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.

H1-2019 Results

Conference Call Transcription

Paris, 25 July 2019

H1-2019 Results presentation

Moderator

Ladies and gentlemen, welcome to the conference call for the presentation of COFACE's results for the period ending 30th June 2019. At this point all participants will be in listen only mode. This will be followed by a questions and answers session. As a reminder, this call is being recorded. Your hosts for today's call are Xavier Durand, CEO, and Carine Pichon, CFO. I would like to turn the call over to Xavier Durand. Sir, please begin.

Xavier DURAND, CEO, COFACE

Good evening everybody and thank you for joining this call. Today, we are announcing our first half 2019 results. As you can see from the headlines, the second quarter turned out to be another strong quarter for COFACE. Our net income for the first half is up 25%, at EUR 78.5 million. The return on average tangible equity comes in at 9.6%. These numbers represent record results for the business.

The other important news is that, earlier today, we submitted our partial internal model to the French regulator. They now have six months to provide us with their comments and decision.

Just a few words on page four, on the headlines, turnover comes in at EUR 732 million. This is up by 6.6% compared to last year, at similar perimeter and FX. Q2 was up 7.6% and I think this is probably the strongest growth quarter we have known in the business. The net loss ratio for the first half is up by 0.8%, at 44%. The net combined ratio comes in at 76%, which is an improvement of 1%.

The gross loss ratio is down by 1.5 ppts, in what continues to be a risker economy. We have seen pretty good past claims management and recoveries, with a relatively low level of new claims. Our net cost ratio improved at 32%, versus 33.8% last year. This is driven by continued cost control and obviously positive operating leverage coming from the growth.

As I said, net income comes in at EUR 78.5 million, of which EUR 42.2 million was in the second quarter. This quarter, we benefited from a EUR 3 million purchase gap on the acquisition of PKZ. Beyond that, this has turned out to be a good acquisition for us.

The solvency comes in at 162% for first half, using the standard formula. This is above our usual target range of 140% to 160%. It is a little lower than at the end of last year, due to the growth that we have had in the period.

Fit to Win is continuing to deliver for us. We have recruited a proven senior management team for our factoring business in Germany, which is probably one of the best teams in the country. As I said, the integration of PKZ is going well.

Finally, the business returned to the SBF120 index on 24th June. I think this is a form of recognition for the team and the work that is has been achieved in the business over the last three years.

Going on to page five, I just wanted to highlight here where we are versus the key *Fit to Win* targets we set out for ourselves in 2016. There is one goal that is not on this page, which is the savings programme we initially set up with a target of EUR 30 million of savings in 2018. We exceeded that target by about 30% last year. As concerns the other metrics, we said the return on average tangible equity would be superior or equal to 9%, after benefitting from capital model optimisation. It stands at 9.6% for the first half. The target for the combined ratio is 83% through the cycle. It comes in at 76% for the first half.

For Solvency, we wanted to be above our target range, or close to the upper range of the target range. We have really improved the solvency from 150% in 2016 to 162% in the first half of 2019.

The other goal was to be focussed on value creation through the cycle and to generate growth that would be profitable. I think this has probably been the best growth for a first half that we have ever had in the business - and at the same time, it has also been a very strong risk quarter and first half. I therefore think we are really on our way to deliver on the different pillars of *Fit to Win*.

On page seven, you will see more details on the growth. As I mentioned, we are up 6.6% on premiums versus last year at same FX and perimeter. What is interesting is that within that, trade credit insurance is growing at 7.5%. Actually, it is even 8.5% in the second quarter. Growth is still driven by the same factors we have talked about over the past few quarters, which are past client activity and a very high retention rate. We are still being disciplined and prudent when it comes to writing new business, and I will talk more about this.

Our services revenues are up 2.1%, so less than the premiums. We are also seeing some growth in fees, but obviously not at the same rhythm as the other pieces of the business.

When you look on page eight at the split by geography, you can see that Western Europe is growing a little bit faster. We are getting closer to the 3% mark. That is on the back of large transactions, better retention, bonding and services. In Northern Europe the good news is that although this has historically been one of the tougher markets for us, we are now growing again at close to 3%. Within that the German insurance business is growing at close to 4%, with some still slow activity in factoring.

Central Europe is a bit slower this first half, at 2%. We have been more prudent on risk in that part of the world and a little bit more demanding on price. Med and Africa continues to grow steadily. These are pretty competitive markets, but I think the business continues to execute.

North America is picking up speed. We grew 10% in the first half year, mainly thanks to large deals and better retention.

In Asia Pacific, underneath the headline of 21.2%, the real growth here (if you exclude the one offs that we had in the first half last year), is more like 11.5%. So again, some nice growth in that part of the world.

Latin America is growing, with an underlining 27.2%. This sounds high but it is not a surprise. It comes on the back of the large deals we signed last year. As you may remember, these are global deals for which Latin America has a disproportionate size of the pie versus the size of Latin America in our total business.

When you go to page nine and look at the usual charts on how growth is made up, and you can see that new business is actually better than last year, although it is lower than in 2016 and 2017. This reflects the fact that our efforts are paying off, but we are also remaining prudent and our underwriting policy has not changed through the period.

Retention remains at a record level, at 93%. On pricing, it is the best year we have had in the last four. We are seeing more opportunities than in the past to tactically reprice in certain countries, markets and places. I think this also reflects an increasing risk environment in the economy.

Volume this year is still pretty positive, but not as much as in 2017 and 2018. When you look at the underlying volume from our clients, it reached a peak in Q1 2018. This is consistent with the growth we saw in the economy in 2017, and since then it has been declining regularly in line with the global economic environment. So that is something to keep in mind as we think about the business.

Looking at page 10, you can see that Q2 turned out to be a pretty good quarter on losses. The loss ratio, before reinsurance and including claims, came in at 41.9%. This should be compared with the numbers in white that you can see in the columns to the left (so 43.6%, 46.3%, and 42.2%), so this is another good quarter.

If you look at the bottom right hand side of the page, you can see that we opened the current underwriting year at 76%, which is higher than usual compared to prior years. This is driven by two things, the first being a large file in France which happened quite soon after the underwriting, and the second being that we acquired PKZ, which is now part of our numbers. PKZ have a policy of opening their new business at a higher rate than COFACE does.

On the other hand, we also had good recoveries compared to previous years, at 37.8%. This is again driven by a large file in France during the period.

When you go to page 11, which looks at the split between the different regions, it has to be said that this is almost a perfect scorecard in the first half. You can see the large markets at the bottom which are traditionally more stable and also Central Europe which is declining somewhat, at 42.2%. Western Europe is pretty flat at 31.2%. Northern Europe has been coming down quite a bit over the last three or four years. Med and Africa is pretty stable, at just below the 50% line.

The three markets that have been traditionally more volatile in the past, have also performed pretty well, with North America at 40.2% and Asia Pacific stable, at 24.1%. Latin America, the most volatile of all of our markets, comes in at 50%, which is also pretty much in line.

The story on costs, on page 12, is that we have remained disciplined on costs. Total costs are up 3.4% ex FX. This is just slightly above the inflation line, if you combine different parts of the world. At the same time, the top line grew by 6.6%, so we achieved good operating leverage during the period.

Internal costs are up EUR 3 million from the first quarter. This is driven in good part by PKZ, which we have now integrated into our business. Commissions are slightly lower as we have purchased our North American distribution, so that reduces commission and increases internal costs. These are some of the same effects we saw in the previous quarters.

During the period, we continued to look for ways to save money and to invest thoughtfully in the business. We made a total of EUR 3.3 million of investments in strategic and regulatory projects across the business. Net-net the cost ratio came down from 35.3% in H1-2018, to 33.9% in the first half of 2019. The bottom right of the chart shows that a good chunk of this was driven by premium growth and strict cost discipline.

With this, I am going to turn it over to Carine to talk about the rest of the presentation.

Carine PICHON, Group CFO and Risk Director

Good evening everybody. It comes as no surprise that the reinsurance results, on page 13, were impacted by low loss ratios. Our premium cession rate was stable compared with last year, at around 29%. The claims cession rate of 23.5% is lower than the 27.5% reported last year, thanks to high recoveries and highly reinsured facultatives. There were also high recoveries on older claims which were reinsured at a higher cession rate.

All in, reinsurance results for the first six months of the year amount to just under EUR50 million.

Looking at page 14, our net combined ratio stands at 76%. This is below the through-cycle average and corresponds to a decrease by one point on a six month basis. This was driven by a fairly stable net loss ratio and a decrease in the costs ratio.

If we look at the quarterly view, which is on the bottom of the page, you can see that we have had a combined ratio for the quarter of 77.5%. This is down by four points from Q2 2018, which stood at 81.5%. This decrease is due to reductions in the cost ratio and in the loss ratio.

Concerning our financial portfolio and results on page 15, we have continued to stabilise our yield, despite the low-rate environment. As you can see on the right, our accounting yield on the average investment portfolio was 1.1% and 0.9% if we exclude gains on sales. This is quite similar to the level reported for the first six months of 2018.

Our net investment income grew from around EUR 13 million to EUR 17 million this half year. This was mainly due to the fact that last year we had some negative FX effects that we did not have at the beginning of the year.

Current operating income, seen on page 16, is very robust at EUR 116.1 million. We have had very limited restructuring charges, down by around EUR 1.3 million. Other operating income and expenses were mainly impacted by gains on the disposal of an Italian building. This was one of the last buildings we owned before we decided to sell it.

Financial costs are quite stable, and we have booked a badwill of EUR 3 million, linked to the integration of COFACE PKZ in Q2.

The tax rate also continued to improve, down to 29% and the Q2 2019 result is that we achieved a record net profit since the launch of *Fit to Win*. Net income grew by 25%.

The return on average tangible equity, on page 17, is at 9.6%, compared to 7.7% last year. Improvements in the combined ratio and growth led to 2.1 points of technical result improvements. A decrease in the financial result (mainly due to FX of last year), and tax improvements led to an additional and incremental 0.6 ppts on the return. All in, this brings us to a RoATE of 9.6%.

That was the view on performance from a P&L point of view. As you know, we also present our solvency position every six months, as can be seen on page 19. It is worth mentioning that, as all companies, we have implemented IFRS 16 on lease contracts. The impact on equity is very immaterial. We have increased our assets and liabilities by EUR 85 million, but all in, there is little impact on our equity.

You may also have seen that both ratings agencies have reaffirmed their ratings, with an AA- from Fitch and A2 from Moody's.

Looking now at page 20, our solvency ratio is still on a standard model formula and continues to be very robust over time. We started in 2016 at around 150% and we have been able to increase that ratio. It now stands at 162% for the first half year. The main reason for the gap between the end of 2018 and the end of June 2019 is linked to the growth (knowing that the change also is less than the growth rate, thanks to the very good underwriting discipline and good performance on profitable growth.

As usual, we are also presenting what the impacts would be of a market shock or a shock to the loss ratio. Because of the way we structure our financial assets, you may see that it is not the highest shock we may have because coming from 162%, either an increase by 100 bases points of interest rate or spread, or decrease of the equity value, the shock represents between two or three points. When you compare this with the loss ratio evolution, which is on the bottom right of the slide, you can see that an impact on par with the 2008 credit crisis would cause the solvency ratio to fall from 162% to 123%. This illustrates a very robust solvency.

Page 21 gives more details on this ratio. On the right, you can see that the total amount for eligible own funds is EUR 2.1 billion. This is mainly tier one and hybrid debt, which has to cover solvency capital requirements for credit insurance, insurance activities and factoring (which was EUR1.3 billion at the end of June).

That completes the capital management update.

Xavier DURAND

I will finish this formal presentation by turning to page 23. Q2 and the total of H1 have been very strong for COFACE. Operating income is up 17%, net income is up 25% and the top line is up 6.6%. The cost ratio is down 1.4%, and the losses are contained, which brings the combined ratio to 76%. De facto, this sets a record for the business.

Our solvency at 162% is strong and is above the range. More importantly, just this afternoon we submitted our internal model for validation to the regulator. In my mind, this confirms the targets that we have set for the second pillar of capital management and, as a reminder, we had a 1% ROE improvement target on top of the 8% operational ROE that we set for ourselves concerning the operational pillars for the business.

When you look at the full year here, I guess we need to talk a little bit about the environment here. As you know, we are in a slowing economy and I think the latest discussions - whether from the IMF, the ECB, or others - concur with this view. We expect the current trends to continue with slowing global growth, a continued rise of insolvencies and political uncertainties. On the one hand, this creates some opportunities; on the other hand, it requires us to remain very disciplined in terms of underwriting and execution. We expect to continue with the same strategy and the same discipline on execution that we have been deploying over the last couple of years and this is working well for us.

We believe that *Fit to Win* is on track to meet all of its targets. As you know, we are in the final stretch of implementing the plan which goes through to the end of 2019. We are obviously working on what is going to be next, but that is still for later.

That is where we stand, and with that we are happy to take any questions, as usual.

Q & A session

Moderator

Ladies and gentlemen, as a reminder, if you wish to ask a question please press 01 on your telephone keypad. Thank you. So, ladies and gentlemen, if you have not already, please can you press zero and then one on your phone keypad now to enter the queue and ask your questions. We go first to Michael Huttner of JP Morgan. Please go ahead.

Michael HUTTNER, JP Morgan

Fantastic results and really well done for fully achieving your 2019 targets.

On the partial internal model, can you give us a feel for what the flex is there? The second question is on tax. How much kind of tax loss have you got left, because I do not think you capitalised it, particularly in Asia? Finally, there was a statement from Reuters saying that Apollo was in talks with COFACE, not with Natixis. I just wondered if there is anything you can say about that? Thank you and really well done again.

Xavier DURAND

Well, thank you Michael. It is Xavier here. Maybe I will address the Apollo question first and then I will pass it on to Carine for the other two. As you know, Natixis has, for the last 10 years, expressed that COFACE was a financial participation which at some point they would like to dispose of. So I guess there is no news on our front and we have no particular comment to make on any name or any possible transaction. However, I think it is no surprise to us that Natixis is looking at some of their options in the context of their view of COFACE as a financial holding versus a strategic holding.

Carine, do you want to talk about the tax?

Carine PICHON

With our tax rates, as you know we have been taking a fairly prudent approach in terms of deferred tax assets based on tax losses. Therefore, in Asia, every time that we have positive results, we do not pay any tax. That is the reason why we have a tax rate which is around 29%, which is quite low. Every time we are making profits in Asia and in some other parts of the world (particularly in emerging markets, where we had losses in the past) we are using past losses to avoid paying tax on the future profits. This is also what we did in previous quarters.

As concerns the partial internal model, the next stage of the process is that the regulator will give his views during the next six months, so we have to wait for that and see what they say. As a reminder, the target we set out in September 2016 was to achieve a 9% return on average tangible equity, with 1% coming from capital management. If you look back over time, you can see how we have mainly used reinsurance to improve our capital management. We have already been able to have a pay-out ratio of 100% and 110%, which leads to an average 42 basis points. Based on this, we reconfirm that we plan to achieve 100 basis points, knowing that we already have done 42 ppts. That is where we are today. We cannot comment further, as this is now in the hands of the French regulator.

Michael HUTTNER

Excellent, and just on the tax, how many more years of this favourable average tax rate could we have?

Carine PICHON

I will say we have had huge losses in Asia, so we have some years in front of us.

Michael HUTTNER

Okay, brilliant, and again, really well done.

Moderator

We now go to the line of Benoit Petrarque of Kepler Cheuvreux. Please go ahead, your lines is open.

Benoit Petrarque, Kepler Cheuvreux

Yes, good afternoon, Benoit Petrarque from Kepler Cheuvreux. Three questions on my side. The first question is on the Solvency II ratio. Growth has been strong, and the SCR is going up a lot over the first half year. It is therefore growing faster than the own funds and capital generation. What are your thoughts, as I think consensus has about 100% pay-out ratio and Solvency II is going down on this basis because of strong growth. How do you see the sustainable pay-out ratio for COFACE, looking at your growth prospects?

Also, I was wondering about the 10% hedge point negative on SCR, coming from the SCR increase. Is there anything else other than just revenue growth in that figure, or something special?

The second question is on the Solvency II ratio. Thinking about partial internal models again, I think in this turnout, from here, you have a 160% level at which you think you are over capitalised. Do you have any thoughts about the ultimate level you have in mind to distribute more excess capital under the partial internal model? Therefore, will the 160% move up, or will it stay at 160, under the partial internal model?

Then final question was on the combined ratio I think you have been getting 83% across the cycle. Obviously, you are now posting another very strong combined ratio. Is the 83% really across the cycle average, or do you think now, looking at all the risk management measures and all the things you have done, actually the 83% might be a bit too high?

Xavier DURAND

Maybe on the solvency, I guess the decrease stems from the growth, right?

Carine PICHON

Yes.

Xavier DURAND

On the standard formula.

Carine PICHON

On the ratio, yes, mainly just because I think, Benoit, you were also commenting evolution of the volume of solvency capital ratio, and capital, and not only the ratio. I think it is interesting if you look back to page 20, on the left side, you can observe the trend between H1 and the end of the year. There is a sort of seasonality effect in the way it is calculated, and you can see, for instance, that in H1 2018 we were at 163%, before moving up to 169%. The same thing happened in 2017. We therefore have part of this evolution which is linked to seasonality and growth.

I think this proves that the standard model is not adequate for our business model as, whatever the quality of the growth is; you have a change in the capital requirements. That is one of the reasons why we want to switch to the internal model, because it will be more business-focussed and help us to concentrate on the quality of our growth, rather than just growth by itself.

In terms of comfort scale - I think it was your second question – it is too early to tell at this stage. First, we need to wait for approval from the French regulator. It is clear that we will come back based on that, on what will be our new comfort scale. It is a little early for us to tell, and we more probably come back on this at the end of the year, when we will publish a new plan.

Xavier DURAND

And then on the combined ratio, we have not changed our guidance. It is, as you point out, the one we issued in *Fit to Win*, and I guess, as we said, we will come back with a new plan towards the end of the year.

Benoit PETRARQUE

Okay, great. Thank you very much for that.

Moderator

We now go to the line of Hadley Cohen at Deutsche Bank. Please go ahead.

Hadley COHEN, Deutsche Bank

Hi, thanks very much. Most of my questions have actually already been answered, but I just had one question around the loss in Western Europe. I think you mentioned it was related to something in France, and I wonder if you could give us any more specifics around what industry it was and what happened etc.? Thank you.

Carine PICHON

As you know, we are not in the habit of giving specific names, but I can say that it relates mainly to distribution sectors, knowing that in the past we also had some provisions that we recovered. So that net-net it is more or less stable on the volume of large claims from one quarter to the other. It is mainly in the distribution sector to answer your question.

Hadley COHEN

Okay. Thank you.

Moderator

We have a final question from Michael Huttner of JP Morgan. Sir, please go ahead.

Michael HUTTNER

Fantastic, thank you so much. I was just asking when are you going to publish the next strategic plan? Have you got a date for that? Also, what is it going to be called? Scor has already given us a name for their next three year plan, which is why I am asking.

Xavier DURAND

Well, as you know, it is not unlike children - we do not look for names before we know what they look like.

Michael HUTTNER

Okay.

Xavier DURAND

We are more focussed on building a plan than finding a name for it right now.

Michael HUTTNER

Okay and a date?

Xavier DURAND

What is really important for us, in order to have a consistent plan, is to have some visibility on the internal model. Therefore, we are looking at the end of the year, but exactly when is still a bit early for us to say. We are working under a pretty tight schedule. We just submitted the model today. As you know, the regulator has six months to get back to us, so we would like to have visibility on the internal model before we put out a plan.

Michael HUTTNER

Excellent, okay. Thank you very much.

Moderator

That is all the questions for today. Can I please pass the call back to you for any closing comments at this stage?

Xavier DURAND

Well, I think we are breaking another record, which is how short the call is today. I guess I will take it as a positive. I just want to thank you all for logging in. Our next call is going to be in October, I think on 23rd October. As I said, I it turned out to be a good first half and we are now focussed on the last stretch of *Fit to Win*, which carries us through the next six months. Then as just said, we will have to come up with a new plan and a new name.

Thank you all for logging in.

Moderator

This now concludes today's call, so thank you all very much for attending, and you can now disconnect your lines.

(End of transcript)

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FINANCIAL CALENDAR 2019 (subject to change)

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 H1-2019 and our 2018 Registration Document.

Coface: for trade - Building business together

70 years of experience and the most finely meshed international network have made Coface a reference in credit insurance, risk management and the global economy. With the ambition to become the most agile, global trade credit insurance partner in the industry, Coface's experts work to the beat of the world economy, supporting 50,000 clients in building successful, growing and dynamic businesses. The Group's services and solutions protect and help companies take credit decisions to improve their ability to sell on both their domestic and export markets. In 2018, Coface employed ~4,100 people and registered turnover of €1.4 billion.

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