Q3 2015 TRADING UPDATE
TRANSCRIPT

4 November 2015

Bruce Hemphill: Thank you, and good morning everybody. Welcome to the conference call for Old Mutual's third quarter trading update. Ingrid Johnson, the Group Finance Director, is here with me. And in a few moments she's going to go through the Group's performance in the quarter, but just a few words of introduction from me. I'm delighted to take up the reigns as Group Chief Executive, which I did at the start of this week. And during my career in the industry I've always seen Old Mutual as a key competitor, so for me it's a great opportunity to be here, to lead the company through the next stage of its development. My plan is to spend the next few months really getting to grips with our individual businesses and understanding what we need to do to deliver the growth and the value that you're expecting us to deliver. And I'm clear that there are two things that are of paramount importance for any business, and Old Mutual is no exception. It must focus determinedly on the customer and it must manage for acceptable ROEs within a defined risk appetite. And I hope to meet a number of you over the coming months, and of course I look forward to presenting the Group's 2015 full year results in March. And without further ado, I'll hand over to Ingrid.

Ingrid Johnson: Thank you Bruce, and good morning. Today, I wish to cover the key points from our third quarter update on sales, flows and funds.

At a Group level, gross sales were excellent. On a reported basis in sterling, gross sales were up by 31% on the comparative quarter at £8.1 billion, with strong local currency growth right across the emerging markets and Wealth businesses. As a result of the sales growth, as well as the effect of previous actions taken to manage persistency, net client cash flows excluding Rogge were £1.6 billion positive. This is a pleasing performance given the volatility in equity markets in the quarter and the impact of that volatility on investment sentiment. It reflects the benefit derived from offering a range of investment choices for customers to suit their needs and desired outcomes, and supporting those with investment performance and service.

Funds under management at 30th September were flat on the beginning of the year. The principal movements in the year to date are: a £5.2 billion negative from currency movements, the impact of rand weakness greater than the benefit of dollar strength, an £8.7 negative from weaker markets, +£14.8 billion from corporate activity, the contribution from Quilter Cheviot acquired in February partially offset by the removal of funds from the businesses sold in continental Europe, and outflows from Rogge, which I'll come back to later. Notably, the impact of market weakness was £14 billion in the third quarter alone, a substantial reversal of the £5.3 billion positive impact in the first half of the year, and clearly this will affect earnings in the second half for those parts of our business whose revenue is fee-based.

Our focus for 2015 is on operational execution and, looking below the Group headlines, we can see the effect of this reflected in the results from our businesses. Old Mutual Emerging Markets delivered a very good performance with sales growth of 22%, and net line cash flows were strongly positive at R5.8 billion. In South Africa our retail businesses have again performed well with positive net flows. In Mass Foundation on a like-for-like basis Life APE sales in the quarter were up by 6% on a strong comparator, and we continue to expect long-term APE growth for the Mass Foundation segment in line with our previous guidance at the lower end of our 10–15% target range. We remain confident that if we continue to innovate, target growth segments and manage persistency, we will deliver sustained good performance in South Africa.

In the rest of Africa we are making good progress in integrating the businesses we have acquired. UAP is now operating under the Group operating model governance structure. Rest of Africa growth in sales was up by 32%. NCCF of R1.1 billion was the equivalent on an annualised basis to 6% of opening funds under management, and funds at 30th September were R66.5 billion, up 7% since the start of the year. So there is great momentum in this business.

Nedbank delivered a resilient performance. The credit-loss ratio remains below the through-the-cycle target range at 76 basis points. Portfolio and specific revisions were further strengthened in wholesale banking, largely to address the pressures arising from the commodity sector, while the retail portfolio continued to benefit collectively from origination and prudent credit-granting criteria as well as effective collection, particularly in home loans and personal loans. The common equity Tier I capital ratio was 11.1%, remaining well within the target range. The Bank's guidance for full year earnings remains unchanged.

Moving to Old Mutual Wealth, we are really pleased with performance in the quarter. Net client cash flows were excellent at £2.3 billion. The business is making excellent progress on its strategy to build a vertically integrated business. Our acquired businesses, Quilter Cheviot, Intrinsic and Cirilium, are

operating well and making a good contribution to sales, flows and funds. At a time when customers need advice more than ever, we have added nearly 200 advisers through the agreement with Sesame Bankhall Group that we referred to in August, and at the beginning of October we also launched the National Advice business of Old Mutual Wealth Private Client Advisers, to leverage the investment capability of Quilter Cheviot and OMGI. Year to date, 24% of net flows into the platform have come via the Intrinsic network, and Old Mutual Global Investors are now managing 13% of platform funds. Three and five year investment performance was good with 79% and 80% of core funds ahead of market index benchmarks. And we have continued to deliver innovative products, specifically to capitalise on our strong position in the pensions markets following the reforms earlier in the year. Pension sales are 71% higher than the comparative period. In total Old Mutual Wealth delivered gross sales of £5.5 billion, actually a record quarter even without the contribution from Quilter Cheviot.

In the US, OM Asset Management will report its third quarter financial and operating results today at 08.00 EST. Investment performance was good, with 84% and 93% of assets outperforming against benchmark over three and five years on a revenue-weighted basis. Overall, the mix of flows – higher fee asset inflows and lower fee asset outflows – continued to generate the positive revenue impact despite negative net client cash flows of $2.5 billion. The net outflow was driven in part by $0.9 billion of investment-driven hard asset disposals, and there was a $1.9 billion outflow relating to the termination of an account by a single large non-US institutional client.

And finally Rogge: where decreasing demand for global government bonds in a low-yield environment led to further outflows in the quarter, which may continue in the near term albeit at a slower pace. That concludes my review of business unit trading.

Now, a few words on capital and debt. You will have seen that last week we launched a £450 million Solvency II-compliant Tier II issue with a coupon of seven and seven-eighths. This continues our strategy of maintaining an efficient capital structure and completes our near-term refinancing activity. In terms of Solvency II, our preparations are well on track but formal regulatory approvals are not expected until later this month or indeed actually December, and we understand that a decision by the European Commission on SAM equivalence is also deferred until later in 2016.

Our individual businesses are each well capitalised, with sufficient local capital to support their normal trading operations and withstand extreme regulatory and internal stress scenarios in accordance with where the risk lies. However, under Solvency II in calculating the regulatory capital surplus and ratios at a Group level we will not be allowed to include any of the South African surplus from OMEM and Nedbank in excess of their capital requirements as it is

considered non-fungible. Accordingly, as previously guided, our expectation is that under Solvency II, reported levels of surplus and coverage ratios at the Group level will be lower yet more resilient than under FGD, and we remain confident that the Group is appropriately yet not excessively capitalised under both the old and new regime.

To summarise, it was a good quarter of strong operational performance. Sales growth was excellent, illustrating that we are offering the right product in the right market and are delivering what our customers want. Investment performance was generally good despite weaker markets. Where we are seeing outflows they are most often reallocation-based rather than performance-based, and we have continued to make good progress at integrating the businesses we have acquired to ensure we deliver value from those investments. Whilst the economic backdrop will doubtless remain tough, we are managing for downside risk and will continue to drive performance with a strong focus on operational efficiency, cash and returns.

Ladies and gentlemen, that concludes our comments this morning, so I will hand back to the operator to open up the line for questioning.

Lance Burbidge: Good morning. Yeah, a couple of questions. Firstly, on the Mass Foundation business, what seems to have happened in Q3 is that savings policies sales have slowed down dramatically, so I wonder if you could comment on that, and is there some hope that that comes back and that's why you're happy with the target? And then on Old Mutual Wealth in terms of pensions, you've obviously done very well in terms of gaining share against your competitors because you have products that people want to buy. Do you think that's temporary as people then start to introduce products later in the year and into next year, or is that a permanent advantage?

Ingrid Johnson: Lance, morning, thank you very much. On Mass Foundation clearly what we have guided is the prior year was a very strong comparator in quarter three. We've also taken some action in terms of pricing on our credit life product linked to our loan product and adjusted the pricing downwards, as well as introduced some cover benefits that should ensure that we continue the sales momentum. So I do just think it's a function of all of those aspects, but we have had a very strong first and second quarter particularly for the 2-in-ONE, you know, clearly it is more challenging. But we do see this as a product that customer needs and we also continue to innovate to make it relevant, and hence we're able to provide the guidance that we should be at the bottom of our 10–15% target range.

On the second question of Old Mutual and the pensions, we are definitely on the right side of the changing regime with 71% growth in the quarter on our

sales. And interestingly of the £5.5 billion of gross sales almost nearing 800–850 billion is actually attributable to pensions, so we're seeing the flexible drawdown product is attractive. You also will have some activity with – if the rules are changing customers will want to invest sooner that may also be a contributing factor. However, with the recent market volatility you are seeing the importance of advice and making sure that clients understand the outcomes they're looking for, and that should also fuel continued investment.

Lance Burbidge: Okay, thanks.

Andy Sinclair: Morning everyone, thanks for your time. Firstly, on Intrinsic, I just wondered, for growing advice the numbers you've currently added a decent number this period – what's your aspirations for the size of that advice force, and what sort of levels of ongoing growth of advisers do you expect? Secondly, I just wondered if you could give us a quick update on P&C experience in Q3 were there any losses of note? And thirdly, just on the Solvency II comments, I just wondered, am I correct to say that Solvency II should not be a binding constraint on cash generation from your business units or on the Group dividend? Thanks.

Ingrid Johnson: Thank you. Certainly from the first question on Intrinsic, we do recognise the value of having a strong advisory force of quality advisers that are giving good advice, and that would be our emphasis and hence are we adding – with the Sesame Bankhall advisers, the opportunity, as well as the national advice business, where we are targeting ten plus regional offices to leverage the capability of OMGI and Quilter Cheviot. So there's never a target as an optimal amount but what you'll see is we want to continue to expand where there's a client need and there is relevance.

On P&C we don't comment on the quarter. This is just a trading update, so we wouldn't necessarily update on losses.

And then on Solvency II, as you correctly outlined, Solvency II is a method of aggregating the Group solvency numbers but doesn't necessarily align with the cash generation of the Group. And hence why we always refer back to the underlying strength of our subsidiaries and their capital and profit and cash generation because that actually is the determinant of the remittances that are made available up to Group within the normal approval processes, whether it's Board or regulator. And that's been the process of the past and will continue into the future. How you then get to a Group number, as the PRA also highlighted in a speech by Sam Woods yesterday, is it's a very conservative number and is determined based on a one in two hundred stress scenario and is very conservative in its determination. And hence it should give the investment community comfort that the number calculated meets the regulators' needs but they're also not looking for one number across the

sector, and basically what it's highlighting, for the industry it's harder to have comparability across the sector because your ratio is unique to your situation. And for us in the northern hemisphere we have very capital-light businesses that are more unit-linked, whereas your actual businesses that have high capital intensities in South Africa, and there clearly the surplus is restricted yet it is absolutely available in terms of determining remittances to Group.

Andy Sinclair: Very good – thank you.

Risto Ketola: Yes, morning. Just one simple question. There was a large single premium in the South African EB business. I just wanted to get an idea: you know, was it a sort of low margin multi-manager business or was it a high margin smoothed bonus business? That's quite important for the margin impact.

Ingrid Johnson: I've got the single premium sales: those were up 30%, and that's in relation to one large customer. I don't necessarily think we do give customer names but that would clearly make it quite competitive in margin. And then on the recurring premium we did have quite a tough comparator last year that wouldn't have been repeated.

Risto Ketola: Yeah, I wasn't looking for a customer name, I was just wondering whether it was more in terms of smooth bonus or pure linked business.

Ingrid Johnson: We'll come back to you with that level of detail, if we can.

Risto Ketola: Okay, fine.

Jon Hocking: Hi, morning everybody. I've got three questions on sort of capital and cash flow. Firstly, I just wondered whether the Solvency II implementation is having any impact on your decision-making in terms of whether you can raise debt from PLC or from the SA business, because I think historically you've been looking at reducing PLC debt and issuing more locally. I just wondered whether there's a short-term tactical shift there given the issues of the ratio. Secondly, when you report the Solvency II ratio I guess in March, are you going to give us a sort of pro-forma number for the expected benefit for SAM equivalence? That's the second question. And then finally just in terms of you know, when the Board sit down ahead of the dividend announcement, to what extent are they going to be able to look through the sort of temporary issue with the ratio, and are they going to be able to set a dividend based on an expectation of SAM equivalence which is not going to be that material? Thank you.

Ingrid Johnson: Thank you. A number of questions within that. I think importantly, firstly, from a debt perspective of where we raise our debt, you would have seen all of our operating businesses will be in the debt markets from time to time, to ensure that we have the correct capital structures at operating level linked to the cash generation of that unit in a way that makes sense, and generally our gearing is similar or slightly less than the peer group or in some cases, like the US business, quite materially so. From a Group perspective in terms of our capital structure, we would equally look at what is the right mix of equity and Tier II debt, and hence you would have seen our successful closure last week of a £450 million sterling, a Tier II instrument that's also compliant with Solvency II at seven and seven eights coupon. So that's really part of just generally making sure we have the right balance sheet construct at Group level as well as in the individual businesses, so it's really not a tactical shift, it's linked to the operational need.

In terms of providing pro-forma numbers, we are still going through the decision process and clearly, as you highlight, SAM is just one aspect of the process in terms of regulatory approvals coming through and then actually achieving equivalence, so it will have some impact to the overall ratio. And what we'd rather do is, as we've shared from prelims and at interims, is give an update once we have certainty on all the aspects, which would be in prelims next year. In terms of dividend the policy is set annually, and it's important to note that your capital structure adequacy as well as your dividend declaration is actually set at that local level. And effectively nothing is really changing in terms of the process or expectations, and therefore those remittances are determined, as it's always been done in the past, coming up to then Group, where we assess in terms of our dividend policy which – what is appropriate, and we review that annually in February.

Jon Hocking: Okay. Thank you, Ingrid.

Ingrid Johnson: Thanks.

Ravi Tanna: Hi, good morning. Thank you taking my questions – just a couple please. So the first one is on the financial advisory school that you've bought and the national advice business that you've built up. Perhaps you can just elaborate a little bit more on what the aspirations are there, and how it's going to tie in with the rest of your business from a kind of vertical integration perspective. And then the second one was just a very simple one on OMGI. Obviously you brought over the team from Ignis towards the back end of last year. I was just wondering when they're going to be fully up and running and when we can expect a kind of contribution to flows from them coming through? Thank you.

Ingrid Johnson: Thanks very much Ravi. Certainly on the school and the national advice business you've outlined, it's just adding more quivers to the bow effectively,

of being able to meet and serve the customers where they need that, and particularly if we look on the work site offering they are small businesses, medium-sized enterprises, that actually also need to be offering pension plans that we can support in terms of some of the advice that is required as well as for the individual. This is still very early days, it's very much part of the Intrinsic capability and our integrated distribution, so it's probably best if we can update you once it's had more momentum, but it's just part of the investment we're making in distribution.

From an OMGI perspective the team is very much on board. You hopefully would have picked up we launched our fixed income absolute return fund – there were two funds within that – on 7th October. And we certainly are attracting the funds flow that we hoped for – that's going according to plan and we'll update you in due course.

Ravi Tanna: Okay, thank you very much.

Michael Christelis: Hi guys. Just two questions. The first one, just a clarification on your comment around the Mass Foundation Clusters target: are you saying that our full-year number you – we should expect it to be at the low end of the range like for like, or are you saying in the medium term you'd expect it to be at the low end of the 10–15% range like for like, given that you're at 7% I think for the nine months? And then the second question just around your pensions sales in the UK, I mean it's been a phenomenal sort of straight line up, which I understand the causes. Can you give me some colour on the monthly run rate during quarter three, you know, are we starting to see it taper off, or is it – you know I'm just trying to build in some sort of understanding of where we're going on our run rate, our sales intention in the UK.

Ingrid Johnson: So certainly on MFC, I mean, that's a medium- to long-term target range of 10–15%, which typically would have implied, you know, like for like, but I think we do have some anomalies in terms of price adjustments that we've made, which would have influenced some of the timing of how you would determine it. If you picked up in quarter two, we were actually running at 12% at a gross level, so I think it's something that we probably see as slightly more stretching than perhaps we would have seen when we spoke in Q2 or Q1, and also influenced by the comparator. I think it needs to be seen in the context of all of those factors.

On pension sales, on a straight-line basis, I think I had seen a figure of roughly £50 million monthly was the increment in the uplift in net flows. What we must recognise is we are going through an unusual period – we're probably also seeing some acceleration of clients accelerating investment ahead of any further changes and it's opportune to do so, but overall if you look at our gross sales of £5.5 billion, the pension and the growth of – within the gross sales was

£1.7 billion. The pensions growth was actually around £350 million of the 1.7 billion, so the big drivers of growth were actually the OMGI growth of 700 million, and that's going into GEAR – the UK absolute return fund, Cirilium as well as the Quilter Cheviot addition from our investment there of 700 million. So what you'll see while the pension sales is important – it's at around 800 million of our 5.5 billion of gross sales – it's definitely not the only driver.

Michael Christelis: Great, thanks.

Greig Patterson: Morning everyone, how are you doing? I'll hit you with three questions. One is just US asset management treatment under Solvency II, I just wondered if you could explain that? The second thing is just a clarification. Are you saying that your solvency ratio will take a hit under Solvency II but then you expect equivalence – South Africa to get equivalence some time in 2016 and then the ratio goes back to a more normal level, that's the question there. And the third thing is on dividend policy. I mean, currently you're setting your dividend per share in sterling and effectively financing a large portion of it in rand. Given the rand has collapsed – I suppose that's a polite interpretation – would you, you know, can we see a situation where the policy is starting to be set in rand from next year, going forward?

Ingrid Johnson: Thank you very much Greig. I think firstly on US Asset Management, it's important to note that it's actually not a very capital-intensive business so its contribution overall to the surplus will be modest. But effectively the treatment is similar with a Solvency II or FGD where you look at the individual affiliates and you also attribute the goodwill to them and you take 100% of any deficit in your calculation or your proportion of the surplus, so that's really not necessarily a material driver of our – of Solvency II from an individual business perspective.

If we then turn to our ratio and calculation for Solvency II there are a number of dependencies that will determine the number, and hence why we'll only update the markets more formally once we have our approvals and worked through them. SA equivalence is helpful but actually more from an operational perspective because of the nature of the calculations and South Africa's regime makes it as comparable as possible with Solvency II, but equally we are very well prepared to be able to calculate on an existing Solvency II approach, but there would be modest changes depending on the aggregation approach.

And then on your dividend policy, it's very much set annually, as I described earlier, but also influenced by the investment phase of our business and where we see opportunity. And so whilst the dividend policy is actually a function of our earnings with a 2–2¼ times cover, so effectively is underpinned by the profile of our earnings, which is roughly 75 odd % is what's been – the dividend

has been funded in the past, whereas previously it was up to 100%. But equally if you look at the investment, of where we're making investment, you're seeing significant growth coming through from particularly the Wealth business, and that's why you would in the near term choose to take some of your investment of cash to support that business, but on the basis that once the investment phase is finished you would need, you know, good earnings and cash remittances coming from that business.

Greg Paterson: So just to clarify, so equivalence won't, if you get it, just all it will probably be will give a big boost to the ratio?

Ingrid Johnson: We haven't said what – how it moves up and down but you know, put it this way, it's nice to have but more from an operational perspective than the effect on Solvency II.

Greg Paterson: So I can take that as it's not going to be a material – a huge material boost?

Ingrid Johnson: We're not saying anything. We'll update you once we actually have our approvals.

Greg Paterson: All right. All right, thank you.

Ingrid Johnson: Thanks.

Bruce Hemphill: Are there any additional questions? Well, thank you all for joining the call and for your questions. To conclude, I think it was a good quarter. We've got quality businesses, which are all well positioned for growth, and I'm encouraged to see that they're all performing strongly despite the tough external environment. As I said at the start of the call, I'll be spending the next few months getting to know these businesses in more detail to ensure that we have and we maintain a complete and consistent focus on our customers and returns. And I'll speak to you again in March with the Group's 2015 full-year results. Thank you very much.