PHOENIX GROUP

Phoenix Group Holdings
Full Year Results Presentation Wirecall
Wednesday 31 March 2010 [Afternoon]

Ron Sandler
Chairman

Well good morning those in the US who are on this call. Good morning to you. Good afternoon to those in the UK who are listening. This is Ron Sandler on the line. I am Chairman of Phoenix Group. I have with me Jonathan Moss our Chief Executive and Simon Smith, the CFO. I hope that you have all had a chance to familiarise yourself with the results that we announced earlier today and have seen on our website the presentation that we would like to take you through quite briefly and then obviously allow time at the end for any questions that you may have.

2009 was an extremely important year for Phoenix Group or Pearl Group, as some of you may have known it by. From the time that the Liberty acquisition was made, we have made quite considerable progress. We said at the time that we would deliver not just financial stability, but that we would deliver progress on a whole number of fronts and I am very pleased to say that as we sit here today, we can see evidence of that progress.

What I am now going to do is hand over to Jonathan to take you through the detail of the results and then to be followed by a more detailed presentation of the financials which Simon will deliver. Jonathan?

Jonathan Moss
Chief Executive

Thank you Ron and good morning to everybody. I am going to start on slide 5 of the Presentation and just take you through our business model which we believe is a simple and easy to understand model. The core of that is the life companies. Life companies represent the most substantial components of our business. 6 ½ million policy holders, £60 billion of liabilities. And importantly £5 billion of capital resources which capital resources over time will run off and form a component of the cashflow further up the business.

The life companies are well capitalised and we have an IGD surplus of £1.2 billion. Alongside that we have both the asset management business and the management services business, each of which is a relatively simple profit and loss type business. They receive revenue from the life companies and third parties, they incur expenses, the difference is cash profit which again can be pushed up the Group. Management services £348 million of revenues received, in this case, purely from the life companies, employing all of those staff who provide services to life companies as managing outsourced relationships. So over time as I say, each period will identify the capital that is being released from the life companies, the profit that has been made from the margins in our life business, the profit similarly which has been released from management services and from asset management. That cash goes up to the corporate level. Within the UK that will be used to meet corporate costs, cover pension scheme contributions and service and amortise the daily commitments that we have got. Any excess cash is then available to be pushed up to Phoenix Group Holdings TopCo and support dividends to shareholders. So we believe that that is a relatively simple business model.

Moving on to the next slide and looking at what we have managed to achieve during 2009. Again, when we came to the market in September, we made clear there were a number of steps we had

to take and we have delivered against those steps. So what it is that we said we would do we believe we have done. At the corporate level, that has included the Liberty transaction itself which has brought in over £1 billion of additional capital for the Group either by way of debt write off of some £500 million or the cash that was sitting in Liberty itself at the time of the transaction. We have revised our governance arrangements, including bringing Ron in as Chairman, but as well as that recruiting four new independent non executives during the course of this year, which means that we now have a UK combined code compliant Board.

In addition to that as you will have seen, last week we reached in principle agreement with the Tier 1 bond holder ad hoc group which represents over 60% of bond holders. Having got that agreement with them, we also now have that sanctioned by the banks and are in the process of getting approval from the FSA and it should then just be a matter of process to put that before bond holders over the course of the next 4-6 weeks, in order to seek formal approval of the terms that we have put forward. That will be another very important step along the way of cleaning up our capital structure.

Whilst we have been undertaking work at the corporate level, additionally we have been continuing to do work on the underlying operating business. We have concluded the merger of Scottish Mutual and Scottish Provident into Phoenix Life Limited. We have resolved a number of legacy issues and released unnecessary provisions. We have continued work on moving from three sites into one in order to gain additional operational efficiencies in terms of the number of people we employ within the business.

And also importantly on the asset management side, we have achieved investment outperformance for most of our life funds and they have achieved probably somewhere between 50 and 150 basis points out performance, which obviously produces value both within the asset management business but also within the life business for both shareholders and policy holders.

And the result of all of that activity, that has allowed us to beat our financial targets. So against our three main measures, we have delivered £716 million of cash ahead of target, that market consistent embedded value has grown to £1.8 billion and I will talk more about that in a moment. And our IGD capital position has increased by £500 million to in excess of £1.2 billion.

Moving onto slide 7 and this is really quite an important slide in the context of how we have changed the way in which we report the business. We have feedback, particularly within the UK, that our embedded value approach was non standard and the more normal basis in the UK was that companies of our sort should be valued on the sum of the parts basis. As a result of that we now calculate the embedded value only in respect of the life business. The other components, particularly the future profit that emerges from the service company and the asset management business are not included with the embedded value. And in valuing the business, to get to an enterprise value, you have to undertake a separate approach in respect to those businesses, whether that supplies an earnings multiple or some other basis. So very important to emphasise that change in approach. Simon will talk about our old approach and how the embedded value would have moved on that basis, but going forward, in order to be UK standard we will continue with the approach as it is presented on this slide 7.

At that point I will hand over to Simon.

Simon Smith
Group Finance Director

Thanks Jonathan and good morning to all of you in the US. I am going to take you through the core financials this morning and it has been a year of strong performance for our operating businesses across all of the key financial metrics that we use. We have previously talked largely about cash and about capital and about embedded value. And what I talk about later, we will go through those again. But in addition we have now produced today, two new things, audited IFRS numbers, that is international financial reporting standards. And we are producing those for the first time as we said we would. Also we have produced audited, what is known as CFO Forum that is a forum of UK CFO's who established a basis of calculating embedded value, MCEV and we are producing those for the first time as Jonathan said as we move to a more UK market standard approach of reporting embedded value as we said we would do.

Turning to the numbers themselves, on page 9, as I say, our operating businesses produced very strong cashflows at £716 million for the full year, ahead of what we said in our Q3 update and I will cover that in quite a lot more detail shortly. As Jonathan said, we have also moved our EV reporting to enable a sum of the parts valuation of the business. So what you see there is a life company embedded value, less the corporate debt, standing at £1.8 billion at 31 December. Now that excludes the value of the service company and the asset management businesses which need to be valued separately. So for completeness what we have done here is show that under our old basis, which effectively includes these items, it shows how the EV has increased from £1.8 billion to £2.4 billion. So effectively, our old basis of reporting embedded value would show EV approximately £2.5 billion for the full year.

Now our IFRS profits for the full year, which we have reported for the first time, come in at £457 million. Our asset management business has been stable in terms of assets under management. And I guess importantly going down to MCEV of £1.8 billion and dividing that by the number of current shares of £132 million, it would give us an MCEV per share of £13.81, i.e. an MCEV value of £13.81 excluding the value of the asset manager and the service company. Finally we said we would pay a pro rata dividend of 50 cents per share for 2009 and today we have announced our first dividend on target, which will be paid on 15 April.

Let me take you into a bit more on cash. And if I can go to slide 11. Jonathan discussed the basic model, which as he said, is pretty simple. And in cash terms, it is also pretty simple. From the management services company and the asset management company, the IFRS profits are really a measure of our cash. So the profits turn into cash. And in 2009 the management services company produced £35 million in cash and the asset manager produced £21 million of cash. The main bulk of our cash production however, comes from the life companies which produce £660 million, that represents effectively the surplus assets that are held over the capital that we have to hold in those life companies. Effectively that is risk based capital, plus a further prudent buffer that we hold on top of that risk based capital. To the extent that we generate surplus in those businesses and that is largely from the fees and the charges that we charge to policy holders, the return that we earn on our net assets and also effectively the capital that gets released as the policies leave our book. Effectively all of those components give us further free assets over and above the capital we have to hold and therefore that can get flowed up to the UK holding company.

We set out here the £716, but in addition we are setting out today a target of £2.7 billion of cashflow over the years 2010 to 2014 to be generated from those three business units going up to the UK holding company. And I will say a little bit more about the detail about the corporate costs, pension scheme contribution and debt service and amortisation in a minute.

So we think it is a simple model. But looking at page 12, there are a lot of numbers so I thought I would take a little bit of time just to take you through how the business has travelled over the period. And I think the first thing, looking at the cash generation on page 12, looking first at the half year '09 then the results for the 9 months to the end of September and then the full year. Just to say how steady the growth has been in the cashflow over the period. And that really reflects the

predictability of our cashflows. Reflecting actually the business running off pretty steadily month on month, year on year. And within the £716 million of cash for the year, we have included in there some £275 million of cash acceleration initiatives that we have pursued and delivered in 2009. And I will say a little bit more about our management action in a few moments.

So now I go on to the uses of cash. We have generated a lot of cash but how has it been spent? Where has it gone? And I set out here a split between recurring and non recurring because effectively 2009 has been a year of, removing a lot of the complexity in our business and this is what the non recurring cashflows represent. Effectively it represents a cleaning up of our balance sheet. We have used significant amounts of the cashflows to settle outstanding liabilities with a company called Royal London, to whom a range of assets were sold in 2008. And this represents the true up of that transaction. It is now well behind us, but effectively that represented a use of cash in 2009. We are also current with our bank debt. We have stability with our pension funds and we made a one off contribution of £25 million to our pension funds in 2009. We settled all the transaction costs that were incurred as part of the restructuring and so forth. And we have also paid outstanding transformation costs. That is in relation to the transformation work on our IT platform and also in the moving from three business sites to one that Jonathan has referred to.

And that leaves a very clear and clean line of sight to the expected future uses of cash. As I say, effectively that is behind us and going forward. And what is represented here in relation to 2009 is ongoing pension contributions and corporate costs and debt service. At the end of 2009 we have also built some further cash buffers in relation to that surplus of £716 million over £606 million cash spent and we are going to use some of that cash to pay the 2009 dividend we have announced today.

So that was 2009. What about the future cashflows? Well if I can take you onto page 13, as I said before, our targets for cashflows for the next five years stands at £2.7 billion. And that is derived in the same way as we set out before. That is from our life companies, from our asset management company and our service company. And that includes the benefit for 2010 and 2011 of £300 million of management actions. That is where we look to accelerate in 2010 and 2011 the cashflow of our business and bring it into that first five year target number. Over ten years our target cashflows are £4.3 billion. Now against that cashflows, as I said before, we pay corporate costs and we are targeting somewhere between £20-30 million of corporate costs. Pension scheme contributions which we are targeting between £25-35 million. Bank interest of £100 million. We have now put in our Tier 1 coupon on the basis that we now move ahead speedily with the formalities of resolving the Tier 1 bonds, that is with £28 million a year. And then finally, you will have picked up from the previous slide, we have the run off of our transformation costs in 2010 which we estimate to be between £30-45 million.

And just to be really clear in terms of cash. On page 14, just set out a couple of further key points. In terms of our normal annual target over the next five years of cash generation before management actions, we are targeting £400-500 million per annum. Now on top of the regular out flows, we also have our mandatory amortisation of debt which is £150 million starting in 2011. There are no mandatory payments in 2010. But we have set ourselves a target of paying down 10% of the outstanding principle of our bank debt as soon as is prudent so that we can then actually allow ourselves greater flexibility in terms of payment of dividend which at the moment are constrained by the banking agreement.

So that was all I was going to say about cash. I just wanted to say something about management actions and how we actually add value on two of the metrics, embedded value and cashflow. And I will take a little bit of time on this. Our model is really about driving value in four key areas. It is about putting our funds together so at the moment we have got 8 life companies, we were 15 and we want to actually move more of those regulated companies together so that we can reduce the running costs of running 8 different life companies. We want to use unrecognised tax attributes which can't be recognised in one company, but when you actually put that company together with

another company, then typically they offset each other and so we can offset tax losses against taxable profits.
We want to try and reduce capital by effectively putting businesses together we can increase the diversification of risks in the business so reducing cost of capital as well.

And then looking at backbook management, we work very hard on focusing entirely on the backbook. We are not writing any new business. We are not distracted by new business. This allows us to really do, and we have talked before with a number of investors and shareholders, about a line by line analysis of these businesses and effectively cleaning up the balance sheet. Ensuring we understand who are the number of policy holders that we have got. That we are not paying amounts out to policy holders who have left the business and really ensure that the balance sheet is clean.

Then tax optimisation. Again this is really going back to the point where we found a lot of the businesses that were being acquired and being consolidated have been in the past loss making. We have stewarded those losses very carefully to bring them forward so that when the business is returned to profit, we can now use those. And a case in point in one of our businesses last year where we freed up a £250 million tax deductable loss. And there is more to come in 2010 on that.

And finally on our outsourcers. We have got four outsourcers at the moment running our backoffice in terms of our policy holder administration. And here by proper management of those outsource providers, and potentially moving from 4 down to 3 and beyond, we can reduce our total cost base through renegotiation of those agreements both for the benefit of our service companies and our life companies.

Now none of this is really new. This is what we have been doing for several years and indeed it is repeatable. It is repeatable with each closed fund that we have looked at.

So that was EV, turning to the second box on page 15 in terms of cash. The same four areas of value apply, but in 2009 specific areas we focused on were fund restructuring, where we were able to release £150 million of cash through putting effectively three companies into one. And secondly, a key legacy issue was resolved in 2009 which allowed us to remove a whole lot of capital that had to be held in relation to the historic pricing of certain derivative positions, where we were able to reach a settlement with various parties in 2009, allowing effectively a cash buffer reserve to be released.

Looking ahead to 2010, it is really more of the same. And we are on track. You will recall we talked about growing EV by £300 million before the end of 2010. In 2009 we have achieved £155 million we have another £145 million to go. On cash, we said we would release up to £500 million of further cash by the end of 2010. As I say, we have done £275 million in 2009 and we have a further £225 million to go in 2010 and we have identified actions to deliver that and we are on track to deliver.

Moving onto capital, on page 16. Not a great deal to say on this. In fact our underlying life companies are actually run on a risk based capital basis, however at a Group level we have a rules based regime which is important for the FSA here in the UK, it is called the IGD, In terms of the capital coverage, we have got over £1 billion of capital over the required amount. So we are comfortably capitalised on that basis.

And just turning to IFRS. As I said, we report under IFRS for the first time today. Audited consolidated IFRS accounts. We have no surprises. The conversion from UK accounting standards to international standards has really not produced any new news. And IFRS for our asset management and service companies are pretty straightforward and as Jonathan said, is largely about income less expenses. For the life companies it is somewhat more complex, it is about the emerging margins that arise as the business goes from one period to the next. The experience that

we have on the book in terms of our assumptions and how those change for example to the extent of longevity or mortality in relation to the lives insured.

And then the third component of life company profits, is the return on the shareholder capital itself. But what is really important about IFRS, is that that isn't really a true view of cash flow. For the closed life book cash will always be greater than your IFRS profits because as well as the sources of profits, you are actually paying out year on year the net assets of the business as well, which can be released and paid away, because it is no longer required to support the policies on the books as regulatory capital. So we expect cash to be greater than IFRS profits year on year.

On page 19, we set out the way we look at the business in terms of the sources of profit from the life companies it is split out between the different product lines, whether it is 'with profits' non profit and plus the shareholder capital itself, the return on that. This is how we are going to be reporting IFRS profits going forward. And we expect it to be, as I say, with these business lines. However, probably more important, we still think to focus on embedded value. That is the better way to look at our business because embedded value itself is really no more than a set of discounted cashflows and as you are aware, really this business is all about cash. And so it is embedded values that I will turn to now.

And moving swiftly through to page 21. As we said on embedded value, we present a so called market consistent embedded value for the first time. And this is aligning to the UK practice, the so called CFO Forum practice which is established in the UK. So our EV over the period has grown from £1 to £1.8 billion. It is probably worth stopping and reflecting on that £1 billion at the start of the year and what that is. Effectively that is the combined Pearl businesses and the combined Liberty business as was at 1 January, net of the debt that the Pearl businesses had at that point of some £3.4 billion. Thereafter effectively we see two halves to the embedded value evolution of the Group as it goes from £1 billion to over £1.8 billion at the end of the year. In this analysis the first half is really all about the bank debt restructuring which has added over £400 million. Effectively that is reflected in the £491 million you see on slide 21, that is reflecting the write-offs that Royal London and the banking syndicates took. Because our amount of debt has gone down, so the tax relief that we can get from that debt has also gone down. Se effectively that is a negative against the write down. We also bring through our deal costs. We bring in the additional capital that came into the Pearl businesses at the point of acquisition from Sun Capital and TDR. And we also reflect the cash that was drawn out by the original Liberty shareholders as they are entitled to do at the point of the deal. So all of that restructuring of the business takes us from £1 billion to £1.4 billion. We then have £382 million that effectively represents the underlying business result for the period. And I take that in some more detail on the next slide on slide 22.

So what are the key points coming here? Again quite a lot of detail and clearly we are happy to take questions on this at the end. But probably the four key areas to focus on. One is the £504 million benefit from markets that is narrowing credit spreads, favourable equity movements in the period. Also on the positive we have the amounts realised from our management actions, what we have been doing to actually drive value in the business. But against that we see two negatives or two principle negatives. One is the outflows as we paid off bank debt and other financing costs in the period and also just to the right you will see £169 million of reduction in the embedded value, arising from a marketing of our Tier 1 bonds to market. At the start of the year we held those at around 20p. They have now moved to over 50p reflecting that increase in the market value of that liability has brought in a reduction of our embedded value of £169 million. That leaves us with an MCEV embedded value of over £1.8 billion at the end of 2009, obviously remembering that that excludes itself the asset management and the service company and future management actions. So overall we think that is a pretty strong performance on our MCEV basis.

Let me just say a few words on Ignis, our asset manager. Probably a couple of key points. One is its stable revenue. And that really reflects the secure fee stream that it enjoys from the life businesses. And it is important to recall that the life companies themselves, when working out their

embedded value, they have deducted all those future fee streams from their embedded values. So they have effectively already gone from the value of the business. And here in Ignis, we see £111 million, £81 million of which has come from the life companies. 2009 has really been focused on bringing two asset management businesses within the Group together and that reflects potential for cost synergies in 2010. We also see Ignis sustaining strong life company fund performance it is really key with £60 billion of assets, that they are managing those assets really well. But in addition we see in 2009 a growth in third party assets under management which we are looking for Ignis to sustain into 2010. It is probably worth on page 25, just looking at how you know, how the assets under management developed.

So it has been pretty stable over the period. Outflows from the life companies, that is the £4.6 billion which is to be entirely expected, reflecting the run off of the life companies. So this is effectively liabilities being paid off, policy holders being paid off. But that has been largely offset by market movements in the period. But we do see in the middle there, the benefit of £400 million of net inflows to the asset manager from third party business.

So just to wrap up on slide 26, strong cash generation, we have £716 million of cash produced in 2009, ahead of target. We have grown the embedded value to £1.8 billion, excluding asset management and the service company. We have completed conversion to IFRS and are showing an IFRS profit of £457million for 12 months. Our IGD capital stands at over £1.2 billion and as I say, in terms of the targets we set ourselves already for 2010, we believe we are on track to meet those.

I will pass you back to Jonathan now.

Jonathan Moss

Okay, I will draw the Presentation to a close with a couple more slides. So on slide 28, what we have tried to capture here is that it is a simple business model. We understand the value drivers and we believe that the process that we have are repeatable. So really there is a life cycle that we can go through each time we acquire a new business of this type.

So starting on the left hand side, we are able to acquire closed life companies. We believe we are well placed to do so because of our position in the market. We estimate we are at least three times the size of our nearest competitor and therefore we should be the natural home for these sorts of businesses.

Having acquired them we then go through a number of steps. Starting with financial management within the life company. We get in, we understand the balance sheet, we understand the risks that we are taking, whether we are being rewarded accurately for those risks and where we aren't we would seek to eliminate them. Whether there are risks that we believe we are adequately rewarded for, make sure that we are properly hedged and adequately capitalised.

Similarly from an operational management point of view, ensure that the businesses are being run efficiently. To the extent that there are not outsourcer arrangements, put those in place. We have existing outsourcer arrangements that we can leverage. Ensure that in putting those arrangements in place, there is an appropriate risk transfer. That the responsibility of each of the parties is well understood and we get a level of pricing which reflects properly our scale.

Within asset management, we want to grow the franchise of the businesses that we acquire. In part that will be in relation to third party assets and as Simon has illustrated, in 2009 Ignis attracted £400 million net funds flow. And similarly in terms of the in-house clients, developing those relationships, simplifying and standardising the processes involved and so forth to ensure that the relationships are as transparent and effective as possible.

Having done all three of those things, it is in doing those that we are able to accelerate cash release from the businesses in order to allow that cash to flow up through the business and ultimately form the dividend flow through to shareholders.

Moving to the next slide and looking at 2010. In the same way that we set out what we were expecting to achieve during 2009, we have done here the same for 2010. So we have done the life business, we will do further fund mergers. That will include moving Phoenix in London, under Phoenix Life Limited, moving London Life under Pearl assurance. We will continue to work in increasing the cost efficiency of our retained business. So we are moving from three sites down to one. Last week we completed the closure of Glasgow. During the course of 2010, we will certainly close down our Peterborough business and that will put us onto a single site.

We are continuing to work very closely with our outsourcers to ensure that those relationships we robust, that there is adequate risk transfer and that we can predict that the cost base that we bought into, we will be saying more about that as we approach the second half of the year.

Like all insurers in the UK and across Europe, we have to embrace Solvency 2 which Europe are moving to a risk based capital regime, which will absorb a lot of resources for us logistically, but ultimately I think will ensure that there is consistency between our reporting basis and the economical capital basis that is currently driving our ability to release cash from the business. So that will add to the transparency of our reporting going forward.

Within asset management, as I mentioned earlier, we want to standardise the relationships with the life companies, move from 300 segregated mandates down to 30. Unify funds that each of the life companies can choose to invest in. That will bring greater simplicity and greater focus on managing that smaller number of funds which should itself lend itself to better performance. And we will continue to build out the third party business.

We have enhanced the capability of our investment managers and we have made some senior hires in the fixed income area in particular.

Corporately, there is still clearly work to do. In particular further work on the capital structure necessary to achieve the premium listing in London which we are expecting to do in the first half. Having sorted out the equity component of the capital structure, as we move into the second half of 2010 and 2011, we will be seeking to again simplifying our banking arrangements and in particular pay down 10% of the debt in order that we can remove the covenant restrictions around the dividends that we are able to pay.

So finally on slide 30, 2009 has seen a year of strong operating performance in the business, where we have beaten most of the financial targets that were set for the underlying operating businesses. £716 million of cash. MCEV growth to £1.8 billion and a strengthening of the capital resources as against capital requirements with a £1.2 billion excess by the end of the year. That means that we are well positioned for 2010 and beyond. We are the market leader in our sector. We have work left to do which will enhance the underlying value in the businesses that we have, and having done the necessary work there, that will mean that as we approach 2011 and beyond, we can look to leverage the model through further acquisitions.

So I guess, all in that means we are looking forward very much to 2010 and we would anticipate a further successful year.

On that point I would like to hand back to the operator for Q&A.

Question and Answer Session

Question 1 : Lee Yungin, Morgan Stanley

Hi, I have a question about your premium listing. Where does the contingent share conversion stand? And can you give me an update on the footsteps towards premium listing?

Answer : Jonathan Moss

Thank you Lee and hello. In order to undertake the premium listing I guess I would distinguish between the logistical steps that we have to take which is all about producing the prospectus through the work that we have been doing in creating a three year financial history and so on, on the one hand, and the commercial aspects on the other which is the sorting out the contingent rights. In practice I think the second, in terms of the elapsed time, takes a lot shorter time than the first which really does involve pulling together a huge amount of information. So there is no particular time pressure on us sorting out the contingent rights, it is certainly something we have plenty of time we have to get done before we issue our prospectus. The negotiations are ongoing. I can't say too much about them, but they are certainly being held in a constructive way and clearly implicit in us saying we are on plan to do the listing in the first half of the year, is a view that we will get to a suitable outcome in relation to the contingent rights.

Operator

There are no more questions at this time

Jonathan Moss

Well I would just like to say thank you to everybody for listening in and obviously look forward to seeing you and hearing from you over the course of the next couple of weeks. Thank you very much.

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