OLDMUTUAL

Conference call transcript

9 June 2020

DEBT INVESTOR UPDATE

Operator
Good day ladies and gentlemen and welcome to the Old Mutual debt investor update. All participants will be in listen only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing * then 0. Please note that this call is being recorded. I would now like to handover over to Casper Troskie, the Chief Financial Officer of Old Mutual. Please go ahead, sir.

Casper Troskie
Good afternoon everyone and thank you for taking the time to be with us today. I am Casper Troskie, the Chief Financial Officer. Joining me today from home is Andrew McPherson, our Head of Group Balance Sheet Management and some of his team members. The purpose of the call is to provide a brief overview of the Q1 2020 operating update released on 28th May, to provide you with an update on when we are consider coming to market to raise debt and to answer any questions you may have. We have distributed a presentation; however, we will not be following that for this session.

While the full impact of COVID-19 lockdown restrictions is not yet fully reflected, these results reveal an extraordinarily difficult macro environment and the significant market volatility experienced in March. Despite this backdrop, we have progressed well against our strategic priorities while improving digital servicing and enablement for our customers and employees.

The arrival of COVID-19 further accelerated our digital journey and we are delighted that Old Mutual customers can now service funeral plans and disinvestments using USSD and WhatsApp platforms.

All of this process is underpinned by a strong balance sheet and a capital position which stands us in good stead to weather the storms ahead.

Looking now at our solvency and liquidity, we have performed downside scenario analyses including a '1 in 200 perfect storm' scenario where severe market shocks are accompanied by a pandemic. The outcomes of these analyses have consistently given us comfort that we remain sufficiently capitalised with appropriate liquidity levels through these scenarios.

The group's liquidity management remains robust and our cash reserves are more than sufficient to cover our business requirements.

In Q1, Life APE sales fell by 15%, largely due to lower recurring sales in Corporate, lower volumes in both MFC and PF as well as weaker persistency as a consequence of consumer pressure in South Africa.
Our loan book growth at 2% was stable in line with our credit risk management philosophy.
I am pleased with our positive Net Client Cash Flows despite higher outflows as we can expect in a time of extreme uncertainty.
Funds under management reduced by 7% driven by the deteriorating market conditions during March.

Results from Operations declined by 33% as life sales volumes fell and Corporate's underwriting experience deteriorated.

As we look ahead to the rest of the year, we are supportive of moves to level 3 lockdown in South Africa.

Although we expect the gradual easing of lockdown across our markets to be positive, we do expect the pandemic to affect our performance for the remainder of the year. Consumer pressure and higher unemployment will be with us for a while longer. This is likely to reduce levels of disposable income resulting in lower volumes, higher lapses and higher credit losses.

Last year we also communicated that we plan to come to market each year to raise debt in line with our capital and liquidity strategy under the Old Mutual Consolidated Debt Programme. R962 million was redeemed in March 2020 and a further R1.288 billion is planned on being redeemed in September 2020. The market has been volatile and unfavourable to raise debt in the first half of the year. However, should the market conditions improve we may consider coming to market in the latter part of the year.

As a management team, we are acutely focused on driving improved operational efficiencies in the short term as well as further out into the future.

Lastly, we remain confident that the benefits of our well-diversified business, our strong balance sheet and stable cash generating ability will help us to weather the storm as we have many before.

Thank you very much for your attention. I will now hand over to the operator to take any questions on the line.

Operator
If you would like to ask a question please press * then 1 on your touchtone phone or on the keypad on your screen. If you decide to withdraw the question please press * then 2 to remove yourself from the list. Again, ladies and gentlemen, if you would like to ask a question please press * then 1. We will pause to see if there are any questions. Ladies and gentlemen, just another reminder, if you would like to ask a question please press * then 1. If you would like to ask a question please press * then 1. The first question comes from Johny Lambridis. Please go ahead.

Johny Lambridis
Hi Casper. Thanks for the opportunity. With respect to the R1.3 billion maturity in September 2020, presumably, Nedbank will not be allowed to pay a dividend or the guidance from the PRA is that banks should not pay a dividend. So surely if Old Mutual then also decided not to pay a dividend it would be more than sufficient to get cash from not paying a dividend than to effectively redeem that without coming to market. I think your interim dividend last year was about R2 billion if my numbers are correct.

Casper Troskie
Johny, in our stress scenarios we have assumed obviously that our dividend payment is in line with our dividend policy. In all the stress work we have done, we have modelled dividends based on what Adjusted Headline Earnings would be and paying a dividend within that range. Where the stress scenario results in a loss situation you take negative Adjusted Headline Earnings. So it is important to put that in context. What we have assumed in the very negative stress scenarios, modelled on an L-shaped scenario, which is the perfect storm scenario we referred to, we are also assuming that we cannot come to market over a three-year timeline for additional debt. Moreover, we believe that we have sufficient capital to be within our optimal range after other management actions, which are mainly related to operational efficiency. I hope that answers your question.

Johny Lambridis
Your capital is different from liquidity though. My understanding with what you have just said there is if you earn X and your target dividend cover is 1.5 times to 2.0 times that your modelling assumes that you pay a dividend to the tune of 1.75 times cover. But from a cash perspective you will not be getting anything from Nedbank. I am trying to work out why you would then equity account Nedbank and then pay a dividend from money that you have not received, putting the business under more undue pressure? The equity accounted earnings are a concern.

Casper Troskie
I hear your point but we cannot make a call on that today. If we decide to continue paying a dividend even though we have not received a dividend from Nedbank we will have to come to the market with a clear explanation of that. But as I said before, we will only make that call once we have looked at our capital position at 30 June and we have looked at any planned capital actions, our forecasts have been updated for forward looking solvency. We will make a recommendation to the board on the way forward in early August and we will make sure if we do continue with a dividend, even though Nedbank has not paid, we will make sure we deal with that as part of that announcement.

Johny Lambridis
Maybe just to follow up on that, last year even before Nedbank you made R3 billion of cash. So again, it does not look like you necessarily need to come to the market to refinance the R1.3 billion. Why don't you use your internal cash as opposed to rolling it?

Casper Troskie
I did not fully catch that, if you can just repeat the question.

Johny Lambridis
You are talking about a R1.3 billion maturity in September 2020 and potentially going to the market in the second half to refinance that. But even if you could not come to the market, in other words the market remains shut, the business did make R3 billion of cash last year before even taking into account Nedbank's dividend. So you could refinance from internal resources. There is not a burning need to come to the market.

Casper Troskie
Johny, the purpose of taking to the market is to make sure that we get to our targeted leverage ratios and removing any event risk. We do not want to raise R4 billion in a year. So the purpose is to get back to what we see as an efficient leverage ratio for our target solvency. And we are below that efficient leverage ratio at the moment. It is cheaper for us to raise debt than equity. So not coming to the market will just put more pressure on getting to where we want to be from a financial management perspective.

Johny Lambridis
And then what if any maturities are there in 2021? I don't think there were any, were they?

Casper Troskie
The issue is not the maturity, Johny. We want to spread our issuance so that we do not have event risk. Therefore, we would have to think about if we raise R4 billion to try to get to our target ratio we would not want to do that all at the same time because you do not know what the circumstances will be when you have to redeem that. That is why we like spreading the issuances.

Andrew McPherson

Casper, can I just add on to that? We have done a review of our financial position and we believe that roughly R10 billion worth of debt is optimal for the overall balance sheet. And we have tried to structure that so that we roll that annually in R2 billion tranches over five years. Therefore, you have a five-year rolling R2 billion issue every year potentially issued in R1 billion tranches over the year. So what we then try and do is to create an Old Mutual yield curve and we try and create liquidity in the market for our investors. That is the goal we have set ourselves. We do not need to raise capital at the moment. It is capital efficient. But if the markets are not open to us we do not need to raise capital and it will not cause a liquidity issue given we hold short-term liquid assets to back our debt.

Johny Lambridis
Perfect. Thank you.

Operator
Ladies and gentlemen, just one final reminder, if you would like to ask a question please press * then 1. If you would like to ask a question please press * then 1. The next question comes from Asief Mohamed of Aeon Investment Management. Please go ahead.

Asief Mohamed
Hi. Good afternoon. Can you give us some sort of indication at the mass level and specifically some sort of indication using funeral cover and funeral policies as a segment on its own, what's happening now with COVID? You have given us broad indications earlier on at the beginning of the conference call. But if we look forward six months' time or a year's time or in 2021 in the absence of a vaccine or something like that what is your outlook for that? And then related to that is really there has been quite a bit of competition coming on funeral policy cover from Capitec Bank. How has it affected your ability to sell product at that level?

Casper Troskie
Okay. Let me start answering and the rest of the team can supplement if I have missed anything. The reason we have run three scenarios is because of the range of possible outcomes that we could see. So we have run a V, a U and an L shaped scenarios. If we now go back into a level 4 lockdown restriction because cases have increased that would materially change what happens in our business. So the fact that we have now moved to lockdown 3 allows us to be more proactive in terms of the sales force. So what you are asking me to describe running into the end of the year is actually very difficult. And it will depend what happens on the ground and the ability of our sales staff to go to work. As we said in the presentation, under lockdown 4 in MFC we saw almost a 90% reduction in sales in April. That did improve. The sales from May to April have improved in MFC and we expect to see a further improvement in June.

In Personal Finance, the lockdown had an impact of 50% in sales month on month. That was a decrease but we have seen that again improve in May and June. So the outlook for sales is very much dependent on our ability to access client worksites for a portion of our sales force in MFC and the ability to open up more branches in Old Mutual Finance because we do a lot of sales through those branches. And we have increased the number of branches that are open now in June. That will depend on how the pandemic plays out and how we are able to get access to client sites or to open branches. And we will obviously give you an update on how that is going at the half year.

In terms of competition from Capitec if you look at the impact that we have seen on the MFC business it relates more to the impact of economic conditions. So if you look back we went into a recession in the third quarter of last year with negative growth. That was exacerbated by further negative growth in the fourth quarter. And a lot of the sales that are reflected in our results in the first quarter there is a delay in the sale being made and that being reported as a sale. That could take as much as six to eight weeks to come through. So what you are seeing in the first quarter sales result in MFC is the fact that we had very difficult conditions in the last quarter of last year. So that is important to understand.

So we are seeing more the impact of affordability, customers not taking up as much product as they did before because of the difficult economic conditions. That also then has an impact on retention where as we have said in our presentation there has been an uptick in lapses during the period. So persistency has reduced with all policies. But it is not so much the competitive issue. It is more an affordability issue. I hope that helps with the question.

Asief Mohamed
Thanks for that.

Operator
The next question comes from Chris Stewart from Ninety-One. Please go ahead. Chris, you may proceed with your question. If your phone it muted please unmute it so that you can pose your question.

Chris Stewart
I am all over it. I will ask the question again, this time not on mute. It might make more sense. My apologies. Casper, good afternoon, and good afternoon to your team. Thanks for making yourself available. Perhaps a comment in line with the comment around affordability in the Mass Foundation Cluster. Can you give us an updated sense of how the credit quality is evolving in your advances book? You did allude in the trading statement that that may be another negative driver of earnings. Perhaps you can just give us a sense of how that book is evolving from a credit quality perspective and what you are doing in order to try to manage some of the cash flow constraints that your clients may be feeling please.

Casper Troskie
Okay. Did you want me to answer that question on our investment credit book as well? I presume so.

Chris Stewart
You can do, for sure. Please.

Casper Troskie
So what you are seeing in the book managed by OMSFIN is a widening of credit spreads. That obviously has an impact on our valuations. So we did have some negative impact on our results because of widening of credit spreads and unlisted equity valuations in that book. And we have disclosed that that impact was between R250 million and R300 million for the first quarter. The March results would have been released at the low point of equity markets for the year. There has been some recovery after that, but we will be able to give you an update on how that has moved at the half year. So that is the first point. The impact is more of a mark-to-model mark-to-market type nature as opposed to a loss.

The second piece is in the Mass & Foundation book where we have seen higher impairment losses compared to the prior year. You will remember that that book accelerated quite a bit in terms of growth in the first half of last year. We then applied a strong handbrake effect by changing the scorecards effective September. And we have applied further handbrakes in February this year. What that has done is it has reduced book growth quite significantly. The book growth in the first quarter I think was about 2%. But you still have advanced lending through impairment categories, what Iain calls the speedboat effect. So your level of credit impairment relative to the size of the book increases. So we have seen a big increase in the impairment loss ratio compared to last year, but the impairments are within our expectation and have been performing within what we call our budgeted level. So there is nothing that we have not expected coming through that book. Year on year because of the impacts I have explained you would have seen a big increase in impairments compared to last year.

Chris Stewart
I fully understand the wash effect or the speedboat effect as you call it. That is quite an appropriate way to describe it. And impairments on the high end but within expectation and I presume pricing tolerances right now. Do you perceive this to be getting worse? Is this the calm before the storm as the extensive retrenchments start to come through, as the ongoing effect of people being short-paid, not receiving overtime etc. start to wash through?

Casper Troskie
Chris, we are looking at that closely. We are obviously monitoring. A lot of our collections come through payroll deduction, so what we are doing is monitoring that. And we have not seen any noticeable trends. I just want the team to correct me if I am misstating the issue, but we have not seen a big impact on our collections moving from March to April to May. A large proportion of our book is government employee linked. So if we do start seeing large-scale retrenchments, yes, it could have an impact on the book going forward.

Chris Stewart
How much of the book is government employees, Casper? Is it in the 30% range, which I guess your peers in the industry typically are?

Casper Troskie
No, it is higher than that. Sizwe can give you the exact percentage I think.

Sizwe Ndlovu
It is over 60%, Chris.

Chris Stewart
All right. Okay. I guess probably less likely given that sort of percentage, but have you been offering payment holidays? Have there been requests for restructure from your client base, or not particularly?

Andrew McPherson
I can answer that. There have not been significant requests, and it has been done on a case-by-case basis in the OMF branches.

Chris Stewart
All right. Thank you very much.

Operator
Ladies and gentlemen, just one final call, if you would like to ask a question please press * then 1. If you would like to ask a question please press * then 1. Casper, we have no further questions in the queue. Do you perhaps have any closing comments before we conclude?

Casper Troskie
Yes. I would just like to thank everyone for joining us on the call today. If you do have any further queries please get hold of our debt sponsors or our investor relations team and they will supply you with answers to those queries. Thank you very much.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT