Phoenix Group plc Q1 IMS 2012

Friday 4th May 2012

Clive Bannister, Group Chief Executive

Thank you very much indeed. Good morning everybody and thank you for attending today's call. My name is Clive Bannister, and I welcome you to our Q1 Interim Management Statement call. I'm the Group Chief Executive of the Phoenix Group. I'm joined here today by Paul Miles, our Acting Group Finance Director, and Katherine Jones, Head of Investor Relations. Paul and I will be very happy to answer your questions in a few minutes; but first I would like to take you through the highlights of our first quarter statement which we released this morning.

I am pleased to report that the Group has generated £100 million of cash from the operating companies since 1st January 2012, and we remain on track to meet all of the financial targets we set for 2012 in terms of cash generation, MCEV uplift and organic deleveraging.

First can I talk about cash generation? Cash generated by the operating companies is the key metric which we use to judge our performance, and one which we think is the most useful in helping investors understand the long-term value and predictability of our business. Since 1st January 2012 we have distributed £100 million of cash from the operating businesses to the holding companies; the vast majority of this was generated by Phoenix Life. The £100 million of cash generated includes £25 million of cash which we have been able to accelerate by undertaking management actions such as the funds merger NPI and Phoenix Life Limited. We are targeting cash generation of between £500 and £600 million in 2012 and we announced at the time of our 2011 results that we expected this to be weighted towards the second half of the year. I am pleased with the progress made against this target to date, and I am confident that we are on track to meet the target for the full year.

Second, can I talk about MCEV uplift? We have a strong pipeline of projects which we expect to deliver our average annual target of £100 million incremental embedded value enhancements in 2012.

And the last of our targets is degearing. Degearing remains a priority and we continue to focus on re-terming our bank debt and reducing our gearing ratio to 43% or below during 2012.

Now, may I turn to Group solvency? Our IGD surplus of £1.3 billion on 31st March 2012 remained stable in the first quarter. Our IGD headroom, which is the excess over the IGD capital policy, increased by £100 million from £0.4 billion at the end of the year to £0.5 billion by March 2012. This increase is mainly due to the completion of the NPI and PLL fund merger which was granted court approval in March.

And finally let's talk about Ignis, our fund manager. Ignis generated net new business from third parties of £388 million in the three months to 31st March 2012. Of this approximately two-thirds was from liquidity fund inflows and the remainder was mainly in property funds and the Absolute Return Government Bond Fund. During April there was an additional approximate £400 million of net third party inflows into liquidity funds. Overall Group assets under management were £71.6 billion as of March, a decrease of about £500 million, approximately or less than 1% since year end, as the natural run off of our closed life funds was partly offset by net new third party inflows.

To conclude: We continue to demonstrate real operating strength, and have delivered another solid set of results in the first quarter. I remain confident on our ability to meet all of our financial targets for 2012 and continue to focus on re-terming our bank debt on a basis which is sensible for all of our stakeholders.

At this point I'd like to finish. And if we may, operator, can we move on to the question and answer session, where Paul and I stand by to answer all of your questions. Thank you very much for listening.

Question and Answer session

Question 1

Jon Hocking - Morgan Stanley

Morning everyone. I've got two topics to discuss please. First of all, if you could possibly remind us of the timing of the cashflows from the underlying regulatory entities during the year?

And then the second topic is the IGD headroom can you give us some idea of what the scope is to increase that headroom further either through more management action or the natural run-off of the book, what is the underlying improvement of that headroom in a 12 month period assuming no management action?

And then finally on that topic given that the FSA seems to be quite risk adverse for the moment what is your real ability to dividend out capital to the extent of the headroom that you've got? Thank you.

Answer: Clive Bannister

Well the dividend point is quite simply dealt with, we operate under a covenant which caps that at £72 million, so that is a statement of where we are today.

Jon Hocking

Sorry, Clive, I wasn't clear, I meant how much of the cash from the underlying regulated companies could you take the full extent of the headroom up to the top company or would the FSA in effect not being happy with that?

Answer: Clive Bannister

This is a decision taken by the life companies in relationship to how they see their own capital positions. I'm going to let Paul answer that in greater detail but you asked two other questions; the timing of the cashflows and then the IGD headroom what quantity is there for

further management actions and the timing. Paul, will you take those and then just address where we are with the relationship with our Life companies and what they dividend up?

Answer: Paul Miles

Jon, in terms of the dividend from the Life company the free surplus is essentially the free surplus over what are already strong capital policies within the Life companies. So it is within the gift of the life company boards to be able to pay out that surplus over and above the capital policies. And those capital policies are agreed with the FSA so we can take that money out in excess of the capital policies.

And that sort of flows on to the timing of the cashflows. At the year-end we had free surplus of around £93 million. You'll have seen as of today we have taken out around £100 million so that will impact on the free surplus. We will have generated more free surplus during the period and we still have in excess of £100 million of free surplus at present. And as we said at the year-end the cashflow will be weighted towards the second half of the year as we undertake those management actions that allow us to generate additional free surplus and we'll release that later on in the second half of the year. So we're pretty much where we expected to be.

And then in terms of IGD, clearly you'll have seen from the announcement we've improved our position from a headroom of £400 million to £500 million. The majority of that came through one particular management action which was fund merger of NPI into PLL that enabled us to release around eighty odd million pounds worth of IGD headroom benefit. Clearly there are more management actions that we will be able to undertake during the rest of the year that will improve that. But generally you'd expect IGD headroom surplus to be generated every year on an underlying basis of around a couple of hundred million pounds.

Clive Bannister

The dividend point often Life companies, well you've described...

Paul Miles

I think we articulated that right at the start.

<u>Question 2</u>

Kevin Ryan - Investec

Morning. I just wanted to clarify that the cash from the NPI deal has been taken in this period and there isn't any more to come? Is that right or will there be some more to come as it's sort of beds down, as it were?

Answer: Paul Miles

The management actions that we've disclosed here around £25 million include the cash from the NPI deal. What you see is that cash essentially goes into our free surplus and then that along with other management actions and as the surplus gets generated naturally that is what enables us to then take the cash out of the Life companies. But once it's generated it then sort of goes into...becomes more fungible in terms of going into the free surplus, and goes in with the other free surplus so it's not as if we specifically take out that cash. But we're not expecting any more cash generation as a result of the NPI transaction.

Question 3

James Pearce - UBS

Morning everybody. A couple of things; can you just clarify how many legal entities there are left on the two sides, I think you said there's just one on the Impala side, is that correct? And then how many are left on the Pearl side? And how quickly will they come down to one on each side and can we expect similar releases when you do crunch together each of the remaining Pearl businesses?

Second, could you expand a little bit on the bank discussions? These seem to be going on for an awfully long time. What are the issues, why is it taking so long, particularly given that the market for banks seems to have improved a little bit judging by the numbers they're putting out and reduced reliance on the government and that kind of thing?

And also can you just say where you stand on Solvency II given recent developments in Brussels? Thank you.

Answer: Clive Bannister

Right can I hand over the first and the third, so the first question about how many companies left and also where we stand with Solvency II and then I'm very happy to tackle your question about the bank.

Answer: Paul Miles

James, in terms of the number of entities left obviously we've got the two silos. On the Impala silo, we're essentially now down to one UK Life company, PLL. We also have SMI which is the small Irish Life company. And then on the Pearl side we have three main life companies; we've got Pearl, London Life and NPLL. NPLL is already a subsidiary of Pearl so much of the benefit from combining those has already been achieved. So the main thing we've got left which we're already starting the process for is the Part VII process for combining London Life and Pearl. And we would be hoping to do something later on this year with that process. But obviously it's dependent on the court process that we've got to undertake, the independent expert and getting the FSA comfortable as well.

Further question

And just in terms of us trying to size that is that similar in terms of size to NPI plus Phoenix?

Answer: Paul Miles

We would hope so yes. And then Solvency II obviously a lot still up in the air so I'm not sure we're really any the wiser at the moment than we were when we spoke to you a month ago. So there's still so much uncertainty out there so it's still difficult for us to comment on it at this point.

Answer: Clive Bannister

Paul, thank you. So, James, your other question was on the bank re-terming as we would call it and our discussions and your question was why so long? Well first of all I think I said on the 23rd March that we are clearly stronger as a company and the IGD, increase in IGD makes us stronger yet again to contemplate a re-terming. And the market is, as you said, in

a better position from a banking perspective although that does go up and down depending on broader macro events. There is inherent complexity to what we're doing the two silos which you're well aware of and the multiple banks we have are on both sides. I have to say the conversations we have with our banks remain extremely cordial and what we are seeking to do is something which is sensible and good for all of our stakeholders, so it's not one single winner and some losers, we're trying to do something which is sensible for all our stakeholders. And in landing that we are very aware of the good value debt that we have in our capital structure and the nature of the covenants that we are seeking to re-negotiate in those discussions.

So when we spoke for our full year results in March, I did say that this was the number one priority for management right now and going forward, but I was not going to commit myself to a timeframe because it's not something that we, the Company, can unilaterally deliver, it is something that will be borne out of sensible discussions between banks that have been long-term supporters of this Group. So that might not be an entirely satisfactory answer but it's a wholly accurate one that these are discussions that we are pursuing and doing so actively.

Question 4

Ashik Musaddi - JP Morgan

Thank you. Two questions. First on your cashflow target of 500 to 600 can you give us some sense of how much market improvement are you expecting on that? Or is it just pure operational i.e. it's totally underlying? That's the first question.

Second question you mentioned that your IGD headroom increases every year is ballpark range of couple of hundred million. Now is that gross of dividend and debt free payment, or is it excluding after the payment of that? These are the two questions. Thanks.

Answer: Paul Miles

Ashik, in terms of the cashflow target that we gave, the 500 to 600 we don't assume any market improvement within that. That is essentially the underlying surplus that we would expect to deliver of around £400 million. And then £100 to £200 million of additional management actions that we would expect to do this year. So there's no assumption around market improvement within that.

In terms of the IGD, the IGD is gross so any surplus that gets generated, as I mentioned earlier, of a couple of hundred million, you would then deduct dividends and interest payments and the like out of that, and add on any additional management actions that we will do over the second half of the year.

Question 5

Tony Langley - Barclays

Good morning everybody. I have a question about debt prepayment. Last year you paid down £21 million, you haven't done any this quarter I was just wondering if you could comment around that and what kind of appetite you have to pay down additional voluntary prepayments or whether the negotiation with the bank might preclude that?

And then secondly if you could give us an update on progress towards replacing members of the management team that have either already left or who have announced their departure before too long?

Answer: Clive Bannister

So please deal with the voluntary payments or the prepayments made last year.

Answer: Paul Miles

So, Toby, the voluntary payments that we made last year essentially within the facility agreement on the Impala silo we paid matching payments. So where we paid dividends out to the Impala silo up to PGH we then make a matching payment to the banks. And we describe that as voluntary because obviously paying the dividend that is a voluntary action. It's a function of how the facility agreements work. So, we have made a small matching payment already in the first half of this year in April of around £14, £15 million.

Answer: Clive Bannister

And as to your question about people, I assume you're referring to our Chairman.

Further Question

And you haven't announced an official CFO appointment yet, have you?

Answer: Clive Bannister

Okay let me take both of those. So, with the announcement of Ron, Ron said that it was his intention to step down sometime during 2012 and so I don't think that is imminent – 2012 has a long way to run. There is a nominations process and a review process which is being undertaken by Alastair Lyons who is our SID. That process is underway, and when it reaches its conclusion the market will be notified. But I should reiterate what Ron said; he had to tell the board, and therefore we had to tell the market, about his conclusion in March about what he wanted with his life – and this is happening sometime over 2012.

In a similar way we have a nominations review process being undertaken by the board before announcing formally our CFO conclusion. And that process is still ongoing and when it is completed we will update the market.

<u>Question 6</u>

Andy Hughes – Exane BNP Paribas

Just a quick question on the fund merger documentation, because when I read the documentation for the fund merger of NPLL it seemed as if there was a big change in the solvency of NPLL during the end of the year; it looks like it was some sort of modelling change. Effectively the independent actuary has done his projections based on the mid-year estimates, which I guess you supplied to him, of 189% coverage of solvency margin and NPLL came out the end of the year 149%, which is obviously below the capital guidance for the FSA. I'm just wondering what caused the 40% swing in the solvency margin. And has that had any implications both in an acceptable level of solvency buffer that you have with the FSA, or indeed the view of the creditors to the resilience or de-risking within the business?

Answer: Paul Miles

We talked about this briefly at year-end. When we go through the year end valuation process obviously we have a lot of funds, and when you go through the valuation process and truing up those funds compared to the MI to the actual final valuation you get some positives and you get some negatives. On this occasion NPLL was a negative true up. As we were going through a Part VII process we flagged that with the independent expert, who then included it within his report. Overall the impact, as you can see, for the year, it was included within the year end position, so we effectively reflected it in the numbers that we disclosed for the year end. So, there was clearly no impact on that overall. And you would expect there to be positives and negatives which is what it turned out to be year-end.

Further Question

When you say MI, what do you actually mean? Do you mean lower lapses or what's actually going on? I'm just wondering because to me it seems like a big percentage, 40% solvency margin change, when you've only got 149% cover at the end of the year. What in the MI was particularly strange or unusual? Thank you.

Answer: Paul Miles

Well, there are lots of things in the MI that we talk about. We're not going to go into specifics on those things. But in any process there are a lot of moving parts, and the way we monitor it is through the MI process. And as you go through it - and clearly the back end of last year was extremely volatile - you learn lessons in terms of how your funds react during those volatile periods which we then take through into our MI going forward and bake them in such that we don't have that volatility moving forward, or we can track it much better. But it wasn't outside the range of what we were expecting.

Further Question

Give me a sense of Q4, is it something to do with sovereign spreads or interest rates?

Answer: Paul Miles

Absolutely it would have been to do with credit spreads widening, yields falling.

Concluding comments: Clive Bannister

If there are no further questions then I thank everybody for taking part today, I appreciate the time and interest shown towards the Phoenix Group. As I said, these numbers are consistent against the targets we set ourselves in 2012, and yet again mark progress and direction of travel along the journey that we've taken to strengthen this fund. So listen thank you very much indeed.