Phoenix Group Holdings: 2017 Half Year Results

Thursday 24 August 2017

Clive Bannister, Group Chief Executive

Welcome to Phoenix's 2017 interim results presentation, and thank you to JPMC for providing a more intimate and warmer environment in which to have our meeting. As usual I'm joined this morning on the podium today by Jim McConville, our CFO, and Andy Moss, the Chief Executive of Phoenix Life.

We have had a successful first half of the year, delivering £360m of cash generation. Our Solvency II surplus is up £600m, at £1.7bn at the Phoenix Group Holdings level. This is a robust and resilient capital position, with the shareholder capital coverage ratio at 166%. And as we indicated at the full year results in March we have increased the dividend by a further 5% to 25.1 pence per share, and this amounts to an annualised level of 50.2 pence per share, a stable and sustainable level.

We are ahead of our plans on delivering the expected capital and cost synergies from our 2016 acquisitions, we've also progressed our UK onshoring plans with the issuance of over £800m of subordinated debt in 2017. This has allowed us to fully repay our bank revolving credit facility, providing additional capacity to fund future transactions. Our financial strength has been further recognised by Fitch Ratings who last month upgraded the Group's Life company ratings to A+.

Finally, we look ahead to new growth opportunities with confidence. As we discussed at our investor day in June our key focus remains on further closed fund acquisitions, but we also see an opportunity for incremental growth by selectively targeting transactions in the annuity space.

I summarise on this slide the key metrics that we are tracking with regards to the integration of last year's acquisitions. We've made strong progress in delivering £282m of cash from AXA, and we expect cost synergies in the range of £13m to £15m per annum. Abbey Life is also progressing well, and we expect the completion of the integration by the end of the first half of next year.

A key part of the integration process is to move the acquired businesses to our target operating model, consolidating the finance and actuarial systems, and basing the core life company functions at our offices in Wythall. Much of this work will have been completed during the second half of 2017; the end is in sight.

Finally, the £175m indemnity agreed with Deutsche Bank provides protection against outcomes from the ongoing regulatory investigations into Abbey Life. These continue, but the current assessment of the settlement and the restitution costs are within our original expectations.

In March we updated our long-term cash generation target between 2016 and 2020 to a new level of £2.8bn, of which £1bn to £1.2bn was targeted over 2017 and 2018. We are on track to meet these targets, supported by the integration and management actions delivered in the first half of 2017. Beyond 2020 we anticipate a further £4.5bn of cash generation, demonstrating the Group's long term cashflow profile remains a key strength.

I will now pass you across to Jim who will take you through the financials in greater detail. Jim.

Jim McConville, Group Finance Director

Thank you, Clive, and good morning everyone. As Clive said, we have had a successful first half of the year and have delivered a good set of results. I'll take you through each of the key metrics in more detail shortly, but let me set out in summary the key results.

Strong cash generation of £360m with holding company cash as at June of £691m. A Solvency II surplus of £1.7bn and a shareholder capital coverage ratio of 166%; these are now calculated at the level of Phoenix Group Holdings, consistent with our plans to bring the Group back onshore. Operating profit of £215m, and an interim dividend of 25.1 pence per share, an increase of 5% on the 2016 final dividend.

The cash generation in the first half was £360m, this includes £165m from AXA, £74m from Abbey Life and £121m from the other operating companies. The AXA cash release resulted from the inclusion of the AXA business onto our Internal Model, and to date we have extracted £282m of cash from the AXA business since acquisition.

We have restructured the Abbey Life pension scheme so that responsibility for the scheme and future contributions has been transferred out of the regulated life company. This has resulted in a cash release of £74m from Abbey Life in the first half. I will come back to the impact from future contributions to the Abbey Life scheme shortly.

With regards to the uses of cash, the Pearl pension contributions are now paid on a monthly basis, rather than an annual payment each September as before. This has increased the contributions in the first half of the year by £30m, which incorporates the charges for the fourth quarter of 2016 and the first two quarters of 2017. The overall quantum of contributions remains unchanged. Non-recurring costs include the impact of project and integration costs relating to the AXA and Abbey Life transactions.

Debt interest was higher in the period due to the accelerated settlement of accrued interest on the senior bonds redeemed as part of the tender exercise which was undertaken alongside the tap of the Tier 3 bond in May. The two separate Tier 3 bond issues in the first half raised net proceeds of £446m, these proceeds from these issues, as well as funds from our existing resources, were used to repay £178m of our senior bonds, together with £300m of our senior bank debt.

The recent Tier 2 bond issue that completed in July is not included in the analysis in this slide, and will come through in the year-end numbers. The proceeds from that issue were also used to repay senior bank debt and the remainder of the Group's revolving credit facility was fully repaid in August. This now leaves the £900m facility completely undrawn.

We have continued to make good progress with our debt strategy. 2017 has seen a number of actions taken with regard to the Group's debt structure. To date we have issued £450m of Tier 3 bonds, together with US$500m of Tier 2 bonds. These issues attracted strong demand from a range of investors in the UK, Europe and Asia. The proceeds from these

debt raisings have been used to repay senior debt. Between 2011 and August ’17 the Group halved the level of outstanding debt. We have extended the maturity of our debt by two and a half years, and by the use of hybrid capital improved the regulatory capital position at the level of Phoenix Group Holdings with an increase in an average cost of only 1.6% per annum.

We were put on a positive outlook by Fitch Ratings at the time of our AXA acquisition and this was reaffirmed on the announcement of the Abbey Life transaction. Following its annual review Fitch Ratings has upgraded the Group with Phoenix’s main life companies having a rating of A+. As a result of the upgrade the interest margin on the revolving credit facility has been reduced by 25 basis points. This is a more appropriate funding structure for the Group and the maturity profile better matches the underlying cash generation of the business.

The work to bring Phoenix Group Holdings onshore has progressed over the past six months. As we discussed in March we aim to create a UK plc topco which will replace Phoenix Group Holdings as the ultimate holding company in the Group. We are therefore now reporting the Solvency II capital position at the level of Phoenix Group Holdings from these interim results, and are currently targeting to put the new UK plc topco in place during the middle of next year. This will allow us to simplify both our Group structure and our board governance processes, as well as provide further clarity for our investors and other stakeholders.

Specific actions for the second half of the year include moving the head office from Jersey to the UK, this will help accelerate some of the internal governance simplification benefits.

So moving on to the PGH Solvency II position. As at the start of 2017 the surplus at PGH was £1.1bn, which included the pro forma impacts of the £300m Tier 3 issue in January and the incorporation of the AXA business into the Group’s Internal Model. Due to further subordinated debt issuance in May and July the surplus at the half year increased to £1.7bn on a pro forma basis. The shareholder capital coverage ratio is 166%, a 27% increase over that period.

As we have discussed previously there are an additional £0.4bn of unrecognised surpluses relating to the Group’s strong With Profit funds and the PGL pension scheme. These surpluses are not included in the overall Solvency II surplus, but do provide the Group with additional resilience in a stress scenario. Abbey Life’s contribution to the Group’s Solvency surplus continues to be calculated on a Standard Formula basis, we are aiming to make an application in the second half of this year to bring the Abbey Life business onto the Group’s Internal Model.

This slide sets out how the surplus has changed over the first half of the year. There have been positive impacts from the subordinated bond issues, the run-off of the book, and the management actions taken in the first six months of the year. Andy will talk about these management actions in more detail shortly.

Economic impacts were neutral over the period, but there were negative impacts from the senior bond tender and the workplace pensions management fee cap. The surplus also includes an allowance for the interim dividend payable in October.

The Group’s Solvency II position remains robust and resilient due to the additional surpluses within the strong With Profit funds and PGL pension scheme and the hedging actions that we undertake, which are designed to protect the Group’s Solvency position and therefore also the future cash generation. The Group’s most material risk driver is longevity related to

our annuity portfolio. The single stress shown in this slide does not assume any offsetting diversification from our mortality book which is shown separately.

It is important to note that there are broadly similar impacts on our expected future cash flows and any detrimental impact on our life company Solvency II position directly impacts the free surplus that is available to distribute up to the holding companies as cash.

Finishing with IFRS the Group's operating profit was £215m for the half year. These results include the contribution from the acquisitions made in the fourth quarter of 2016. The first half operating result also includes a net benefit of £68m from changes to assumptions.

There were positive impacts relating to reduced life company expenses together with changes to our mortality and longevity base and improvement assumptions. Following the recently updated CMI mortality tables the Group has now incorporated CMI 16 into its reserving assumptions.

These benefits were partly offset by a negative impact from the low interest environment by an expectation of persistency for products with variable guarantees, which has particularly impacted the Group's supported With Profit funds. We have shown the operating profit for each main product line in the appendix.

Investment return variances were negative overall with the key impacts being from the equity put option that the Group holds to protect its Solvency II capital position as well as falls in the value of swaptions that the Group holds to protect the solvency position against lower interest rates.

Other non-operating items were also negative in the first half and include a £25m impact from the tender for the senior bond and a £28m impact of the management fee cap relating to workplace pensions which we mentioned at the time of our investor day in June.

We have set out here an updated version of what is now a familiar slide to you all showing the illustrative sources and uses of cash over the period to end of 2020.

We begin with our cash at the holding company level of £691m, the green bar to the right of this of £2bn represents the remaining cash generation expected to emerge over the period to meet our long-term target of £2.8bn. And continuing to the right we show the various uses of that cash.

As previously mentioned we have restructured the Abbey Life pension scheme and transferred it out of the life company. We have therefore incorporated the additional impact of the anticipated contributions to that scheme, which amount to £58m over the period, into the uses of cash.

We have also included the revised interest costs following the bond issuance in the first half of this year. We have reflected the repayment of £166m of the bank's revolving credit facility that we made earlier this month. There are no other debt repayments due over the period. There is also £0.7bn to fund an illustrative stable level of dividends taking into account the increased dividend level.

So after these uses of cash we are left with an illustrative £1.2bn of cash at the holding companies as at 2020, which is £0.2bn higher than we discussed at the full year results in March.

This build-up of cash balances over the coming years together with our current Solvency II surplus demonstrates the potential for the Group to deploy more of its own resources for future acquisitions supplemented by the Group's undrawn RCF. To give some order of magnitude we currently believe around £500m of our own resources could be utilised towards potential acquisitions.

Turning to the position beyond 2020 we start with the £1.2bn from the previous slide and then include the future £4.5bn of cash emerging over the longer term, slightly up on the £4.4bn we showed at the time of the full year results. It is important to remember that the amounts shown here after 2020 do not include any benefit from management actions. As we have always stated the key strength of the Group is to continuously find ways to add value to stakeholders and this will continue well into the future.

That brings me to the end of the financial section and I will now pass you to Andy to discuss developments within the life companies.

Andy Moss, Chief Executive, Phoenix Life

Thank you, Jim, and good morning everyone. 2017 has been a busy year with a number of management actions achieved alongside the work undertaken on the integration of the two acquisitions.

This has continued into the second half with a further portfolio of equity release mortgages acquired in July which takes our total portfolio to approximately £1.1bn.

Integration of AXA and Abbey Life into the Phoenix Way has seen strong progress and is well on track to complete in the first half of 2018.

From a customer perspective we continue to make improvements to service in line with our strategy, in particular around information delivered through our website.

In addition we seek to ensure customers get the best possible outcomes including changes made to workplace pension charges.

Management actions broadly fall into two categories under Solvency II, those that increase Solvency II Own Funds and hence increase the total quantum of cash flows emerging from the business; and those that reduce capital requirements and hence allow an acceleration of cash that would otherwise have been expected to emerge over time.

Management actions added a total of £317m to our Solvency II surplus in the first half. Those management actions that have increased Own Funds by £138m include the benefit from investing in illiquid assets and lower expenses for the life companies which have been possible due to the economies of scale from the enlarged business.

The remaining £179m is from cash acceleration actions such as the AXA Internal Model and the hedging actions undertaken.

Moving on to the AXA integration, progress is ahead of plan. The Phoenix Way governance and risk management oversight has been put in place; the transitional service agreements are operating to support business as usual processes and these will be terminated in full as we move toward the target operating model.

I talked in more detail at the investor day about the work we are undertaking with regard to policy administration and how we are leveraging our previous experience in migrating policies to Diligenta. We've also made progress on integrating the financial and actuarial reporting processes.

An important milestone was achieved in March when the AXA business was incorporated within the Group's Solvency II Internal Model allowing us to deliver further capital synergies from the diversification of AXA's mortality risk with the Group's existing longevity risk.

Finally, we have rebranded the business as Phoenix Wealth Assurance and will over the next few months move the retained functions to our main office in Wythall. This will involve creating around 20 additional roles in Wythall to ensure the necessary activity for both the AXA and Abbey Life businesses is resourced. We will materially complete the migration work by the year end.

Moving on to the Abbey Life transaction. The operating model of Abbey Life was already closely aligned to Phoenix's target operating model and this has made the operational integration less complex than for AXA. In the first half of the year the key focus was to put in place governance and management quickly ensuring that the oversight of the business and its outsourced arrangements were enhanced. The existing outsource relationship with Capita has been retained and ways to improve the policy administration service have been identified. We have now also exited all of the transitional service agreements that we had with Deutsche.

Now that the AXA Internal Model application has been approved we are focusing on the Abbey Life application. This is expected to be submitted in the fourth quarter of the year. Once the Internal Model has been granted, most likely during 2018, we'll then look to undertake a Part VII transfer of Abbey Life into Phoenix Life Limited.

Finally Abbey Life had far fewer employees than AXA with 45 people based in Bournemouth. The activities undertaken within the Bournemouth office will also be moved to Wythall as part of the 20 new roles that I referred to earlier. Therefore, although the AXA business started with a very different model to Abbey the end state of the integration will look very similar.

Phoenix has been active in progressing the work required in response to the Abbey Life annuities review and legacy enforcement action. The cost assessments remain within expectation and the Group has made a provision of £34m in respect of the annuity review with a related indemnity asset of £28m.

We continue to actively review customer outcomes and aim to ensure that we are proactive in dealing with potential issues. One example of this is a reduction in fee levels for our workplace pensions customers which we have capped to protect against negative outcomes for certain of those policyholders. This has had a one-off IFRS impact of £28m.

Finally, we continue to work through the PA(GI) creditor insurance issue that I discussed in March. The provision has been maintained at £33m, following payments out of £8m, and we have outsourced the claims handling to an industry specialist. The deadline for claims has been set by the FCA at August 2019.

Delivery of strong service both to existing customers and those of the acquired businesses continues to receive significant focus. Improving customer engagement with our products remains key to us, hence our investment in our digital programme and, along with Abbey Life, being the first closed life and pension provider to join the working group for the government's pensions dashboard project.

The new digital service has already seen an increasing level of take-up by customers helping us to manage our conduct risk and our costs. We have also initiated schemes to improve customer outcomes including ensuring that non-GAR annuity customers shop around for their annuity, repatriating unclaimed life insurance policies with policyholders' estates and speeding up the claims process for smaller life insurance policies and endowments.

The right hand side of the slide sets out some of the key customer metrics and indicators that we track against. I'm glad to say that we are well on track on all the stated targets. These take into account benchmarks that we see externally and we'll aim to additionally deliver high levels of customer service to the customers joining us from AXA and Abbey Life.

I will now pass you back to Clive to wrap up.

Clive Bannister

Andy, thank you. It is clear from recent industry changes that the old, bundled model of life insurance comprising investment management, administration and underwriting, in our opinion is breaking apart. Phoenix's operating model is structured to take advantage of these changes using outsourcing and a specialist skill set to manage legacy products. And as we look to the future we have a growing sense of certainty that potential closed life vendors are appreciating the upsides to the redeployment of heretofore trapped capital.

Our main focus remains resolutely on making acquisitions in the closed life sector. The drivers for consolidation are self-evident and we are confident that future opportunities will become available in the coming years. Phoenix is a proven acquirer and is well placed to lead further consolidation in the UK market.

Annuities are an integral part of the Group's current business and future M&A strategy.

There are three sources of additional annuity assets available to Phoenix. First, Phoenix will continue to write annuities for our vesting policyholders, and annuitisation of pension pots at around £500m per annum.

Second, many potential closed books will incorporate existing annuity portfolios, as was the case with the Abbey Life deal last year. In addition, it is likely that vendors may sell annuities separately in order to release capital tied up within those liabilities.

Third, the bulk annuity market is a potential complementary source of annuity back books. These are back books. The market has grown steadily in recent years, and there is a projected demand of around £350bn over the next 10 years as pension trustees look to de-risk.

Given the current supply in the market, Phoenix will apply its proven pre-existing skill sets and experience, demonstrated for instance by last year's £1bn PGL scheme buy-in, to compete on selective transactions using the Group's existing capital resources. Let me say that again, on selective transactions using the Group's existing capital resources. Any bulk annuity transaction will have to meet the same key M&A criteria that we use to assess closed life fund acquisitions, namely they have to be value accretive, supportive of our dividend, and protective as always of our investment grade rating.

To end. Phoenix has a clear set of strategic priorities. The cash generation target of £1-1.2bn to be delivered over this year and the next, is well supported by the efficient and well

managed integration of the AXA and Abbey Life businesses. This work lies alongside the continued development of our customer proposition, including investments in our digital capabilities.

The simplification of the Group structure as we on-shore Phoenix Group Holdings to the UK, will be achieved by June 2018. And thus Phoenix remains well placed to examine further M&A opportunities that meet our stated criteria, and believe that the Group has both the platform and the financing flexibility to generate additional value from those future transactions.

That, ladies and gentlemen, brings the end of the formal session. I'd now like to answer questions.

Q&A session

Question 1

Craig Bourke, Whitman Howard

Two questions. First of all, do you have at the moment a vision on where you see your illiquid asset classes' allocation going forward? I guess it will depend on what you're doing on the annuity market, but do you have something in mind already as to where you're seeing that going?

And secondly, I'm wondering if you could give just a little bit more detail on the changes in assumptions on your guaranteed annuities and the With Profit, the £70m changes behind that please?

Clive Bannister

Craig, thank you for kicking off. Why don't we do that in reverse order? Jim, will you take the assumption changes, and then lead on the alternative assets that we've been investing in and whether we have an end position.

Jim McConville

Thank you, Craig, good morning. On the changes in assumptions, we were already about half-way towards CMI 15 as at the end of last year, so as I said, we have moved to CMI 16. That has meant taking into account both the longevity and the mortality sides of the equation; an improvement of round about £100m. That has been offset by changes we have made for the persistency of some of our long-term guarantee products where we're continuing to see customers staying slightly longer than we had anticipated, and that more or less offsets the longevity improvement.

But in addition, we've also been able to make assumption changes in relation to our expenses where we're seeing lower levels of expenses going forward, partly as a result of integration, and partly as a result of ongoing good cost management. In net terms, if you take all the changes that we've made into account, you see a benefit of £68m.

Craig Bourke

It's just more on the detail on the change in persistency on the With Profit side, the £70m on the With Profit. Can you give me any more colour on what the new assumptions are on persistency?

Andy Moss

Basically, I think Jim refers to, we are seeing people generally across our whole book retire later than 65. I think we're probably seeing that as a country. Within our With Profit book what we are seeing is that the average age of retirement is increasing, so from something which would have been round about 65, it's now more around the sort of between 66 and 67. So what we've done is strengthened our assumption across the With Profit book with one particular element on one of our supported funds which has a guarantee in terms of continued roll up. So we strengthened our assumption, and that's really based on what we've been seeing over the last two years. And we're comfortable where we are in terms of strengthening that assumption, and it is reflected in the experience that we're seeing.

Clive Bannister

On the alternative assets, Jim and perhaps Andy, because you've led the charge.

Andy Moss

We do have an overall target in mind, which is in the range between 30 and 40%. We continually review that, because obviously we're looking to optimise our risk and return for those assets. As you know from our previous presentations, we've been in the process of building up our exposure in illiquid assets over the last couple of years. So we've still got quite a bit of headroom to that target, and indeed with the acquisition of Abbey, one of our key management actions will be to roll out effectively our asset allocation to Abbey over the next sort of 12 to 18 months. Obviously we made a significant step forward, as I referred to, with the acquisition of a £600m ERM book in July, which you'll see the impact of coming through in the full year results.

<u>Question 2</u>

Abilash P T, HSBC

I've got two quick questions. The first one is on the cash generation. Last year it seemed the management actions and the cash generation were second half weighted. I appreciate it's a bit lumpy, but this year it seems because of acquisitions they have been a bit first half weighted in terms of the management actions. I'm just wondering whether you have any comments in terms of what you should be expecting going forward on that front?

The second is from the Abbey Life acquisition. When you do get the Internal Model approval, do you expect any significant capital benefits from that?

Clive Bannister

Two questions about the management actions, one in general, and then one more specific about the Abbey Life model. £360m of cash generation, that's 74% of what we achieved in the full year of last year. Jim, do you want to go through the management actions behind that?

Jim McConville

Yeah. So as you say, Abilash, management actions can be quite lumpy, and I think as we've referred to many times before, our cash generation isn't smooth but does reflect the timing of completion of these management actions, many of which can take many, many months from start to finish. So 2016 was very much back ended. I think we advertised that at the beginning of 2016 that it would be back ended, and it did turn out that way.

Whereas in 2017 we have seen, particularly with the AXA Internal Model changes, we've seen a shift where we've had a significant management action complete in the first half of the year. I don't think our guidance for the short-term target of between £1-1.2bn has changed because of that, it's just the way the timing of these management actions play out. So we're very much reaffirming today our confidence in that short-term target, and indeed the long-term target.

Clive Bannister

The Abbey Life model?

Andy Moss

I wouldn't expect a big impact from the Internal Model approval, so from an Abbey Life perspective they're currently on Standard Formula. So what we'll see is some strengthening of the model onto our Internal Model basis, but that will be offset by the transitionals which we'll obtain. So overall it's likely to be reasonably neutral.

Clive Bannister

And the timetable?

Andy Moss

The Internal Model approval will be submitted in Q4, so it will probably be mid next year before we know whether we've got the full approval or not.

<u>Question 3</u>

Ashik Musaddi, JP Morgan Cazenove

Just one question with respect to your M&A appetite. How should we think about that? Number one, you have said that you have £500m of firepower on your current cash balance. Second, you also reiterated that you have paid down your revolving debt facility so you have firepower on that. Having said that, this RCF will not be counted as capital if you tap that again, so how should we think about your risk appetite with respect to M&A? Would you be looking at new sort of debt, Tier 2/Tier 3, or would you still be using RCF just for cash perspective and take the hit on solvency ratio if you want to do the deal? So how should we think about that? Thank you.

Clive Bannister

Ashik, thank you very much. Great question. Two parts. The first one, Jim, is how big is your treasure chest, so you have to fess up here! And the second thing is in the context of a transaction how might you go about financing the debt.

Jim McConville

I mean I think you're right, Ashik, in that there are two separate things there. There is the capital behind any acquisition and the liquidity for the funding of any acquisition, and they are two separate things as you say. In capital terms I think what we're seeing from our own results is, you can think broadly that we have £500m available to spend. That is supplemented by the improvements we see coming through in the next few years, as I discussed. To that, it would then depend really very much on the capital structure of the acquired business, and then how it looks on a pro forma basis. But you could think of the £500m being supplemented by appropriate leverage; the key thing being that we will solve that equation to maintain our leverage between our stated target ratio of 25-30%.

On the liquidity front, we do obviously have the £691m of cash in our balance sheet at the present time, and the £900m RCF is undrawn, and that is an acquisition friendly facility.

Ashik Musaddi

Just one follow up. With respect to leverage, is your view solely on the rating agency leverage or do you also look at Solvency II leverage? You have got a lot of headroom on the Solvency II leverage.

Jim McConville

There is indeed. Certainly in Tier 3 terms we're probably nearer the top end of where we can go. But there is significant headroom in Tier 2 and Tier 1 should we choose to put that into the transactions, absolutely.

Clive Bannister

Any leverage will be done in the context of protecting our investment grade rating, which as we celebrate the up-notch to A+. And that is extremely important to us.

<u>Question 4</u>

Oliver Steel, Deutsche Bank

Just a couple of questions on clarification. So just back to this $500m of resources so that as I understand it doesn't include the tapping of the RCF, but it does include the cash releases which you're expecting over the next few years.

In terms of how far we build that out is that say the cash releases which you're expecting out to 2020 or should we be thinking about just the cash releases that you're expecting out to 2018 and then potentially you have more beyond that?

Secondly, again actually just a question of clarification. I thought you said that neither the $500m Tier 2 bond issue nor the repayment of the RCF in August were in your current cash position facility of £691m; but then in the waterfall you seemed to be only stripping out the repayment of the RCF, so perhaps you can just clarify what's in the £691m?

Then finally, what proportion of your annuity book is longevity reinsured at the moment?

Clive Bannister

Three questions there, Jim. Do you want to deal with the first one: is that £500m standalone and good to go today or do we have to wait for further cash releases? The second one is,

and I've put up the waterfall chart, to say what is included and not included. And then finally the percentage of our annuities book, which is running at about £13bn where it's £3bn or 70% reinsured.

Jim McConville

The £500m we referred to is good to go today, so don't take it as being a 2020 number but it will be a number that we believe applies today. In relation to the way we have treated the debt repayment, so on page 16 we have the sources and uses of cash and the £166m repayment of the remainder of the revolving credit facility was made in August and is not included in the £691m cash number.

Oliver Steel

The $500m?

Jim McConville

The $500m has been pro forma-ed into the capital number.

Oliver Steel

In cash?

Jim McConville

No, not cash.

Oliver Steel

So, where is the $500m in that?

Jim McConville

The $500m comes in and goes back out again because it immediately repaid senior bank debt.

Clive Bannister

Do follow up directly. I'm looking at Rakesh in the front row here: am I right on the percentage of our reinsurance of our annuities book at 70%?

Andy Moss

Yes, probably around that sort of number.

Clive Bannister

Yes, around 70%. Any other questions?

<u>Question 5</u>

Andrew Crean, Autonomous

You described the dividend as stable and sustainable. If you don't do any more acquisitions the company runs off, so how long is it sustainable for?

And then you've mentioned the 4.5bn of cash generation beyond 2020 with no management actions. In terms of quantum if you don't do any further acquisitions from now by 2020 your most recent acquisitions will be four years old and the others will be a lot older than that, and I assume quite a lot of the juice will have been squeezed out of the lemon by that stage. How much more management actions – and I'm not meaning acceleration I'm meaning actual finding more fivers down the back of the sofa – do you think is possible?

Clive Bannister

Thank you for reducing our business to that! Very elegant. It's a big sofa and there are a lot of fivers so let me deal with the second part first.

We're sticking to our £2.8bn between now and 2020, including management actions that on average are running at about 30%. So organically if we sit on our hands and do nothing 60-65% will come out organically generated capital unwind, and the number is around 30-35% on management actions.

Heretofore we've never really done less than 20% per annum, right now it's a higher percentage because we're doing all the management actions associated with the acquisitions so it's a higher percentage. Thereafter post 2020 £4.5bn, up £100m from where we were just six months ago at £4.4m. And I'll let Jim talk in a moment about the management actions that we look to do in the future.

Let's take the first observation: what happens to our dividend? This is a run-off business as we all well understand. We use the phrase 'stable and sustainable' for a period that looks out over many years. All the maths we put up today is deliverable without doing any further transactions.

It is almost inconceivable, Andrew, looking at the industry as we do, with the two enormous steam trains that are coming down the track: one is retirement and those people looking for protection, so we have 9.1 million people in the UK today who are over 65, in the next three years, by 2020 that goes up by 3 million because of the bubble of baby boomers going back 60 odd years, so that will be 12.1 million people, one in five over the age of 65, and we resolutely believe that those people are looking for protection, which is the business we're in.

The other steam train is other parts of our industry who are reinventing themselves as capital light and as fund managers. So there are two parts of that triptych we talked about administration, underwriting and investment management, and we do two of those three; it's what we major on. And therefore we see this stream of business where companies will restructure themselves, whether it's because of A-day, Solvency II, Brexit or just because they want to redeploy trapped capital against business opportunities, that makes your counter factual 'what if there are no more deals?' almost inconceivable to where we are. But we accept that were there no more deals post 2020 then we would rely on the £4.5bn in the kitty.

Jim, do you want to talk about the management actions that we think about?

Jim McConville

I'm not going to, with respect, answer your question as to the percentage of management actions beyond 2020 because it's quite some considerable way away.

I think what I would point out is if you think back in history the last acquisition before the two we did last year was way back in 2009 or before, and we've managed to continue to keep management actions averaging over 30% over quite a sustained period between 2009 and to 2016 before the recent acquisitions. So I think we've quite a track record of demonstrating that we have continued to deliver management actions quite successfully over a long period.

But you are right over time the juice does run out and it will decline, but we do see as we stand today a continued strong pipeline of management actions. We will update our targets in due course as we go forward, extending out beyond 2020, but I'm not going to do that today.

Question 6

Ashik Musaddi, JP Morgan

Just one more question. With respect to your ambitions on bulk annuity market can we get some sense about what sort of ROE or ROI you are looking to get as a minimum on any sort of third-party bulk annuity market, not acquisition related but going out to the corporates, getting the back book from corporates?

Clive Bannister

Do you want the short answer? The short answer is no, we don't give ROEs and IRRs. Let's give a more informed answer which is the word accretive. Annuities are in our business right now, it's 20% of our business, we see the opportunities as entirely complementary to the existing vesting annuities. We did £274m of vesting annuities at profit to our shareholders. Last year we bought a business that had embedded in it an annuities book; that has clearly proven to be accretive because of the cash forecast we've given that business in the next four years to 2020 and thereafter. And we look in the area of bulks.

We have a skill set, be it access to reinsurance, access to alternative assets, our lower cost of capital, the funding that Jim has made available to all of us, that means that it is intelligent of us to deploy that capital in opportunities that meet the three criteria that really matter: first it has to be accretive, and that has to be provable and demonstrable; secondly, it has to protect and defend our investment grade rating; and also support the dividend paying capability. And that is why we use that trinity of words, we say it has to be selective – this is not a random walk – a selective process, something that is entirely proportionate and funded out of our own funds. This is additive to what we do today rather than some form of revolution.

So I end that answer by saying the word is accretive and we will demonstrate that on all occasions.

Question 7

Edina Rozinka, Deutsche Bank

Hi, it's Edina from the credit rating side. Congratulations on the good results. Just one follow up question please. It's obvious that you're well positioned for M&A, and you mentioned that you're pretty full on Tier 3 where we know and you have plenty of capacity of Tier 2. I'm just

wondering, given that the acquisition targets would be probably in the UK, would you consider printing the new Tier 2 in sterling, or given that you just printed a deal in dollars would you consider dollars or euro for the next tier?

Clive Bannister

Edina, thank you for that question. You may have noticed that we gave Jim a passport, which he massively used in the last four months.

Jim McConville

As you say, the Tier 2 deal we did recently was a US dollar deal where we had strong support from Europe and Asia. And it was important to us because we wanted to broaden the investor base for future debt transactions, so that was an important first step out of the sterling market.

Thinking forward to the financing for any future acquisition we would obviously assess market conditions at the time and make an appropriate choice as to how we would take that forward.

Question 8

Colm Fagan

While shareholders will appreciate the higher dividend would it not have been better for the long-term interests if the directors had left it unchanged as this would improve the Group's strategic options for future acquisitions?

Clive Bannister

We've honoured a commitment that we made when we raised very substantial funds last year, this was upon the completion or the announcement of the Abbey Life deal, a deal done at £935m to which we raised £735m of equity; when you raise equity when you're doing a transaction you reward shareholders. 98.5% followed their rights, and we are just therefore honouring that commitment.

On the outcome of the transaction it is clear that that has been more than self-financing, and thus we're proud, in addition to the strong financial results, that we're ahead of where we thought we would be on the integration and that justifies the financing structure taking place last year. And we think that we have more than sufficient resources and access to financing, as Jim has said, to finance future deals.

Question 9

Ming Zhu

In regards to M&A size appetite you've done a £400m and a £1bn deal what's your next ideal size M&A? Given that you've got £500m cash available to spend could we assume that you will be looking at the large sized deals around £1bn level?

Clive Bannister

Size is not the driver of us doing transactions. There is clearly a smaller level south of £200m where I think it's hard for us to deploy our skill set and then there's a number north of that, but it can never be driven by size.

An acquisition has to be determined by the scope and opportunity we see for realising value, and therefore it's accretive generating cash, and that means our ability to use it's basically three core skill sets: capital synergies, which are released by bringing on to our Internal Model and into our life companies; the administrative skill sets in terms of using our very unique outsourcing capability to lower ongoing expenses; and the final capability is using our financing structures where we clearly have increasingly have been able to deploy lower cost of capital against market opportunities. So it's never driven by scale; it's driven by the businesses and the scope we see for doing what Phoenix does so well.

Concluding comments: Clive Bannister

I think that wraps things up and I thank you very much indeed. It's a holiday weekend in 48 hours, enjoy it, and thank you very much indeed.