PHOENIX GROUP

Phoenix Group plc 2011 Q1 Interim Management Statement

Monday 16th May 2011

Operator

Ladies and gentlemen, welcome to the Phoenix Group Holdings 2011 Q1 Interim Management Statement Call. My name is Claire and I will be the operator for your call this morning. I would now like to hand you over to your host, Clive Bannister, to begin today's call. Please go ahead, Clive.

Clive Bannister: Chief Executive

Claire, thank you very much. Good morning everybody and welcome to our Quarter One Interim Management Statement call. I'm Clive Bannister, Group Chief Executive, and I'm joined today by Jonathan Yates, our Group Finance Director and Lorraine Rees who is Head of our IR, well known to you all.

Jonathan and I will be happy to take your questions in a few minutes. But first I would like to take you through the highlights of our First Quarter Interim Management Statement which we released earlier this morning.

I'm very pleased to report that the Group performed strongly in the first quarter and that we are absolutely on track and confident of delivering on all of our 2011 financial targets.

First on cash generation; cash is a key performance measure for Phoenix Group and I'm pleased to say that our cash generation to the end of April was strong at £314m demonstrating the cash generative strength of our business model. This figure compares £14 million of cash received from IGNIS to 31 March; and a further £300 million received in April from Phoenix Life.

We have noted previously that cash is typically distributed from Phoenix Life to the holding companies twice a year following full actuarial valuations at 30 June and 31 December so the timings of these remittances does indeed vary. These remittances have not included any benefits from cashflow acceleration management actions, during the course of this year we do expect management actions to contribute upwards of £300 million towards our annual cash generation target. We remain confident that we will meet the 2011 cash generation targets that we set at the end of our full year of between £750 million and £850 million.

Second, turning to embedded value; we have a number of projects in the pipeline which are expected to deliver our target of £100 million incremental embedded value growth in 2011.

Third, de-gearing remains a key focus for us. We continue to work towards reducing our gearing ratio below 50% as we made our commitment. And we remain on track to deliver this by the end of the year. Since the end of the first quarter we have made scheduled and sweep repayments to our banks in accordance with the lending agreements, and of course also paid the Tier 1 coupon.

Fourth, looking at IGNIS, our fund management company's performance; our total assets under management fell ever so slightly to £67 billion in quarter one from £67.5 billion reflecting the run off of the closed life book and small outflows in the net new business which was offset by lower investment growth.

Fifth, we have maintained a solid capital position. From a regulatory capital point of view we have an estimated IGD Excess Capital surplus of £2.9 billion and an estimated IGD Surplus at the 31 March which remains robust and unchanged from the year-end at £1 billion.

So in summary, overall we have a lot to do to achieve over the remainder of the year, but our robust platform and the solid financial performance to date allows us and me, personally, and my management team to look to the future and the targets that we have set ourselves with growing confidence.

At this point I'd like to finish and if we may, operator, can we move to a Q&A session. Thank you.

<u>First question</u>

Jon Hocking - Morgan Stanley

Morning everyone. I've got three questions please. Could you talk a little bit about the IGD headroom you've got and how that might pan out across the year, to what extent is there room to do something on the capital requirements and open up a little bit headroom over the £0.2 billion you had at the year-end? That's the first question.

Second question, could you be a little more specific about the nature of the management actions you intend to undertake during 2011 to drive that extra £300 million cashflow?

And then finally I'm struggling a little bit to reconcile the extra three hundred million quid of cashflow you expect to come through with the comment that there's going to be an additional £100 million of embedded value, what's the relationship between those two numbers? Thank you.

Clive Bannister

Well, Jon, thank you very much indeed for asking those three questions. I'm looking at Jonathan and you asked three and I think he can tackle all of them.

Jonathan Yates

Thank you, Clive. Morning Jon. The IGD headroom in terms of looking forward you're absolutely right, this is something that we need to be on top of in terms of actually managing, and we are looking at a series of management actions that should see the headroom increase quite materially. As I'm sure you know IGD headroom is a Pillar 1 measure and is therefore driven off the assumptions that, you know, the Pillar 1 assumptions that we make. And restructuring the business to make it more efficient from a Pillar 1 perspective is one of the things that we can do to give us more comfort in that regard.

Having said that of course we are actually Pillar 2 Company, most of our life companies, in fact virtually all our life companies with one exception, are actually on a Pillar 2 basis and therefore we do actually actively manage our business to a Pillar 2 standard. So it does require some sort of deftness to try and make sure that we are hitting the Pillar 1 targets as well in order that we get the best IGD benefit. But that certainly is our objective. And one more comment is this every time we make payments to the banks in terms of interest and capital and when we make payments to the pension scheme, for example, that all comes off the IGD headroom, so it is important that we do manage that measure and we are very much recognising that in terms of the way we run the business going forward.

Further question

And just for follow up the £448m of cash at the end of the first quarter how much of that is held within the regulated life company and how much is at the Topco.

Jonathan Yates

£448m of cash I think that was all within the holding companies. I think the cash that you're referring to... we usually have two measure of cash; one is obviously the holding company cash which, I'm pretty sure, is the one you're referring to. Yes it is, sorry. And the other one is the cash surplus that we hold within the life companies which is the cash that we rely on and is dividended out to increase the holding company cash going forward. So the £448 number is the holding company cash.

Jon Hocking

So the £448 that's without any constraint from the IGD at all. So in theory you could place that against the debt?

Jonathan Yates

No that falls within the IGD perimeter.

Jon Hocking

Okay. Fine.

Jonathan Yates

Not all of it actually. To be clear there is a small amount which falls outside the IGD perimeter, but the majority of that 448 falls within it.

Jon Hocking

Okay. So subject to getting some more headroom on the IGD measure some of that 448 might be available to prepay debt ahead of the amortisation profile that's been agreed?

Jonathan Yates

Very much so. That is our objective to make sure we've got sufficient headroom to make all the debt payments that our cash available will enable us to make going forward.

Jon Hocking

Thank you.

Jonathan Yates

The next question you asked was about management actions in 2011 and I think as Clive said we haven't actually... the £300 million of cash didn't rely on any management actions to bring it forward. The sort of things that we will be using to generate cash, and when we say cash what we mean is cash that has actually emerged from out of the life companies, so not surplus within the life companies it's actually got to have come out of the life companies before we count it towards our cash target. So the sort of things that we're looking at there are the corporate loan restructuring that we undertook in the first quarter of the year which gave us a fairly significant increase in embedded value of about £130 million. That should give rise to a not dissimilar amount of cashflow benefit as well going forward.

Other things are, as you're probably aware, we've had a programme of de-risking now over several years and that will also give rise to significant benefits in the remaining part of this year in terms of cashflow.

And the final point I'd make is probably around managing our tax liabilities. We have a fairly complex tax position as a business, although not an unadvantageous one, and managing that going forward to release some of the provisions that we set up is part of our ongoing programme.

Jon Hocking

Okay. Thank you. And just the relationship between the £100 million of EV benefit and I think Clive made a comment that you're going to have to see up to £300 million of cash from management actions but I may have misunderstood?

Jonathan Yates

No you're absolutely right. So we've got the target of £300 million of cash management actions and an embedded value target of £100 million. Some of those things are related but not all of them. Some of the actions that we take literally are just an acceleration of cashflow. We've just a relatively small embedded value impact, in other words, it's money that would have emerged anyway in the fullness of time, but what we're doing is we're managing to get our hands on it now. And then others are very much a sort of a long term cashflow generation embedded value increase. I can't give you any detail on what I expect the balance to be or the reconciliation between the two over the remaining part of this year, that's something we're still working on.

Jon Hocking

Okay. Thank you very much.

Jonathan Yates

But certainly the specific items I just mentioned certainly are cashflow items and not embedded value items.

Jon Hocking

Excellent.

Question 2

Grieg Paterson - KBW

Morning. Sorry I was going to ask three questions. Just for clarity that £130 million EV uplift was that last year or are you talking about this year?

Jonathan Yates

Yes it was. It was actually a the restructuring of the loan portfolio which gave rise to the £130 million of embedded value benefit that happened before we signed off our accounts, but was actually something that we'd set in train last year.

Grieg Paterson

So it was part of last year's...

Jonathan Yates

Exactly. So the auditors deemed that it was part of the 2010 embedded value. But the cashflow is emerging, or has emerged this year, and therefore is not included in 2010 but will actually be part of 2011.

Grieg Paterson

Alright. That was the comment you made when you said that the IGD at the beginning of the year was £1 billion, but after the Phoenix and London Life it was another £100 million.

Jonathan Yates

No that was a different thing. Phoenix and London Life that transfer of the funds took place on the 1 January and that gave rise to the benefit at that point.

Grieg Paterson

So the £130 million was in the £708 surplus that you disclosed at the end of last year?

Jonathan Yates

No you mean the cash surplus in the life company?

Grieg Paterson

Yes.

Jonathan Yates

No it wasn't, no. The £130m... sorry are we talking about the same 130 odd here? There was £100 million of IGD benefit which came out of the funds merger on the 1 January and that was PALAL into Phoenix Life. And then there was £130 million due to the corporate loan portfolio restructuring which came out in February and that came out as embedded value which we took credit for at the end of 2010. But in cashflow terms the £139 million that should come out we estimate will come out in the cashflow for this year, for 2011.

Grieg Paterson

So it'll be... is it part of that £300 million that you said coming in April?

Jonathan Yates

No it's not, no it's not actually come out yet. The £300 million related more to the release of the cash which was surplus which was sitting in the life companies at the end of 2010 that we disclosed.

Grieg Paterson

So it's to do with the target, the £300 million target?

Jonathan Yates

Yes it will be yes. The £130 odd will be part of our £300 million target.

Grieg Paterson

All right, perfect.

Jonathan Yates

A very good part of it.

Grieg Paterson

That wasn't the question I was going to ask. That was a just clarity. I was just wondering in the second quarter considering the £708 million of free surplus you had at the end of the year can we expect some more releases in the second quarter over and above the £300? That was my first question.

My second question is I wonder if you can just reconcile the drop in the IGD from £1.1 billion post the PALAL transfer down to the £1 billion what was the market movements etc?

And then the third one is the £300 million transfer how much of that is tax recovery, I'm trying to get an idea of... and is it sustainable? Is it boosted by the tax recoveries from the current holding companies cashflow? Or do you have a tax loss that you are also using to boost the cashflow? I'm just trying to understand the tax probable impact on the transfers and how sustainable it is.

Jonathan Yates

Okay. Right, taking those in order then. In terms of further releases in Q2 I don't expect anything beyond the £300 million that we've just disclosed. And the reason for that being that the life companies based the dividend payments on the actual year-end valuation. Sorry, let me clarify that. I don't expect anything more from Phoenix Life relating to Q2 because that's the £300 million dividend. And there won't be anything until the valuation's completed at the end of the first half. But in respect of Pearl Assurance we're still completing the transfer out of that. Pearl Assurance due to its dividend or surplus position won't make a dividend, but what it will do is pay a loan up note and I would estimate that would be somewhere in the region of £200 to £300 million going forward.

Grieg Paterson

So when we have the same discussion at the end of the second quarter you'll say we've got £300... we've £500 to £600 million dividended up.

Jonathan Yates

I would expect so, yes.

Grieg Paterson

So the divi includes loan repayments divvied up from the...?

Jonathan Yates

Say it again, sorry?

Grieg Paterson

Your definition of dividends paid from the life company includes loan repayments?

Jonathan Yates

Well not loan repayments. This is a loan up because we can't take a dividend or no distributable reserves.

Grieg Paterson

Oh no sure I've got no issues I'm just wondering does it include the loan payment?

Jonathan Yates

It will include it, yes, because it'll be cash which has effectively come up and is free for us to use.

Grieg Paterson

And then the IGD recon from the £1.1bn

Jonathan Yates

Yes so in terms of the IGD position. The IGD position went down for a number of reasons. Market movements are a part of that, but as I was saying earlier every time we make payments to the banks, or to the pension scheme, that's effectively a pound for pound reduction in the IGD surplus. And IGD's only calculated half yearly. We then do a sort of... we effectively monitor it weekly and we're trying to true it up but as things stand we haven't yet had the surplus emerge that would have been able to recognise which would cause that to go up. We also had some year-end true ups which caused it to go down very slightly as well.

Grieg Paterson

So it doesn't include operational cashflow?

Jonathan Yates

Not as it stands today, no.

Grieg Paterson

Alright. Cool. And just the tax situation how much is coming through?

Jonathan Yates

Yes. The surplus emerging from the life companies obviously benefits from group relief because, as I said earlier on, and I'm sure you're aware we have a fairly sort of advantageous tax position in terms of the way in which we are able to use the interest on the debt that we have to shield the actual taxable profit which emerges within the life companies. I can't give you an exact number for how much of the £300 million that came up was probably attributable to group relief, but that's something we can actually look to give you. We do actually give you something which is probably a reasonably close proxy to it which is when we show the tax in our year-end and half year results in the IFRS profit statement.

Grieg Paterson

Alright. So do you have a tax loss? So you're obviously accruing a tax benefit each year from the coupon but do you have an accrued tax loss already and how big would that be?

Jonathan Yates

No we have a very sign--... a very significant part of our embedded value relates to the value of tax losses.

Grieg Paterson

Do you know what the face value of that tax loss is?

Jonathan Yates

Something in the region of in excess of £600 million.

Grieg Paterson

£600 million. And isn't there a risk that because you've got the debt in a Jersey based company that the tax authorities are going to, say wait a second, that's not deductible?

Jonathan Yates

No. All our debt is in the UK.

Grieg Paterson

Alright. So then why is it not included in the IGD surplus? Why is IGD surplusnot net of it then?

Jonathan Yates

Because it sits outside the IGD perimeter because of the way in which the Group is structured. The debt is effectively borrowed outside of PLHL which is our ultimate UK or EU holding company.

Grieg Paterson

Alright. So there's no risk on the tax, that's the point of the question I was asking?

Jonathan Yates

No this has been all round the houses over several years. From a tax risk perspective we're very comfortable with it.

Grieg Paterson

Excellent, thank you.

Clive Bannister

Grieg, thank you.

<u>Question 3</u>

James Pearce - UBS

Morning everybody. I'm afraid I missed the start of the call so I apologise if this was already covered at the beginning. But could you comment on any progress you may or may not have made with the banks? And also could you talk about the Hexam outflow which I have pencilled in for Q1 is that still going to happen in Q2?

Clive Bannister

James, thank you very much indeed. As we said at the full year announcements we continue to have good discussions with our banks looking at a range of options. As you know full well it's not the quantum of the debt it's some of the more onerous restrictions dividend and some of the operating implications for us by way of covenants that we're seeking to resolve. These discussions are ongoing. As I think I said at the full year when we have something clear and definite to say to the market that is precisely what we'll do. And so that is the situation where we find ourselves at the moment.

James Pearce

Okay.

Clive Bannister

Hexham, can you give me one second on that? Do you have a follow up question because there is a note on Hexam.

James Pearce

No I'll just have to wait.

Clive Bannister

Fine I'm going to come back to you in one second. I think the answer is yes.

Lorraine Rees - Head of Investor Relations

It is yes.

Clive Bannister

Okay, thank you, Lorraine.

James Pearce

Thanks very much.

Question 4

Oliver Steele - Deutsche Bank

Morning everyone. Just two questions. Clive, in your introductory remarks I thought you said, when talking about the management actions, upwards of £300 million. And I'm just wondering if that was a slip of the tongue or whether it's an improvement on the previous wording which just talked about £300 million?

Clive Bannister

Let's stick with £300 million okay? Sighs of relief. I put that in but I think we are working on a whole range, as Jonathan as just said, of management actions etc and we'll stick with the £300 million and we are still working within the range of cashflow forecast this year of £750 to £850 million and that's the good news because we feel confident about confirming to the market today that we're on target for that for a full year.

Further question

Oliver Steele

Okay. And then the second question which I guess sort of links into what you've just said is, can you just talk a bit more about the timing of cashflows over the rest of the year because I was assuming that you'd have your £300 million odd that you've just announced and then we'd be waiting until pretty much the fourth quarter for any other news on the rest of the money. But Jonathan seemed to be implying that you'd be getting £200 to £300 million in the first half in response to Grieg's questions?

Jonathan Yates

Yes that's right. We took £300 million out of the Impala silo by way of a dividend, and we'll be looking to take out another, as I said, £200 to £300 million out of the Pearl silo by way of a loan in the remaining part of this year. All of those relate to the year-end valuation, sorry in this quarter I should have said. Those relate to the year-end valuation at end 2010. When we've completed the valuation at the mid year, we'll take out the remaining part of the cashflow that we expect. But exactly when that will come out it's just not possible to say at the moment. It may well be in the third quarter, end of the third quarter. It may have to be sometime during the fourth quarter. But we're reasonably confident that it's going to come out by the end of the year, we've no reason to suppose that it won't.

Oliver Steele

Again so does that £200 to £300 million from Pearl include management actions?

Jonathan Yates

No it doesn't, no.

Oliver Steele

Because I'm sort of coming out with potentially a much larger figure than £750 to £850 because if you've got over £300 million, just announced that you've got £300 million of management actions, you've got £200 to £300 million from Pearl and then presumably you've got any transfers that develop from the half year accounts. It seems to add up to quite a lot more than your maximum?

Jonathan Yates

I'm not sure the numbers do but I think we're getting towards that target. You've got to bear in mind that what comes out at the half year stage is only going to be a half year's worth of surplus, and our regular run of surplus is of the order of a couple of hundred million pounds at best. So on top of the management actions then it should be of that order that we have projected. We are very confident at our ability to be able to hit our targets, having said that.

Oliver Steele

Okay. Thank you.

Clive Bannister

Oliver, thank you.

<u>Question 5</u>

Grieg Paterson - KBW

Yes just two points of clarity; one is when you said your regular run rate is a couple of hundred million I assume that's from the Impala silo and I assume is that per half year or for the full year?

Jonathan Yates

No a couple of hundred million would be our... what we would expect to come out of... We would expect something in the region of £400 to £500 million to come out across the entire business, so not just the Impala silo, both Pearl and Impala.

Grieg Paterson

Alright so it refers to that number you always talk about £400 to £500 million. Alright, cool.

Jonathan Yates

Exactly.

Further question

Grieg Paterson

And the second thing is just on the restructuring of the debt within the life companies, you said it was £139 million EV uplift. Does that mean you've already achieved the target for the year of £100 million?

Jonathan Yates

No, sorry, this was the portfolio of corporate loans. It's a bit like corporate

Grieg Paterson

Oh that was the last year ones, I apologise.

Jonathan Yates

Yes exactly. Yes.

Grieg Paterson

Alright.

Jonathan Yates

So the cashflow will come out this year but the embedded value came out last year.

Further question

Grieg Paterson

And the 50% debt to EV target what does that actually mean in terms of how much debt you will repay?

Jonathan Yates

Well it means a number of things. It means the amount of gearing will come down as a consequence of the embedded value sort of going up with management actions then obviously also the debt coming down. I haven't got the...

Grieg Paterson

You targeted I mean I've got 400 and something in 430 odd for the year is that too high or too low?

Jonathan Yates

Let me come back to you. We're only planning on paying down £150 million this year. The fact that the cash emerges means that we would effectively treat that as an offset to the debt. So what we look at is net debt, in other words, debt at the holding company level less the cash that we hold which is available to pay down that debt at the holding company level. Whether we're able to or choose to pay down that debt using that cash is another matter. But you shouldn't assume that we'll pay down as things stand today anymore than £150 million that we're mandated to pay.

Grieg Paterson

Alright, perfect. Thank you.

Jonathan Yates

Thanks Grieg.

Clive Bannister

We're going to wrap up now. Thank you for everybody paying attention and calling this morning, we really appreciate that. I'd summarise by saying this has been a good first quarter. It's good because it sets us up to achieve the full year targets that we set ourselves. That's a powerful cashflow target of between £750 and £850 million. We will achieve the uplift in our MCEV of £100 million, we set ourselves a target. Gearing, as Jonathan has just commented, we look to taking that down below the 50%. We ended last year at 52%. And we look forward to a continued contribution by IGNIS as forecast.

So thank you very much indeed. Lorraine, thank you for organising it. Claire, thank you for making the arrangements work. Thank you very much.