Please note that the conference call was accompanied by a complementary presentation in PDF format available on the Group's website: http://www.coface.com/Investors, under the "Financial results and reports" section.

9M-2024 Results

Conference Call Transcription

Paris, 5 November 2024

Presentation

Xavier DURAND, CEO, COFACE

Good evening to all here in Paris. It's 6:00 p.m. Thank you for joining. We're happy to report our Q3 earnings today. You will have read from the headlines that this was another strong quarter of execution for Coface. We're reporting €207.7m in net profit for the first nine months, and €65.4m in the third quarter. I think if you read through this report, you'll see the continuation of some of the trends we've discussed in past quarters, as well as some better news on the growth side as we're seeing the inflation cycle play through. You've seen that insurance revenue decreased by about 4% at constant FX without any contribution from client activity. The total revenue for Q3 is actually stabilised at just slightly below zero. The same number in Q2 would have been -4.6%. Revenues from other activities are actually up by 6%. What you see, which is fairly consistent with prior quarters, is client retention that remains high at 92.7%, albeit down from the record level we saw in 2023. Pricing is down 1.4% in line with historic trends.

Good news on the business information side which posted double-digit growth of 17.2% in the first nine months. We'll talk about debt collection. And then factoring is down 3.6%, mainly on the back of slow industrial activity in Germany. Continued very strong performance from Coface on the loss side in an economic environment which is hardening. The nine-month net loss ratio stands at 35.5%, which is almost five points better than last year. The net combined ratio of 64.4% remains very strong. The gross loss ratio improved by six points, and you'll see in the next pages that we're continuing to open the new year at a pretty high level. We also have continued benefits from strong reserve releases on the past vintages. The net cost ratio actually rose by 3.2 points to 28.9%, and we'll explain how that's being impacted by lower revenues and the continuation of our deliberate investment strategy. We continue to invest in growth and technology, which has really been a constant since we published our new plan Power the Core. So overall we have had another strong quarter. The annualized RoATE at almost 15% is the highest we've had in the last nine years.

If we go into page 5, we wanted to give you a little bit more colour on the services business that we are building as part of our Power the Core plan. It's been intensifying for the last four years. We believe we're developing a unique set of services to serve clients in what is now a hardening cycle. On the left here, we described some of the value propositions that we've been building on the business information side. We're building supply chain risk management capabilities, customer risk evaluations including portfolio monitoring, credit decisions, risk model improvement and portfolio due diligence. We're investing significantly and constantly in our data patrimony. We have now almost 219 million companies referenced in our database, covering 200 countries. We're digitally connected to more and more information providers at this stage (56). We've got about 15,000 clients, two thirds of which are uninsured, so that's considerably expanding the commercial reach of Coface. If we look at some benchmark numbers, we've got about 20,000 credit decisions which we think are being taken by our clients on a daily basis and that's growing strongly.

More recently, we've also been building capabilities around debt collection. This is really based on the fact that we have one unique system now that's serving many countries around the world that we are known for collecting for ourselves. We have the brand, we have access to the market, we have teams, we have clients who also need those services. And we do this at a time in the cycle, when the need for collections is increasing. As you know, insolvencies are rising around the world. On the top right-hand side, we've provided some numbers. We're 566 people at the end of Q3, dedicated to business information. So, with

Coface being a 5,000-employee company, this is quite significant. We are building that up, and there are 220 people dedicated to sales. We've actually hired another 50 in 2024. So we're continuing to invest and expand. We're tripling in two years the FTE that are dedicated to sales on the debt consolidation side. We're also making progress on the revenue side where we have about €58m of revenue out of these two businesses for the first nine months of the year. We're seeing strong double-digit growth, and this is profitable. We are making all these investments at no cost to the P&L, but the gross margin in business information is something north of 60%. So this is really building for the future. We thought it would be helpful to give you a little bit of a read on what we're trying to do here, expanding both the capabilities, the commercial reach and validity of Coface. At the same time, we're building really interesting data capabilities which will help support the insurance business.

Moving onto page 7, total revenue is down 2.1%. Services are up 6%, and trade credit insurance is down 4%. We're not yet seeing a rebound in client activity, although it's not negative anymore. But we still have a weak economy and lower inflation playing through. Other revenue is up 6%, which includes Business information, which is up 17.2%. Third party debt collection is up almost 19%, although that's a much smaller business. Factoring is down, mainly due to German industrials. We also saw a nice pickup in insurance fees, which are up 8.3% all things equal for the quarter.

On the next page, we describe the growth by region. What you see on this page is more or less the state of the global economy. Western Europe is down 3.1%, which is an improvement on Q2. Northern Europe, which for us is primarily Germany, is probably the tougher part of the world right now with low growth and slow industrial activity. Central Europe at -3.5%. The exception is Med & Africa, which is still growing at about 5%. North America is at -6.5% and starting to feel a little bit better. Asia Pacific is at -8% and Latin America is improving from the past with 2.3% growth. So really not a whole lot of news. As you can see, some of the same trends are actually playing out in the different regions, compounded by the state of the economies.

On page 9, there is some better news on the growth side. New business is up 8% from last year and 17% from 2022. So we are picking up some speed here. There's more demand in this market, which is a little bit more stressed. Retention is improving even though it's not as strong as it was in 2023. Pricing is negative but less negative than the two prior years, and the volume effect is not negative anymore. It's just kind of flat. So we are not benefiting from inflation anymore. The world economy is kind of flat. I wouldn't call this a rebound yet, but it's certainly better than having negative activity.

On the loss side on page 10, you can see the loss ratio before reinsurance, including claims handling at 33.7%, which is very much in line with the prior quarters. If you look at the market, you can see that insolvencies are well above 2019 levels in most countries. So clearly the cycle has hardened. We see the number of claims continuing to increase, and we're seeing bigger insolvencies than before. So clearly, this is a market which is getting a bit tougher. The economy is rather slow. Monetary policy and companies' treasuries are tightening, which you can probably see in the earnings reports that have been released over the last few weeks. Companies' treasuries are being put under more pressure. There's no change in our reserving policy. We opened the year at 78.4. We still benefit from 45% of reserve reversal. So past claims experience remains strong, and we continue to execute in a tougher market.

You see on the next page the totals for 2021, 2022 and 2023 and then the first nine months of 2024 by region. There's really not a whole lot of news quite frankly on this chart. Things are very stable. There was an improvement in Latin America, which had been the subject of our attention last year, and this is probably the smallest and most volatile region for Coface, but pretty much everywhere else the stories are in line with historical trends.

On page 12, we describe the same numbers, but this time by quarter. The four largest and more stable regions of the world at the bottom are again fairly in line with historical trends. So there’s not a whole lot to talk about. The same goes for the markets on the top, albeit with more volatility. Latin America is under control, and Asia is actually doing very well.

On page 13 is the cost story. If you recall, in Q2 we had shown more than 6% growth in the cost base. Q3 on Q3 last year is up 3.3%. So we have better comparables to last year. You can see the gross cost ratio before reinsurance at 33.7% on the top right. If you go to the bottom right, you see the gross cost ratio between 2021 and 2024. After reaching a record in 2023 at 30.5%, the gross cost ratio is now up from last year. As was the case last quarter, the increase in the cost ratio is driven by three things. One is we have negative premiums, which account for about a third of the increase. We continue to invest deliberately in BI and in other services and in our development, which accounts for 1.7 points. And then there's cost inflation that we've taken on from the last couple of years of inflation, particularly on wages and outside services, which is partially offset by the product mix and the increase in sales and services. So better news, but we’re still in a situation where costs are growing more quickly than revenues. We think it still makes a lot of sense for us to continue to invest and to build for the future. So that's what we're doing on the back of a strong performance. Now I'm going to turn it over to Phalla to take us through the next few pages as we usually do.

Phalla GERVAIS, Group CFO and Risk Director

Thanks Xavier. Good evening, everyone. Let's go to page 14 on the reinsurance side. Honestly this is very similar to what we saw last quarter in terms of cession rates. The premium cession rate is at almost 28%. And the claim cession rate is at 22%. Here again for this quarter, almost €30m pre-tax is going back to the reinsurers with a total of €95m year to date.

The net combined ratio stands at 64.4%. This is an improvement compared to the same period last year. As Xavier explained, the net cost ratio increased, and the net loss ratio decreased.

If we move to page 16, the financial portfolio, the mark to market of our investment portfolio is now €3.2bn. The asset allocation has changed slightly. We have slightly increased the allocation to bonds with higher duration and higher yield. Our investment in real estate is exactly the same at 5%, and equity is at 3%. If we look at the recurring income, which is almost €71m, this is 50% more than what we had last year. At this stage, we are benefiting fully from the interest rate increases over the last two years. The new money is now invested at 4.3%, which is slightly below what we had in Q2, but is still a very comfortable rate. Realised gains stand at €8.4m. What needs to be highlighted here is the investment in real estate. Up to Q2, we booked some negative mark to market, but we saw in Q3 that we haven't booked much. I think it's a very small amount of negative mark to market. So on this front, we think that the value of our investment in real estate has stabilised. IFE expenses stand at -€25m and of course we booked an additional almost €2.8m of hyperinflation, especially in Turkey and Argentina.

This gives us net income for the first nine months of the year of almost €208m with operating income up 15% from €273m to €315m. The tax rate stands at 27%, which is very stable compared to Q2. What we are highlighting here is that we expect a limited impact from the French budget, even though is not final yet, but at this stage we don’t expect to be impacted. Our net income has increased by almost 10%

compared to last year with a comfortable Q3 net result. Our book value is €14.1. I think we're now trading above the book value, which is good news.

If we move to page 18, return on average tangible equity. IFRS equity increased from €2.05bn to €2.1bn. Of course we paid our dividend, we accounted for nine months of net income, and then we have a positive mark to market, especially on our bond portfolio due to the interest rate decrease. As a result, our return on average tangible equity increased from 13.4% to 14.8%, with a strong contribution of financial results.

Xavier DURAND

So just to wrap up, it's pretty short because the story is fairly straightforward this quarter. Another set of strong results as the credit cycle continues to harden. The 64.4% combined ratio is well below our through the cycle targets. We continue to invest deliberately. I try to show that on the second page of the pitch. The Q3 revenue is now almost stable versus last year as the biggest part of the disinflation headwind is behind us, and we continue to see some really nice growth on services. You saw that we are now fully benefitting from the uptick in rates in our investment income. We've been talking about this for a couple of years now. At 14.8% our RoATE is the best we've had so far. So a really strong first nine months of the year. And I think what's encouraging is the services strategy continues to deliver double-digit growth in what we consider to be a structurally profitable business. We're doing this at no cost to the P&L and obviously no profit to the P&L, but it's really an investment for the long term. We're seeing double-digit growth again for BI and for debt collection, and we continue to expand our patrimony and our assets, whether it’s technology or people or knowledge or expertise in the space. So that's the story for today. Shorter call than usual. We're very happy to take questions.

Q & A session

Michael HUTTNER (Berenberg) Thank you very much and congratulations on the outstanding results. I had lots of little questions. The first one is the insolvencies are higher now than 2019, but your loss ratio has never been better. Or it has been better, but it's certainly better than back then. I can understand where the numbers are today, but there is a disconnect between the market as a whole and Coface. Can you maybe remind us or remind me what's driving this? And then my second question is on the business information. The gross margin of 60% is fantastic. I just wondered, you say it's no cost to the P&L, so my very rough guess is there's a roughly €50m gross margin give or take for the year. And we have roughly 560 employees. So if I do the math, I get an average salary, one covering the other of about €85,000. Is my math correct or are these employees also doing work or allocating costs to other parts of the business? I just want to understand if there's any overlap between these two activities. Thank you.

Xavier DURAND (CEO, Coface) On the first one, we've been describing our stance, our strategy, our execution for years now. I'm almost nine years complete in this business. So we always said that we're going to take a very value creation-oriented approach to underwriting. We are going to underwrite with courage and discipline, and we are continuously improving our tools and processes. So it is true that we continue to deliver strong risk performance. The market is hardening. It is what I call normalizing and I've been describing this for three and a half years now, but it's normalizing in a slow and continuous way, which allows us to manage risk in the manner that you've seen. That's really all I can say. It is good to see the performance of the business in that environment. Another environment could also lead to a different outcome. But I think that's what we've been able to achieve.

On the BI side, the math is not completely disconnected from reality. You have to factor in the fact that we have technology costs as well and services that we buy from the outside. But essentially, we do employ close to 600 people. They're mostly employed, not completely, but there's a mix between mature markets and some developing markets. I don't want to get into a nitty gritty discussion on the P&L, which we're not willing to disclose here, but basically with that gross margin, we're paying people and we're paying for some technology and some fees to outside services.

Amalie ZDRAVKOVIC (Deutsche Bank) Yes, hello, good evening. This is Amalie from Deutsche Bank. Thanks so much for taking my questions. I have two. First, do you have any colour on costs going forward? I'm thinking here in particular on the cost inflation side and the premium growth component. And then second, what, if anything, are you expecting as a result of the US election on your business model? Are you thinking about anything related to the tariffs? I was just curious to get your thoughts on that. Thank you very much.

Xavier DURAND (CEO, Coface) Thanks for the question. We've been very consistent in these calls about not giving forward-looking statements. So unfortunately that will apply again, as frustrating as it might be. I think what we're trying to describe on this call is how the cycle plays, and I'll just qualitatively describe that here. We had a surge in inflation. The way we bill our clients is we bill them a percentage of their turnover. And so, when inflation strikes, the first thing we tend to see is actually an increase in our revenues. And then like every business we have to pay people and buy services from the outside. Then we get hit by inflation in turn. That drives our costs up, and they tend to be sticky because those increases cannot be reduced further. So at this stage in this cycle, what we've seen is clients' turnover has actually started to decrease because commodity prices and things like this have started to come down. So, we're not seeing the top line benefit that we were seeing a year or a year and a half ago. At the same time, the costs taken on from the inflation years are still hitting us, but the comparables are changing as time passes and inflation comes down. The same elements are going to play through in the cycle. So I think that's really what you see at play in our numbers.

In terms of the US election, it's anybody's guess here in terms of what's going to happen, both in terms of the election result and what that means for economic policy. So I would not try to design a scenario. I think we have to look at a range of issues, scenarios and possibilities. Could there be more tariffs? Yes, there could be. Could there be more geopolitical stress? Yes, there could be. Could there be resolution of some conflicts? I guess there could. But at this stage, we're less trying to plan for one thing or another than trying to stay very close to the action, because in our business we're able to affect the level of risk that we take on over a four- to nine-month period. And I think what's important for us is to stay very close to the action and help our clients one by one to navigate whatever is going to happen. That's what we do. That's why we collect millions of data points, and we make about 13,000 credit decisions a day. Just to give you the nature of our business, so tomorrow we're going to make 13,000 credit decisions and the day after tomorrow we're going to do 13,000 again. Depending on what happens and what policies are being put in place – clearly, it's going to take a little bit of time for the world to change – we will alter those credit decisions and positions we have on different companies as we see fit. And our ability to do it in a timely, detailed and granular way, sticking with the reality of whatever is going to happen is what's going to determine our performance. So I hope that helps. We're not trying to paint the world with a big brush because I think if you try to do that, you're probably going to get it wrong, and you wouldn't even be able to determine the timing anyway. So many things can happen out there.

Benoit VALLEAUX (Oddo BHF) Yes, thank you for taking my questions. The first one is regarding client activity, which is still close to zero. You mentioned the fact that inflation headwinds are now over. What can we expect for next year based on what you see from your client base or the view of your economists? Any colour, any comments on that would be very helpful. And the second point in terms of pricing trends, do you see any reason why the price decrease should be higher than usual next year? The average is still stable at minus 1.5%. The second question is regarding reinsurance. You have been very profitable this year. It may be a bit too early, but what do you expect in terms of pricing for the next renewals in terms of reinsurance? And my last question is related to Western Europe. If I look at your slide, I think it's slide 12, your loss ratio is still excellent, but there is a slight deterioration in Western Europe in Q3. I just wanted to know if there's anything specific to be mentioned in terms of country, sector or frequency. Is there something specific behind that? Thank you.

Xavier DURAND (CEO, Coface) Thanks for the questions. So this is usually the time of the year when we start getting questions on reinsurance. The only thing I would tell you is it's a bit early, because the negotiations take place at the end of the year. You're probably well aware of the stuff that the reinsurance market is going through right now with the storms and floods and rain. So part of that plays into this. The credit cycle plays into this. So that's an end of the year discussion that we haven't had.

In terms of your two first questions, where are we going in terms of client activity or pricing? I think we've described this. Again, we're not going to make forward-looking statements here, but we've come from a high inflation world with high client activity to a lower inflation world with negative client activity for some time to around zero in the last quarter. I think what you're seeing here is some of the world economics playing through. It will depend on the price of commodities. We tend to be a little bit more skewed towards commodities than the general GDP mix. It will depend on industrial activity because we tend to be a little bit more focused on industrials than on services. It will depend on Europe because we tend to be 50% Europe centric. So there are a lot of moving parts in the mix. We see the world economy slowing, but as you know, this is the delicate phase of monetary tightening where it's now coming to reality. The economies are starting to slow. The central banks are starting to ease, and the governments are running a bit out of money. So you have all these factors playing against each other. And we'll see where that lands. So far, it seems like they've managed to engineer some kind of a soft landing, but there is also the geopolitical uncertainty, the social unrest or uncertainty in different countries. I think there are a lot of moving parts, but I think these are the things that will drive the level of client activity.

When it comes to pricing, I think the market's hardening a bit and you see that in the pricing history for the last three years. We went from very negative last year to a little bit better this year. We're pretty much on the long-term mark here that we've observed for the last 10 years. Industry pricing has been falling about 1.5% year after year. So nothing exceptional. It's also a factor of the level of competition, which remains very strong. And the level of demand in the market, which is improving. So it's anybody's guess as to where this is going to go, but we're pretty much on the long-term historic trend here.

Phalla GERVAIS (CFO and Risk Director, Coface) On Western Europe, we don't see the risk increasing. It's just the fact that in Q2 we released some reserves related to this region, for cases that have now disappeared. We released some reserves, and this is why you see this increase. It's much more related to the Q2 reserve release than the risk actually increasing in Q3.

Michael HUTTNER (Berenberg) Thank you so much. About a month ago, Hanover Re held an investor afternoon and they highlighted the growth in their insurance-linked securities business, effectively where they're providing clients with reinsurance cover, but tapping outside capital, so not using their own capital. I thought 10 or 15 years ago when they started this business that they were kind of cannibalizing their own business. In fact, they're not, the core and the new business grow together. Is this how you see Business Information services? In other words, although the way I understand it, a client can have a choice of doing it yourself by buying the information or relying on Coface. In fact the two are kind of complementary. And then the other question is just on numbers, there was a figure on Turkey and Argentina that I didn't catch.

Xavier DURAND (CEO, Coface) The second one will be Phalla's to answer. We've heard a lot of people say business information is actually competing or will compete against insurance. I don't think so. Of course, it serves the same purpose, but not everybody needs or wants insurance. Not everybody can deal with the information. You've got different market needs. The penetration of insurance in the world is still very limited. We're talking about covering 5% to 7% of the global receivables, so there's plenty of space, which means that almost everybody is actually not using insurance and doing something else. And almost everybody is somehow buying information or using information to watch their book. So to me these two things are complementary, plus we use the information for insurance. So getting better at information makes a ton of sense if you want to do insurance yourself. I'm going to turn it to Phalla for the Turkey and Argentina points.

Phalla GERVAIS (CFO and Risk Director, Coface) This is not new news, right? It's the application of IAS 29 on hyperinflation. So, we've been booking some negative impacts since last year. What I was saying is that in this quarter of course inflation is coming down. So, what we've booked in Q3 is probably a less significant amount than we had booked in past quarters.

Michael HUTTNER (Berenberg) I understand that. It's just I didn't catch the numbers.

Phalla GERVAIS (CFO and Risk Director, Coface) OK. I'm sorry. I think the total amount year to date is €10m, and in Q3 we booked only €2.8m.

Xavier DURAND (CEO, Coface) Thank you very much. Thanks for logging in. Thanks for taking time here to schedule. You're giving us 20 minutes back, which we'll put to good use, so that increases our productivity. We will be meeting again on February 20th for the full-year results, so looking forward to that discussion. I wish all of you a great fourth quarter. Thank you very much.