and Latin America. As we have both said, it's impacting the portfolios that we write in these parts of the world. Also, because a good chunk of our business is export driven (and by the way, this is one of the strengths of Coface), we're seeing that it has an impact on the portfolios that we write in Western Europe - or in North America, for that matter.

Well, there's really nothing different from what we've seen, except that, in these markets, as I said, the payment delays are longer than they are in the traditional Western Europe credit insurance space. We're seeing claims that are higher than we've historically seen in these parts of the world. I think it just translates to the fact that the crisis is steeper and probably longer than was anticipated by the business. So we're seeing this impacting our books in these parts of the world, as well as in the developed markets.

We still expect the measures that we've taken (and we shared that with you, last time, at the end of Q1), to have an impact. Actually, we've seen the impact that it has had already in Q1, in the Latin American book. So there is no change to that perspective. It's just that I think what we're seeing in reality is that the crisis, or the rise in claims, is stronger and more durable than we've seen in the past in these parts of the world.

When it comes to profitability, I'll turn it over to Carine, to talk about what it means for Coface and on the dividends.

Carine PICHON, Chief Financial Officer, Coface

Thank you Xavier. On profitability for 2016, it's clear that with the range we have given to you in terms of loss ratio, it will have an impact on the net profit. As a reminder, last year we made an assessment that one point of loss ratio represents around €6 million less of net profit. That's the average on which we can try to make an assessment based on 2015 figures –but let's say it won't be very different for 2016. It's too early to say for 2017 and 2018, as that's something we will discuss in the framework of the strategic plan. We will have to explain this within the framework, knowing that it's clear that the risk environment will be taken into consideration to make this assessment.

The dividend policy has not changed. Clearly the 60% pay-out ratio on the EPS will be lower than anticipated. It is also too early to say what the final policy at the end of the year will be. We can say that it will be a minimum of 60% for this year. I think we will come back on this particular issue later.

Guilhem HORVATH, Exane BNP Paribas

Okay, thanks.

Operator

Thank you. The next question is from Benoît Pétrarque, from Kepler Cheuvreux.

Benoit Pétrarque, Kepler Cheuvreux

Yes, good morning everybody. A couple of questions on my side. I just wanted to make sure I understand how much is linked to the potential clean-up/conservatism on the provisioning policy, versus the real deterioration of the environment in emerging markets? You are guiding for higher losses, but I just want to make sure I understand how much is linked to a real deterioration, versus a more of a clean-up effect. That would be useful.

Then, on the country-specific side, are the problematic countries still the same -i.e. Brazil and China, or do you see more countries potentially joining this list of problematic countries, potentially?

Just a general remark is that the market seems to be pretty relaxed on emerging market risk. I remember last year that we were kind of worried by emerging markets in July/August. You have also guided for deterioration of risk, so you were already de-risking by that time. Do you think there is a kind of disconnection between where the market is now and what you see going on in the emerging markets –because you have the real data, let's say, on your screen?

Then, finally, is there any impact on the Solvency II ratio? Is there any impact on capital from this increasing net loss ratio in 2016? Thank you.

Xavier DURAND, CEO, Coface

Okay, maybe I'll address your questions in a different order, but we'll get to each one of them. I think the first one is on solvency, and no, this has no impact on the solvency ratio of the company, just to be clear on this one.

In terms of the countries, yes, it is the usual suspects. We are seeing continued, protracted and increasing claims in places like Brazil. We spoke at length about Asia at the end of last year. As I said, there has been a deeper, longer, more protracted and maybe wider crisis, or rise in claims, than was anticipated.

As to your question around the markets being relaxed and are things getting better, as you know, we have an early read on what is going on in the economies. I think we are probably a little ahead of the cycles, usually. We have seen a lot of government interventions that have impacted the markets. I'm thinking in particular of China, where last year the government started tightening credit and liquidity, which impacted smaller companies, then relaxed them again. There is always a risk that they might come back, or change their policies, and we are clearly, exposed to these changes in policy.

When it comes to Brazil, I think it's pretty clear that the country is undergoing some pretty important changes and there are political events that will probably have an influence on the level of confidence in these markets. So there's nothing new, in terms of the big themes, but it's more about how they will play out.

When it comes to our reserves and our risk policies, we are taking this into account and recognising the reality of what we're faced with, in terms of duration and strength, and how we plan for the year, in terms of the loss levels. So I think we're being realistic in terms of what we're faced with in the markets.

Benoit Pétrarque, Kepler Cheuvreux

Thanks, very useful. Do you have any visibility, currently, on 2017? You are guiding now for a net loss ratio on 2016, but do you have any visibility? I mean, there should be a material improvement on the net loss in 2017, but by how far? How do you see 2017 at this stage?

Carine PICHON, Chief Financial Officer, Coface

I think it's too early to answer you. It is clear that we anticipate that this will improve, as we are not happy with the level of the current loss ratio. Now is a little early to say, as we will have a lot to explain, in the global framework of the strategic plan, about where we want to grow, or not, because of the global economic situation. So that's what we are currently doing. I can understand you would like to have the answer today, but we will share it with you in a few weeks, at the latest, in September.

Benoit Pétrarque, Kepler Cheuvreux

Great, thank you very much.

Operator

Thank you. The next question is from Thomas Fossard, HSBC.

Thomas FOSSARD, HSBC

Good morning, my first question would be just to better understand the change in the reserving policy. Does that mean that, going forward, we should not expect as much reserve release as you reported since listing? I think that you are probably at around 20–25 points of reserve release, which looks pretty high compared to your peers. So do we have to think about any significant changes for 2017–2018, in light of the more cautious reserve approach you are implementing today?

The second question relates to the deterioration in the claims pattern. So we see a big change in terms of trends compared to Q1 reporting numbers. Did that trigger any additional risk mitigation measures? Can you comment on that? How much more risk exposure do you need to cut in order to preserve the profitability of the book and the exposure of the books? At the end of the day, what will be the impact of all these measures on the top line for 2016? I think that you reported something which was down in Q1, FX-adjusted, but could you comment on what could be the impact, on the full-year basis, of additional risk mitigation efforts? Thank you.

Xavier DURAND, CEO, Coface

First Carine will talk about the reserve release, and I'll take the second question around additional risk measures.

Carine PICHON, Chief Financial Officer, Coface

In terms of reserving policy, what we have taken into consideration now, is the change in pattern, in terms of claims. Firstly, we have a higher average size of claims, which come from previous underwriting years -2014 and 2015 for some of them. This clearly, automatically leads to a level of positive run-off which is lower than reported in previous years. That will be the automatic effect on our loss ratio in 2016.

The second effect is that we will take this into consideration for the opening underwriting year of 2016. When we see that there is a deterioration, globally, of claims (in terms of size, longer patterns and so on), then we integrate this. So there will be the effects of a less positive run-off coming from that and a higher underwriting year for 2016.

Xavier DURAND, CEO, Coface

When it comes to risk measures, we have discussed this at length. We cut our exposures quite significantly last year, in Latin America and then in Asia. I think what we are seeing, as I said, is a protracted rise in claims and we recognised that we need to be prudent. We are continuing to adjust our risk exposures on a daily basis and we're monitoring these very carefully. We are looking at this country by country and into the differences between different sectors within each country. So there is a lot of work going on in real time and permanently. I don't expect a major, massive event such as we saw last year, but we are continuing to work on our risk policies on an ongoing basis.

Thomas FOSSARD, HSBC

So, no specific comments on the trends, or the potential decline of sales and turnover on a full-year basis?

Xavier DURAND, CEO, Coface

On that one, I think we'll comment on our growth at the end of the second quarter. I think that will be the right time to talk about the growth trajectory for the business.

Thomas FOSSARD, HSBC

If I may ask, Xavier, on the risk control and the risk monitoring of the group, what you're reporting today, is it just bad luck and this is the nature of the credit insurance business, and you're there to protect your client and from time to time you can potentially face an increase in claims? Is that just the normal nature of your business? Or, are you considering that the risk monitoring and the internal risk control function was not completely state of the art, and obviously you need to strengthen the IT platforms, data collection and management as well? So how should we take this deterioration in claims reported today, in terms of internal procedures?

Xavier DURAND, CEO, Coface

Well, what I would say is, in the past, in 2008–2009, we saw a crisis that started in the US and carried on to Europe but pretty much left Asia untouched. I think what we're seeing here is the first serious rise in claims and delinquencies in emerging markets. And I think that's where it's new, in the sense that these are places where we have been taking risks for years, and these places have been relatively untouched by the past crises.

I think it does require an adjustment on our end, in terms of recognising that this is a different risk environment that we are operating in. We are taking measures to reinforce our risk infrastructure in these places, in the light of a rise in the risk environment. So that's the essence, if you will, and the spirit in which we are recruiting people into these parts of the world that actually have deep, long experience in managing risks in these regions.

Thomas FOSSARD, HSBC

Okay, thank you.

Operator

Thank you. The next question is from Michael Huttner from JP Morgan.

Michael HUTTNER, JP Morgan

Fantastic, thank you so much. Just a follow-up question on solvency. I remember from the past that solvency was a function of stress and volatility. Clearly we have a volatility event, because there's a spike in the loss ratio this year - yet you said that solvency is not affected. I just wondered if you could explain. Thank you very much.

Carine PICHON, Chief Financial Officer, Coface

Good morning Michael. You may remember that during the 2015 results, we gave you some sensitivity on loss ratio and the impact on the Solvency II ratio. We then simulated the crisis of 2008–2009, with a level of loss ratio which was above 100% (and we are far from this with what we have said for 2015), and the solvency ratio was around 118%; let's say 120%. So that's why we say we are not concerned, because it's a scenario which is worse than the one we expect for the end of this year. As you can see, in any case we are comfortable with the loss levels of the Solvency II ratio. That's why we don't have any concerns, in term of cover ratio, for the end of the year on the framework.

Michael HUTTNER, JP Morgan

Okay, so just so I understand, there is an impact on solvency but it's a modest one, and we're far away from any levels which would be of concern. But there is an impact, right?

Carine PICHON, Chief Financial Officer, Coface

Yes, it may have an impact, knowing that we will also have to integrate the fact that in Q1 we have a decline in our turnover. So when you have also a decline in your turnover, you need less capital.

Michael HUTTNER, JP Morgan

Of course, yes.

Carine PICHON, Chief Financial Officer, Coface

So that's why I said that, all that taken into consideration, I am not very concerned about solvency.

Michael HUTTNER, JP Morgan

Not very concerned?

Carine PICHON, Chief Financial Officer, Coface

No, that's why I think you have to take both lines in the simulation.

Michael HUTTNER, JP Morgan

Yes, I understand. That's very helpful, thank you.

Operator

Thank you. We have another question from Guilhem Horvath from Exane.

Guilhem HORVATH, Exane BNP Paribas

Thanks for taking my additional questions. The first one is a follow-up on my previous question, actually, on the risk action plan. So basically you cut half of the exposure in China and Brazil in 2015. My understanding is that the risk provided from these countries is much less important than what you had before in your total book, right? So what I don't understand here is, how that can enable mature market deterioration if the risks are well monitored in these countries? I mean, isn't the spill-over effect to mature markets included in the risk action plans? So that's my first question.

The second question is for you both –and it's a very high level one. How confident are you now that the new reserving policy is well adapted to navigate in this very complicated market environment, and that it is sufficient so that you won't have to have a more conservative reserving policy going forward? Thank you.

Xavier DURAND, CEO, Coface

Thanks for the question. I think as Carine said –and I'll just go back on this to make sure we're clear– we have taken strong risk actions in 2015, both in Latin America towards the beginning of the year and in Asia towards the end of the year. It takes time for these actions to bear fruit, given the payment delays in these markets and the time that clients have to declare claims. For example, in Asia, these cuts were made in December, so we're six months on, and we expect to see claims relative to the years 2014 and 2015 continuing to come for some time. So I think it's just the normal credit cycle. When you make a risk action plan, it does take time for these to translate into lower claims. There is a significant amount of time between the time that you cut and the time that the client has to declare a claim that's still covered under these prior year underwritings.

Guilhem HORVATH, Exane BNP Paribas

So basically, how long do you think it will take to have the full impact of these bad exposures? What is the maximum amount of time you need, until you're perfectly confident that it's all cleaned up?

Xavier DURAND, CEO, Coface

Typically the delay is nine months, to one year, something like this. Again, this is where these markets are slightly different from Western Europe, because the payment delays in these parts of the world are longer, so traditionally companies exchange cash after an order, at a later time than they do in other parts of the world. So we're saying longer overall delays between the time we make a cut and the time they take effect. I think that's just the nature of these markets.

Hence, to go to your second question, we think we've taken reasonable reserving policies to adjust to the reality. In that sense this crisis, if we call it that –if that's the name we give it– is different from the ones we've seen before and we're taking that into account into our reserving policies, to the best of our knowledge, at this time in the cycle.

Guilhem HORVATH, Exane BNP Paribas

Just coming back on the first question, how do you explain that you didn't see any effect on the mature markets before? It was all very profitable and now it's not anymore?

Xavier DURAND, CEO, Coface

Well, they're still profitable. Let's not get this wrong. And we'll talk about this in the quarterly results. So I think what we had seen is they had been coming down and there's always some quarterly variation here. We would always expect these to revert to the norm, which they are. It's all a matter of timing here. However these markets continue to be profitable, so I don't want to send the wrong message here.

Guilhem HORVATH, Exane BNP Paribas

Okay good, thanks.

Operator

Thank you. The next question is from Hadley Cohen from Deutsche Bank.

Hadley COHEN, DEUTSCHE BANK

Hi, good morning, everyone. Thanks for taking my questions. Most of them have already been asked, but a couple of follow-ups. You talk a lot about payment delays. Can you talk about any effects that this will have on the expense ratio? Obviously you've given guidance to the loss ratio, but you didn't talk about the expense ratio. Are you comfortable with where consensus is for 2016 and 2017 -or is there's anything you can say on that?

Secondly, can you talk about your ability to re-price this business and what you're doing on the pricing side at the moment, given these higher claims?

Then finally, I think it was to Benoît's question earlier –but implicitly with your updated guidance, you are assuming that the second half of the year loss ratio will be at least as bad as the second quarter. Can you talk about to what extent this is, I guess, an element of kitchen sinking on the reserving side and what is the current accident year split? Thank you.

Xavier DURAND, CEO, Coface

Well, I think when it comes to expenses, the business has been highlighting for quite some time that it had a pretty conservative policy and that it was evolving its internal costs pretty much in line with the premiums. I don't think we expect any major change from that.

I would say on the pricing side, as I highlighted during the last quarter results, that we are starting to see some price effects. I think it's too early to call it and that we need to wait for the total quarter results to give you more colour on that. So if you can hold that question for a few weeks, we'll give you the full details when we are at the end of the quarter.

For the third question, on the second half, would you like to talk about that, Carine?

Carine PICHON, Chief Financial Officer, Coface

Yes, in terms of loss ratio for the second half of the year, you have to take into account the fact that the underwriting year 2016 (and this is a technical answer, so sorry for that) will have a higher effect on the second half of the year than on the first half of the year. This is because we can say that we will have twice as many premiums as at the beginning of the year. That is why you may have some technical effects, but in terms of anticipation of claims levels, we expect more or less the same level as we have in Q2.

Hadley COHEN, DEUTSCHE BANK

Okay, thank you.

Operator

Thank you. We have another question from Guilhem Horvath.

Xavier DURAND, CEO, Coface

Ok. I think time-wise, it's probably going to be our last question, if that's okay?

Guilhem HORVATH, Exane BNP Paribas

Yes, this will be my last question. I have a question regarding Brexit. Did you start assessing the effects of Brexit on the risk environment in Europe, and what would be the different impacts it could have on the book? Thank you.

Xavier DURAND, CEO, Coface

When it comes to Brexit, this is clearly one that's come out of left field. What we've done first, is we've revised downwards our growth expectations for the UK. I think it was from 1.8%, down to 1.2% for this year. I think the main effect, in the short term, is that the British pound has come down quite a bit from where it was prior to the announcement. That's probably going to have a dual effect: one will be to help exporters, but that's more of a long-term effect. The short-term effect is that, for those that import a lot, there will be an adverse effect. We also expect that households and companies will be more prudent when it comes to making investments in the UK. I think it'll vary by sector. We're being more cautious on construction, for example, as it is a sector which is purely domestic and has more imports than exports –actually, it doesn't export anything. So we're adjusting our view of the risk, but I think it's more of a long-term effect. Short term, it's going to be more of the currency effect that's going to be the important one.

Guilhem HORVATH, Exane BNP Paribas

So no need for a risk action plan in the near future, right?

Xavier DURAND, CEO, Coface

We don't see a major event. I mean, it's ongoing adjustments, but nothing, I would say, dramatic. We always make adjustments, as you know, every day, to many aspects of our business, but as I said, it's going to be more adjusting sector-by-sector than anything dramatic.

Guilhem HORVATH, Exane BNP Paribas

Okay, great. Thanks very much.

Xavier DURAND, CEO, Coface

Thanks to all of you for logging in and being part of this call. We look forward to updating you at the end of the month on our Q2, on July 27th, then again in September, for our Investors' Day. Thank you everybody.

Carine PICHON, Chief Financial Officer, Coface

Goodbye.

Operator

Thank you. Ladies and gentlemen, this concludes the conference call. Thank you all for your participation, you may now disconnect.

(End of Conference Call)

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Please refer to the section 2.4 "Report from the Chairman of the Board of Directors on corporate governance, internal control and risk management procedures" as well as chapter 5 "Main risk factors and their management within the Group" of the Coface Group's 2015 Registration Document in order to obtain a description of certain major factors, risks and uncertainties likely to influence the Coface Group's businesses. The Coface Group disclaims any intention or obligation to publish an update of these forecasts, or provide new information on future events or any other circumstance.

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FINANCIAL CALENDAR 2016

July 27th 2016: publication of H1-2016 results
September 22nd 2016: Investors' Day (London)
November 3rd 2016: publication of 9M-2016 results

T R A N S C R I P T

FINANCIAL INFORMATION

This document, as well as Coface SA's integral regulated information, can be found on the Group's website: http://www.coface.com/Investors

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The Coface Group, a worldwide leader in credit insurance, offers companies around the globe solutions to protect them against the risk of financial default of their clients, both on the domestic market and for export. In 2015, the Group, supported by its 4,500 staff, posted a consolidated turnover of €1.490 billion. Present directly or indirectly in 100 countries, it secures transactions of 40,000 companies in more than 200 countries. Each quarter, Coface publishes its assessments of country risk for 160 countries, based on its unique knowledge of companies' payment behaviour and on the expertise of its 660 underwriters and credit analysts located close to clients and their debtors.
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