Please note that the conference call was accompanied by a complementary presentation in PDF format available on the Group's website: http://www.coface.com/Investors, under the "Financial results and reports" section.

Q1-2019 Results

Conference Call Transcription

Paris, 24 April 2019

coface

Q1-2019 Results presentation

Moderator

Ladies and gentlemen, welcome to the conference call for the presentation of Coface's results for the period ending 31 March 2019. At this time, all participants are in the listen-only mode. A questions and answers session will follow. As a reminder this conference call is being recorded. Your host for today's conference will be Xavier Durand, CEO and Carine Pichon, CFO.

Xavier DURAND, CEO, COFACE

Good evening everyone and thank you for joining us on this call. Tonight, we are reporting our figures for the first quarter of 2019. I will move directly to the main highlights, on page 4. In short, I would qualify this first quarter as a strong one. We are reporting a total net income of EUR 36.4 million. Clearly, we are now seeing the full effects of our Fit to Win actions. As I have said in the past, I am convinced that this plan is the right one and each quarter that goes by confirms this view. If I look at the underlying trends, we are showing progress in nearly all of the metrics. Our turnover reached EUR 365 million, up 6.7% at constant FX and perimeter. You will see that most regions are contributing positively to growth. Further good news is that new production is improving in mature markets. Revenues are also being supported by past clients' activities growth.

On the loss front, our Q1 net loss ratio is up 2.8% compared to the record we achieved in the first quarter of 2018, so we are at 42.6%. The net combined ratio comes in at 74.5%. The gross loss ratio is almost stable, driven by favourable recoveries and disciplined underwriting. I think we have been very consistent with these aspects over the past. What is more, our net cost ratio is down by 0.7%, at 31.9%. This reflects positive operating leverage in the quarter.

We knew we had a tough comparison versus the first quarter of 2018, which was strong. We beat that number in terms of net income by 3.4%, excluding FX, and we are reporting a net income of EUR 36.4 million. Our return on average tangible equity comes in at 9%, just to put that into perspective with our long-term targets, which included capital actions.

Finally, we continue to execute on Fit to Win. As we announced recently, we have closed the acquisition of PKZ, which is Slovenia's leading credit insurer. This is Coface's first acquisition in 10 years. The Board has announced a decision of a 2018 dividend per share of EUR 0.79. The ex-dividend date will be on 22 May and payment date on 24 May.

Finally, we are still targeting to apply for a partial internal model in the summer of 2019. Discussions with the regulator are continuing.

With that, I will just dive into some more detail. On page 6, on the growth front, our total revenue is up 6.7%, everything comparable, versus last year. What is interesting is that the trade credit insurance premiums are growing organically at 8%, at constant FX. There were a couple of negative one-offs that helped the comparison from last year, but overall, we are seeing growth driven by client activity, better new business, improved retention and the easing of price pressure. I will discuss these trends on the next page. Revenues from services are up by 2.8%, despite the continuing slightly negative impact from factoring. Fees are up 0.9%. They are outpaced by the premium growth, which brings the fee-to-premium ratio down a little bit from last year.

Looking at page 7, on the geographic contributions, we can see that growth is happening in most regions. Western Europe is just slightly negative, driven by single risk, while underlying trade credit insurance is growing. Northern Europe is growing again at 1.7% and trade credit insurance is growing at 2.3%. In Central Europe, we are a little slower than in prior quarters, as we are being careful with risks in some parts of the region. Nevertheless, the region continues to enjoy steady growth. It is the same story in Med & Africa, with steady, significant growth driven by both credit insurance and bonding. North America is starting to pick-up, at 7%, and the key there is better client retention. There are some pretty strong numbers in the other two regions, but they have to be corrected in terms of Asia for the one-off that we had last year. All things compared, our growth for the quarter is around 10.4% for Asia. In Latin America we always have to adjust the numbers for some complex FX impacts. Net-net, the growth comes in at about 25% and this has mainly been driven by large international contracts, which have had a significant impact on the region.

On page 8, new production is still low in comparison to other years, but better than last year by about 8%. This confirms some of the improvements we started to see at the end of last year. Client retention is at a record level, as it has been during previous years, but it is getting even better. The price effect is still negative, but again, it is less of price erosion than we have seen in previous years. This reflects the fact that we are able to obtain relatively better pricing, particularly in the riskier parts of the world. When it comes to the volume effect, I think we all anticipated that the economy would slow and we are seeing some of that, albeit slightly less and slightly later than we thought, so the first quarter still shows a nice pick-up in client activity.

If we go to page 9, taking a look at the losses, I think that we can say the loss story is pretty strong. You can see on the top left, with the quarterly sequences, the numbers in white are corrected for the effect of the facultative insurance, which we choose to selectively pass on to the market. The number comes in at 42.2%, compared to 46.3% in Q4 and 43.6% in Q3. We opened the year at 71.1%, so a little bit better than the quarters in prior years and we are still seeing some pretty nice recoveries from the past, at 33.8% for the quarter. This is a little bit less than last year, but still pretty good.

On page 10, each of the regions has a positive story to tell. Among the more stable regions, Central Europe shows improvement, at 44.5%. Western Europe, at 32.7%, is stable compared to last year when you correct for the facultative insurance. Northern Europe is improving at 40.7%, while Med & Africa is stable at 47.2%. Among the more volatile markets, North America is again fairly flat from last year, at 44.6%, with Asia Pacific at 28.6% and Latin America at 51.3% - which, all things considered, is a pretty good score for the region. I would say the numbers were pretty good on the risk side.

The costs side, shown on page 11, are quasi-flat compared to the last two quarters. Internal costs are flat versus Q4 2018. As you are aware, we had slightly more costs in Q4, as we booked the profit share for our French employees for the year. This time, in Q1, it is because we have basically purchased our distribution network in a good chunk of the US. We have passed on some costs of these external acquisitions into the internal costs. As a result, you can see that, despite the fact that we are growing, our external acquisition costs are flat, when they should actually have been growing. As a result of better growth and well-contained costs, our cost ratio is coming down. This is due to the strategy we have been following through over the past couple of years, which is to continue to seek savings on the operating front and to thoughtfully reinvest these savings in the business in a disciplined manner, in areas such as risk, processes, services, technologies and selected growth opportunities. We are continuing this practice, so there is no change in the way we are driving the business. We are continuing to drive costs and to make selective investments and I think it is paying-off. The cost ratio has come down versus last year and this is driven by the operating leverage between the growth and the premiums, as well as the fact that the costs overall are very well-contained.

I am now going to hand it over to Carine.

Carine PICHON, Group CFO and Risk Director

Good evening everyone. The reinsurance result this quarter is impacted by the low loss ratio. The premium cession rate stands at 29%, which is quite stable compared to the same quarter in 2018. We have a lower claims cession rate, due to recoveries on highly reinsured facultative. However, all in, the reinsurance result is approximately a negative EUR 27 million. This is a little higher than last year, mainly because of the low loss ratio I mentioned.

Page 13 gives a view on our net combined ratio, which is 74.5%. This is well below the cycle average. The net cost ratio of 31.9% is an improvement on the 32.7% we accounted for Q1 2018. As previously mentioned, investments are fully financed by additional cost-savings. The loss ratio is 42.6%, which is below the cycle average and below the last three quarters.

Page 14 contains some comments on our financial portfolio. Clearly, our target in the way we are managing the portfolio, is to stabilise our yield. The accounting yield on average investment portfolio is 0.5%. If we exclude gains on sales, it stands at 0.4% for the quarter, which is exactly the same as for Q1 2018. If you have a look on net investment income, it was EUR 5.1 million in Q1 2019, compared to EUR 8.3 million in Q1 2018. The main reason for this difference is the negative contribution from non-consolidated entities. We have decided to restructure our Peruvian operations and to disinvest in our subsidiary there. We will continue to operate in Peru, but through Chile. When taking the decision to close in Peru, we also decided to take the negative losses from the past. This is the reason for the decrease in net investment income.

Page 15 gives the full picture on net income, which has risen to EUR 36.4 million. Our operating income is very robust, at EUR 56.9 million, within a more complex environment. We have also been able to decrease our tax rate, down to 29% from 35% in 2018 (and even higher in previous years). All in, net income is up by 2.3%, compared to a very good Q1 2018.

Return on average tangible equity, seen on page 16, went from a return of 7.7% in 2018, to 9.0% for this quarter. The main increase comes from our technical income, so a very good result on the combined ratio. There was a decrease of 1.5 points from financial results, which was mainly linked to the decision to disinvest in our Peruvian subsidiary. Some improvements came from the decrease of 0.5 ppts in our tax rate. All in, we have a 9% average for this quarter.

This summarises the overview on our results. I will now hand back to Xavier, for the key takeaways and outlook.

Xavier DURAND

Just to close this presentation, I would say in terms of the environment, we see a slowdown in global growth, but I do not think this is a scoop. However, in a way, trade was more resilient in the first quarter than we probably could have predicted. As I said, the environment is slowing, but I think we clearly delivered a strong quarter, despite this. We are showing improvements in every metric, with a 74% combined ratio, a 9% return on average tangible equity and a lower cost ratio than last year.

As I said, we are seeing the impact of the actions we have taken starting to materialise and to pay-off:

- This is the highest net quarterly profit since we began this plan.
- Growth is picking-up, driven by client activity, better retention and growing new business.
- Loss ratios are under control, within an environment which I would describe as hard to read.
- The cost ratio is down by 0.8%.
- We have closed the acquisition of PKZ – our first acquisition in 10 years.
- We are confirming our target to apply for an Internal Model by the summer of 2019 and we are continuing discussions with the regulator.
- I think this makes for a fairly simple story on Q1. With that, I would like to turn it over for questions.

Q & A session

Moderator

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

Michael HUTTNER, JP Morgan

Fantastic. Congratulations, these are great results. I really have two questions. One is, are you going to continue on the same trend? To put it in your words is this simple story likely to maintain or continue? Secondly, on the internal filing, which I see as key to my hopes of more capital management, can you give us a bit more colour on timing, or the progress, etc.?

Xavier DURAND

As you know, Michael, we do not provide guidance for the year. What I can tell you is that the principles, actions and the way we run the business have not changed. I want to stress this point, because every quarter we see the impact of these actions and in my view, they are proving to be the right thing to do. Nobody knows what the environment holds for us. As I said, it is a particularly difficult time to read the economy. There are things that are still panning out there, such as Brexit and trade wars, but I would say that we are not going to change the way we run the business and I think you will see some of the actions we are taking as being quite constant. I would like to refer you to the seasonality in our numbers, as over the years we tend to see a Q1 a bit higher than the other quarters. I just wanted to point that out.

In terms of colour on the Internal Model, there is really not much I can add to it. As you know, these discussions are ongoing with a regulatory body which is fully sovereign in its decisions. All I can tell you is that we are progressing as we thought we would and we plan to submit this application during the summer. As you know, there is then a period of time they have to study this and come back with a decision, which is six months. From there we will know what the outcome is, and I cannot comment further on that.

Thomas FOSSARD, HSBC

I have a couple of questions. The first one is related to your top line growth, which I would say is pretty impressive at 6.7%, I know you are not providing guidance, but looking at the consensus expectations for 2019, the market is currently expecting 2.8%. Clearly, there is a significant discrepancy between what you are reporting in Q1 and what the market is currently shooting for on a full-year basis. I know there is a base effect as well, but could you tell us a bit more what you believe is the underlying growth rate of your business. If I am right, I do not think that growth was really what we expected for Coface. I think you were more looking at controlling your risks and making sure you had your business in order. I would just like to understand better if there is now a new chapter opening up for growth and what numbers we should put in. Looking in particular at page 8, the volume effect coming from your clients is positive, which is great, but it is not accelerating. So I still have some difficulties in understanding how we should read this 7% top line growth in Q1.

The second question relates to the buyout of your US distribution network. I think that you had some actions on that already in Q4, if I am right. It seems to me that you had another one in Q1 this year. Could you tell us a bit more, or provide us with a strategic update on what you are doing there, how much there is still to come and what could be the overall cost of buying out your US network?

Also, on the strategic side, I am not sure why the shutdown of the Peruvian activity is showing up in the investment income and not in the other lines - or why this is part of your investment portfolio.

Xavier DURAND

I will just address the Peruvian thing first. It shows up in that line because it is a non-consolidated entity. So it is just technical work supporting. You are right to point out that it is not an operating financial asset management question. It is an operating loss that has been accumulated and then recorded, but because it is a non-consolidated entity it is in that line. That is really all there is to it.

In terms of the top line growth, I think what I would say is that you have seen a number of metrics improve quarter by quarter. Number one I would say is retention. When I joined Coface I thought we could do better on retention. I think we have proven that and it continues to happen. I think that is a very important driver and we have seen it happen at the end of the year. A lot of our contracts actually renew at the end of the year and this is what happened again this year. New business is a bit better than last year, but still not anything spectacular. Pricing is better, so we have also been working that angle. I think the trick here is being able to work pricing at the same time as you work risk. Then in terms of client activity we had an exceptional year last year. We anticipated – and we still anticipate - that the market would slow down and I think we are seeing this, albeit not at the pace we thought. We are all now watching a number of things in the market, such as what is going to happen in Germany, with trade wars and it is very hard to read and forecast. Commodities are another factor, but they are actually holding up for different, quite unpredictable reasons, such as sanctions on Iran. It is very hard to read, but you are seeing some of these adjustments happen and you have seen that happen for a while. It is in the details that these things are happening.

What happened with the buyout of our US distribution network is that we purchased a good chunk of our distribution, probably two-thirds, at the end of last year and the beginning of this year, in two different batches. I cannot remember which quarter the first batch was in.

Carine PICHON

I think it was in Q1 2018 and the main part in Q4.

Xavier DURAND

The main part was in Q4. Now we own two-thirds of our distribution, we are able to take control and obviously start to operate differently, but this will take time. The project did not just stop with the fact that we were purchasing the distribution - it is also what we do now with it. We appointed a new leader in the North American business just a month and a half ago. He is now in charge of this particular transformation, which I think is pretty important for us in the future. That is really what is going on in the US. We still have about a third of our business that, as in the past, originates through agents. I think we will have to continue to look at that as an opportunity for the future. The focus is mainly on making what we already have now happen, in terms of integration and changes in processes and things like this. I hope this covers your questions.

Thomas FOSSARD, HSBC

Just to come back on the top line. What would be the kind of underlying growth, if we netted off all the positive or negative noise, or base effect? Would 4% or 5% be reasonable in the current environment?

Xavier DURAND

I will have to be a little dry on this one. We do not provide guidance and I do not want to commit to guidance on growth for obvious reasons. I think that being agile, as I call it, is the key in this business. We will be thoughtful. It is hard to read the environment. Slower growth is happening, but again, to what extent it is hard to say.

Thomas FOSSARD, HSBC

At least I tried. Thank you.

Michael HUTTNER, JP Morgan

I have lots of little questions. I know you do not give guidance, but maybe you could say what we might expect on tax? On Peru, are there any more, I would call them one-offs, potentially coming like that? Could you give a few metrics on what the deal in Slovenia could do to sales, profit, etc.? On solvency, I know you do not provide quarterly updates for solvency and the last one I had was the 169, I think for the full year. Given current trends and profitability, and I think solvency embeds the improvement in combined ratios when it happens, I just wondered if we are likely to see a bit of a step up lift? The final one is, because you have improved processes and risk control and you keep investing in this, which is fantastic, I just wondered if you could give a live example that thanks to these processes, we avoided a big loss.

Xavier DURAND

Let me start with the last question. I think the proof here, or the fact that I am more assertive on the risk improvements that we have made, is what happened last year and what we had to manage. Last year, you saw some quite brutal events in Turkey, a crisis in Argentina, Italy slowdown pretty steeply from the first part of the year, Brexit going on throughout the year, the slowdown in Germany at the end of the year and a couple of significant bankruptcies around the world of retailers. When you add it all up, I think Coface did pretty well last year and that is what I am referring to.

In terms of Slovenia, it is about 15 million in premiums, which is about 1% of our business. What it does do is give us scale locally. This game is all about having scale and having skills and how these two things come together. This is going to allow us to run this part of the world more efficiently. To me, it is a perfect example of the strategy we are trying to emulate in different parts of the world. I will let Carine talk about tax, Peru and solvency.

Carine PICHON

On tax it is maybe difficult, because we are located in a lot of countries. That is why I cannot give guidance on it. As you can see, with this 29%, we are starting to benefit and to use some tax losses from the past, particularly in emerging markets. We are also able to correctly monitor mature markets. Let us say that 29% is a very good tax rate. I do not like to give guidance, but it is clearly better than last year.

Your question on Peru was on whether we could have additional potential losses on it. On Peru, we have taken the accumulated losses from the past into 2019. We have taken these because the company was not consolidated. We now have to see if we have any additional costs from the fact that we need to liquidate the company - but I think we have taken most of the losses on this quarter.

One last comment on solvency, we are not disclosing any solvency ratio in Q1. Clearly the solvency ratio could benefit from loss ratio improvement, but you also need to finance growth. It is a mix between financing growth on one hand and improvements in loss ratio on the other.

Hadley COHEN, Deutsche Bank

I have a couple of very quick questions. Firstly, on the restructuring charges, can you remind me of your guidance and how you are thinking about this going forward? Every quarter, I seem to put in a number for what I think your guidance is and every quarter you seem to positively surprise us. I am just wondering how you are thinking about these restructuring charges and when we are going to see them. Secondly, with regards to your thinking behind the 100% cash payout of the dividends and why you chose cash rather buyback, is it liquidity? Is it that you think the shares are reasonably, fairly priced at the moment? How should we think about that going forward? That is, if you are going to pay out more than 60% dividends, should we think about that as dividends going forward? Is this a signal that we should expect dividends instead of buybacks in the future?

Xavier DURAND

I will let Carine talk about the restructuring charges but let me talk about the dividends. As you know, we decided we would distribute 100% and the question was, in which form, so 60% was a given, because that is our policy in terms of a dividend. For the other 40%, the question was asked whether it was going to be a dividend or a stock buyback, and in this matter, it is the Board's decision. As you know, this is the decision that the Board has come up with and I do not think I can really make any further comment.

Carine PICHON

On restructuring charges, it is clear that they have mostly been booked in the previous year, at the start of the Fit to Win plan. This was because we were doing a lot of restructuring at that time. We may have some during this year, but not to the same extent as in the past.

Thomas FOSSARD, HSBC

Just to come back to Hadley's question. I think that in the full-year call, you indicated that you were expecting to make EUR 25 million in investments in 2019, if I am right. How much of this EUR 25 million have you already invested in the business so far this year? Secondly, regarding the loss environment, you are obviously reporting a very strong loss ratio, maybe better than you expected yourselves. How would you qualify the loss environment in terms of frequency and severity? Have you noticed any change in pattern? For us, the main surprise is probably that, as you say, the macroeconomic environment is difficult to read, and we have seen news that the environment remains tough for some companies in some sectors. But it still does not translate into a pickup into your loss. Is it just good risk management? Just to understand better what is going on in the underlying basis of your business.

Xavier DURAND

On the loss line, as I said, it is hard to read the environment and as I keep saying, we are all watching extremely closely. Every week, we get 1,200 claims that come from all over the world and we watch them like "milk on fire", as we say in French. I think that what we have seen, particularly in the latest period, is fewer large claims. That is how I would probably describe it. I think frequency is still creeping up, but we have not seen the kind of large deals that we could have feared. It is hard to say whether it is us or the environment, but we are continuing to watch this very closely.

In terms of investments I will turn it over to Carine.

Carine PICHON

When we say that we have an envelope of EUR 25 million of investments, it is in global investments such as in, IT, people etc. It is therefore not comparable with restructuring charges which are linked to the decisions we take on restructuring, such as buyouts. The EUR 25 million investments you mention is more global and I would say it concerned "classic" investments in processes, lean, regulatory and strategic aspects, which were half-financed by savings.

Xavier DURAND

These would show up in the running rate.

Thomas FOSSARD

We should therefore expect this EUR 25 million, or even a part of this additional investment in 2019, to be offset by savings coming from elsewhere in the business - so net-net on the cost income ratio, which would be a kind of wash?

Carine PICHON

Let us say the difference is fully included in the cost ratio, so it is financed by savings and what we have said and done in the past year. There is no change in that respect.

Moderator

There are no further questions.

Xavier DURAND

That is unusual, but I think it is great. I will take it as a good sign. If we do not have any other questions, I think we can cut it here. I just want to thank everyone for joining and being part of this call. We will update you on Q2 on 25 July. We will speak with you then.

(End of transcript)

CONTACTS - ANALYSTS / INVESTORS

Thomas JACQUET
T. +33 (0)1 49 02 12 58
thomas.jacquet@coface.com

Benoît CHASTEL
T. +33 (0)1 49 02 22 28
benoit.chastel@coface.com

FINANCIAL CALENDAR 2019 (subject to change)

Annual General Shareholders' Meeting 2018: 16 May 2019

H1-2019 results: 25 July 2019 (after market close)

9M-2019 results: 23 October 2019 (after market close)

FINANCIAL INFORMATION

This press release, as well as COFACE SA's integral regulatory information, can be found on the Group's website: http://www.coface.com/Investors

For regulated information on Alternative Performance Measures (APM),

please refer to our Interim Financial Report for H1-2018 and our 2018 Registration Document.

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