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.

H1-2020 Results

Conference Call Transcription

Paris, 29 July 2020

Presentation

Moderator

Ladies and gentlemen, welcome to the conference call for the presentation of Coface's results for the period ending 30 June 2020. All participants are now in listen-only mode. The call will conclude with a questions and answers session. As a reminder, this conference call is being recorded. Your hosts for today's conference call will be Mr Xavier Durand, CEO and Carine Pichon, CFO. I will turn the call over to Mr Xavier Durand.

Xavier DURAND, CEO, COFACE

Thank you and good evening for those of you in Europe and good morning if you are in the US. Today, we are happy to report our results for the second quarter of 2020. As you probably read in the documents, we are reporting a profitable second quarter, with a net profit of EUR 11.3 million. This brings the total profit for the first half of 2020 to EUR 24 million. We will go into a lot more detail, but I will just give you some highlights on the first page.

Turnover is down by 0.6% at constant FX and perimeter. It declined a little more in the second quarter, by minus 2.1%. I would say this is probably moderate considering that many economies in Western Europe were actually in lockdown during that period. On a number of items, the business has actually performed pretty well. New business is at record levels, as is client retention and this drove positive net production of EUR 33 million for the first half. We are starting to see the first impacts of the repricing that we started, and we will talk more about this. Services grew by 7% and information services are up by 13%. Of course, we do not control the activities of our clients which continue to slowdown. We expect this trend to continue over the coming quarter. The crisis is obviously not over and we are now entering a slow and differentiated recovery. In terms of the losses, the first half net loss ratio is up by 13.4%, to reach 57.4%. This brings the net combined ratio for the first half to 88.6% and to 91.4% for the second quarter. The gross loss ratio is up by 18.1 points. This has been particularly driven by the provisions we have taken on the new vintage 2020, to cover what we anticipate will be higher loss frequencies as this vintage develops. When we take account of the government schemes that have been put in play, the net loss ratio is only up by 13.4%. Our net cost ratio is down by 0.8%, to 31.2% and this reflects the continuation of tight cost discipline, the projects we have launched in the past and the growth in our service revenues. As I said, there is EUR 24 million of net profit in the first half, with return on average tangible equity at 2.8%. Our solvency is an important point and you will remember that we started from a very strong position in 2020. It remains very strong at 191%. This figure includes support from governments and even if that is excluded, it is still 183%. This is well above the target range of 155% to 175% that we highlighted as our comfort scale. Finally, you probably recall that we had agreed to purchase a company in Norway called GIEK Kredittforsikring, which is the state-owned credit insurer. We closed this transaction in the second quarter. This is the second purchase Coface has made in 18 months. We are expecting to book a badwill of about EUR 8 million at this stage. This will be booked in the third quarter, given that the acquisition was closed in July.

Coface continues to execute in a challenging environment. The latest forecast, on page 5, has changed a bit from what we showed at the end of the first quarter. I think that since then we have understood that the lockdowns have been longer, deeper and tougher than we anticipated and the impact on global GDP is actually going to be greater. At this stage we are thinking about minus 4.5% for 2020, followed by a recovery next year. However, the impact of the pandemic will clearly last well into 2021. This is a health crisis for which we have no vaccine at this stage and obviously no cure. We know that social distancing works and as the pandemic continues to flare in North America and Latin America (and to some extent is coming back to places where we have already come out of lockdown), that social distancing will be the key tool for controlling the virus. As such, we expect a slow and differentiated recovery and we have published a lot of literature on this if you go to our website. It will clearly depend on the country and the sector. There will be and is a recovery, but it will be slow and differentiated.

Our forecast in terms of insolvencies is 33%, which is an increase from I would stress was a low point in 2019. It is a significant increase and the main culprits are the US, the UK, Italy and France. To some extent Germany is doing better than the rest. What is interesting in this crisis, which is very different from 2008, is the reactions of governments. Although this is a health crisis and not a normal hazard, I think governments have learned from what happened in 2008. They have taken fast, bold actions to protect the structure of the economy and implemented support mechanisms that far surpass anything we have seen in the past. As a result of this, the claims activity that we have seen is well below what we experienced in 2008. Obviously, we expect monetary policies to remain highly accommodating going forward. In addition to supporting the economy through loans, guaranteed loans, paying for employees etc., governments have been talking with the credit insurance industry to put into place schemes that would allow us to provide support to the economy and avoid what they feared would be a corporate credit crunch. We have signed contracts with 11 different governments so far and there are a few more ongoing at this stage.

We presented our Build to Lead plan literally two weeks before we went into lockdown. In reaction to this unprecedented crisis Coface has reacted extremely quickly - and I would say extremely well - to things within our control. On page 6 you can see the number of prevention actions over the last four years. It is clear to see that we have more than tripled the number of actions we have taken since the fourth quarter of last year and probably quadrupled them from what they were in the first quarter. Our teams have responded well. We went into lockdown overnight and there has been no major rupture of our service to clients or brokers. We have committed to not doing automated reduction plans, so this has all been about maintaining the dialogue with clients manually.

Coface's total exposures are down by 6.4% compared to the end of last year. I think this is the steepest decline within six months on record for Coface. On the right hand side of the slide, I thought it would be interesting to provide you with some colour on where the risk has altered most. Latin America (which I do not think will be a surprise to anyone) is down by 27% since the end of last year. Central Europe is down by almost 11%. The numbers for North America are a little skewed because we entered into a large contract in a better segment just before the crisis - but if you take that out, we would be down by double-digits. Asia Pacific is at minus 5%. Northern Europe is down by 2.7% on a pro-forma basis. Med & Africa is down by minus 7% and Western Europe at minus 5%.

Some very significant actions have been taken in the spirit of what we committed to do when we started Fit to Win, which is to maintain a strong level of dialogue with our clients. In addition to managing the risk, it's also about being very selective in where we want to play and we have entered into contracts with governments. On the left hand side of the slide on page 7, you can see where we stand at the end of Q2, in terms of the contracts we have finalised with different governments in 11 countries. These contracts represent close to 50% of our total exposures. In addition to these, we are in ongoing discussions with other governments and for extensions of existing programmes in terms of scope or geography, which are close to another 15%. Currently we expect a big third of our book not to be covered when this is done.

These government programmes come in-between us and the reinsurance programmes that we have in place. The right hand side of the chart show the two different quota-shares we have in place, currently for 11.5% each. They are two-year contracts which renew every two years, on alternate years. We also have an excess of loss per risk policy which limits Coface to a 3% exposure of total shareholder equity for one single event. Then we have a stop loss programmes that protect our downside when losses go over a certain level. We maintain a broad pool of well rated reinsurers with strong ratings, so we have not altered our reinsurance policy, but the government programmes come in-between us and the reinsurance market. This is something very new, brought by this crisis.

On page 8 I just want to highlight how we are managing this crisis and the left hand side of the chart summarises the strategies we introduced when we presented the Build to Lead programme at the end of February. As we said then, we want to be seen as a leader and as a reference in this industry. That is in terms of how we operate in terms of risk management, of being very proactive and agile; in providing quick service, in being consistent and flexible, being able to adjust to whatever the environment holds for us; and in terms of our operating model, being simple, integrated and digitised. We want to maintain our focus on growing the business and creating value over the cycle by investing in things we see as profitable over the long-term and maintaining an average return above our cost of capital through the cycle. We also want to put into practice the culture we have spent the last four years building for Coface and making sure that it is now a reality for the business.

On the right hand side you can see how well Coface has been executing on the things that we can control – particularly new sales, new business, retention, prevention actions, total exposure management, price management, sales of information and cost management. I think Coface has actually done well in the first phase of this crisis over the last six months on these elements that we can control. Obviously, we are very careful about monitoring the things that we do not control as much, like client activity. A lot of businesses have seen that their turnover will be impacted significantly going forward and factoring volumes have been slow in this second quarter. This is something everyone can understand given that factoring is mainly in Germany, where a lot of surrounding countries are in lockdown mode. Fee volumes are tied to some extent to the two items above. As to financial revenues in the portfolio, clearly the expansionary policies being put into place have an impact on the rates and we will see an impact on our own book. Again, we have been very conservative in the way we manage the book and we are not looking to maintain the yield at the cost of risk that we would be uncomfortable with.

I just want to say a word about our corporate culture, as we conduct an employee survey every 18 months. and we decided to go ahead with it. We got the results from the most recent survey 10 days ago and we had 94% spontaneous participation from our entire employee base worldwide in survey. This is even higher than in 2018. The survey results were up 24 points from where we were last time reaching the level of the international benchmark. The message I want to send here is that we are on the ball and the business is operating well. Of course we do not control the environment but the business is operating well on the things that we can control.

I will now go into more detail, on page 10. As I said, turnover is down 0.6%, all other things being equal. Trade credit is down 2.3%, a decline that is led by a decrease in client activity. Turnover is still benefitting from positive net production. As I said, we do not necessarily expect this to continue over the next few quarters. The good news is that we have put a bit more of a focus on service revenues and information sales, which are up 7% and 13%. As I mentioned earlier, factoring is down almost 14%, which is really a function of the draws made by clients on the capacities made available to them. Obviously, we have also started to act on the pricing of that book, which we highlighted as one of our key items in the context of Build to Lead. The fees to premium ratio is starting to creep up again, which I think is good.

On page 11, looking at the geographic split of volume, Western Europe is down 4%, which is mainly due to lower client activity. It is the same story in Northern Europe, which is mainly Germany, where we see low client activity and as I mentioned, a decline in factoring volumes. Central Europe is flattish at constant scope, growing a bit on credit insurance and shrinking a bit on factoring. Med & Africa continues to grow, and they have been very strong in terms of client retention and driving fees and services, so we are seeing a good performance there. North America is flattish, with new business pretty good but lower activity from clients. Asia Pacific again has lower activity, which is not a surprise as some of these countries were the first to enter the crisis. Latin America is probably the most difficult environment, net net and correcting for FX (because you know there is a lot of variation here), is slightly up. However, as I have said before, that is a result of the momentum we had there on international contracts going back a couple of years, not something driven by aggressive business underwriting.

On page 12, to illustrate what I said earlier in terms of our ability to perform on things we can control, we see new business for the first half is up at 86, the best year we have had since we started the whole turnaround effort. Retention is also the highest it has been, at 93.4%. Pricing, although it is not massively positive, is probably the best it has been in the last 10 years, at 0.2%. Volume is still positive, but as I said, I would expect that to continue to be challenging. The economy will recover but it will be slow over the coming period.

Looking at page 13, on the loss side, for the first half the loss ratio before reinsurance and including claims handling expenses, is up at 59% from about 41% for the first half of last year. The quarterly sequence shows an increase starting in Q1 and continuing in Q2. The gross loss ratio for the first half of the year is really partly due to increased claims but mainly further anticipation of an increase in corporate bankruptcies. As I said, there has been a bit of a disconnect between the macro impact and the micro impact, with companies being supported by governments. We have not changed our reserving policies and we have used all our abilities to see through what is going on to increase the reserving on a new vintage 2020, which opens at a reserve rate of close to 88% from the 73% we had last year. At the same time, the recoveries on prior vintages continue to be pretty good at 31% for underwriting years 2019 and before. That leads to the 56% risk performance for the first half.

Page 14 highlights how the different regions have performed by year and page 15 shows the quarterly comparison. On the slide we show the larger more stable markets at the bottom and the traditionally more difficult markets at the top. In Western Europe, after a spike in the first quarter of 2020, which we explained was linked to an industry-wide claim, things have come back down, so are a little higher than before, mainly due to the reserving process we underwent in 2020. Northern Europe is seeing the same thing except that it also has some good recoveries on prior vintages. Central Europe is up at 57% and Med & Africa, again driven by the reserving methodology, is up at 62%. Latin America is the toughest market and we have reduced our exposures from 27% at the beginning of the year. This is after we had already reduced our exposure there quite dramatically in 2019 and 2018. This market has seen some very large risk actions and I think we all understand they were in an economic down cycle before the COVID crisis hit. The COVID crisis is now raging there in a way that is probably one of the least controlled in the world and then there is additional social and political turmoil adding to the noise. Asia is holding up pretty well at 58% and North America is traditionally a market that reacts faster on both the upswing and the downswing. This time is no different. You have probably seen the list of retailers that have gone into bankruptcy over the course of the last six months. It seems as if the Mall of America has pretty much gone bankrupt with household names like JC Penney, Neiman Marcus, Barneys and specialised retailers like J. Crew, G Star RAW and Aldo for shoes, Modell's for sports and Wendy's. The number of bankruptcies in the US is clearly on the upswing and there are no government programmes in that part of the world. However, I think the team has taken this into account and as I said, we are adjusting our exposures in these markets.

On page 16 you can see our costs. Our costs for the quarter come in at 166 compared to the 177 for the second quarter 2019, so we are down 5.1% on cost. Obviously, that is more of a cut than the drop in premiums which means that the cost ratio has actually been improving in the first half, from 33.9 to 33.2. I think it is a good sign that the business is focused and the actions we have started in the past are paying off. We are not letting go of our desire to simplify, digitise and make the business better. Of course, we are benefitting from savings linked to COVID, with hardly any international business travel. We are benefitting from the cost benefits that came from the integration of our US agents, which is now final. These things are coming into play, but net-net I think what matters for the business is that we are executing on the cost front and we are not abandoning our ambitions when it comes to the Build to Lead plan.

With that I will turn it over to Carine.

Carine PICHON, Group CFO and Risk Director

Thank you Xavier and good evening everyone. I will start with reinsurance, on page 17, which has clearly played its role of absorbing the higher loss activity. The cost of reinsurance, which was not far from 50 million euros last year, was a little less than 6 million euros at the end of June. This includes government schemes for the first time, which are in force in several countries. The impact of these schemes represented a positive impact of EUR 8 million in Q2 2020. It has also resulted in an increase in the premium cession rate, which has gone from around 29% in H1 2019 to a bit less than 40% in H1 2020. The higher cession rate of claims also reflects the impact of these schemes, as well as a higher opening loss ratio.

Continuing on page 18, the net combined ratio stands at 88.6.% for the first six months of the year, so an increase of a bit less than 13 ppts. This is clearly due to an increase in the claims ratio, as Xavier just mentioned. The cost ratio is down by 0.8 points, which shows that we are continuing to execute good cost discipline. On a quarterly basis, the combined ratio is 91.4%. The net cost ratio is at 33.5% versus 32.2% in Q2 2019. This is mainly due to the fact that commission rates granted by governments are lower than ones we usually have from traditional reinsurers. This affects the cost ratio. The loss ratio is 57.9%, which is quite stable compared to Q1 2020, because even if there are higher losses and an expected increase in defaults, it has been absorbed by higher reinsurance and in particular the effect of government schemes.

Slide 19 looks at the financial portfolio. We aim for resilient and secure investment income as far as possible and you may remember that we decided to increase the liquidity in the financial portfolio. This has had an impact on the accounting yield, which is 0.6% compared to previous 0.9%, mainly due to lower interest rates. Having said that, the net investment income is stable at around EUR 16 million (compared to EUR 17 million previously) as we had some negative one-offs last year which did not occur this year.

Net income on page 20, was at EUR 24 million and EUR 11.3 million of this was in Q2. This decline clearly comes from current operating income and the increase in the loss ratio. I also want to comment on the tax rate, which is 46%. It was even higher in Q1 because we had one big claim in a country where we have not booked any deferred tax assets. It did not happen in Q2, so the tax rate is around 39%, coming back to a more usual level. Overall for the first six months, the tax rate was 46%.

On page 21 you can see that the return on average tangible equity stands at 2.8%. As we have already mentioned, this decline is mainly due to technical results, loss ratio deterioration and, to a lesser extent, a lower financial result and a higher tax rate.

Equity is very stable, and I will come back to this because there is IFRS equity and a very high solvency. Of course, there is an impact on the result of the first six months, but there is also the lower impact of re-evaluation of reserves following a rebound on the market. There are also low treasury shares and currency translation. As you know, currencies varied a lot during the last quarter. Overall, equity was quite stable between the end of 2019 and the end of June 2020.

At this point, I'd like to go to part 3 of the presentation on capital management. There is still a very solid balance sheet. Xavier mentioned our financial strength and the fact that we have kept our AA- rating from Fitch and A2 from Moody's. Considering the current environment, it is normal that we have been put on negative watch. We have also kept an A (Excellent) rating with AM Best, with a stable outlook.

Page 24 analyses solvency and shows our strong balance sheet. We had a solvency ratio estimated at 191% at the end of June, which is clearly above the target range of between 155% to 175%. Even without the government schemes this ratio would have been 183%, so it would also have been above the target range. At the end of 2019, we were at 203% including the fact that we had decided not to pay any dividend. The main reason for the decline is own funds variation, meaning the solvency shareholders because there is not only a negative re-evaluation on the financial portfolio, but also the fact that we have reviewed our best estimate on anticipated losses. This has a direct impact on own funds variation. When it comes to the sensitivity of these ratios to either market shocks or loss ratio deterioration, we want to limit the impact of changes to the financial portfolio, so the gap in the solvency ratio can move by a maximum of 7%, which is significant but not enormous. When it comes to the loss ratio evolution, if we have to replicate a crisis of one year over 50, we would be at 175%. Even the ratio for this scenario is at the top of the target range, which shows that we have very robust solvency over time.

On page 25, you can see the 191% is split between the total required capital of EUR 1.1 billion. This capital requirement is quite stable and resilient to meet this crisis. This is thanks to the partial internal model, as we have calibrated it so that it can be still seen through the cycle. We are very happy to have this model instead of the standard formula because there is less pro-cyclicality in that calculation. However (and that is where we have the most impact), within the 2.1, there was a decline on eligible own funds; because we reviewed the level of best estimate of provision, which is directly computed in deferment.

I will now give the floor to Xavier for Part Four of the presentation, with the key takeaways and outlook.

Xavier DURAND

Just to summarise what we have discussed here. We book our second quarter of profit in 2020, in an environment that is frankly extraordinary in terms of disruption and government intervention. We are also maintaining prudent reserving. I think for me what is important is that this quarter demonstrates again the resilience, agility and the ability of Coface to navigate the environment. As you have seen, the solvency ratio, even excluding the benefit and even if it is from governments, remains well above our target range, so we have got a strong balance sheet. I think we can say that we have successfully managed the first phase of this crisis so we are focused on the crisis, but are not losing sight of our Build to Lead strategy. We have to make some tactical changes because priorities are priorities, but in the end, we are not changing our strategy. I would say that our risk prevention actions remain at an unprecedented level. We are still trying to grow very selectively and remain true to what we said in terms of creating value over the long-term. Our risk exposures have been reduced by the most that they have ever been in six months during the history of Coface. Our new business, client retention, pricing, service revenues are all going in the right direction given the things we can control. Solvency allows us to continue to be on the hunt should things come our way, as we illustrated with the acquisition of GIEK. As a reminder, this is our second acquisition in the last couple of years. Finally, we continue to cooperate with governments to support the economy and participate in our industry.

Clearly, the big unknown is the economic environment and the resurgence or not of the virus. In this case, the health situation really drives the rest of the economy. We are continuing to focus on executing in this environment and trying to do the best with what is out there. We remain confident that Build to Lead is the right plan and that is what we are focused on in the medium-term.

With that, I am happy to turn it over to questions.

Q & A session

Thomas FOSSARD (HSBC) I have three questions. First, on the drop in exposure, minus 6.4% year-to-date. Could you provide a bit of a forward looking view, bearing in mind the current environment. Should we expect further cuts in exposure towards the end of the year? Is there more work to be done in the second half? Second, on the costs, it is quite impressive to see your internal costs dropping to 126 in Q2 standalone. I would like to understand if there were any specific one-off items, or if 126 was now the run-rate for the upcoming quarters? Third, on the duration of the government schemes, are they more or less all established with a timeline for the end of the year, or are some of them already expected to be prolonged to 2021?

Xavier DURAND (CEO, Coface) The government schemes more or less all focus on COVID. Basically, I think that everyone understood that this thing started in March and everybody is planning for these schemes to finish at the end of the year. There may be one that goes a bit longer, but I cannot remember.

Carine PICHON (CFO, Coface) Not for the moment.

Xavier DURAND (CEO, Coface) I think they are all ending at the end of the year and the question is what happens then. That will really be a question of what is happening in the economy and on the health side. We will either start to see things clearing out and the governments focusing on trying to winding down their programmes, or if COVID is still ongoing they might decide to expand some of them. I think it is too early to say and I do not want to speculate.

In terms of the cost you are right there is a decline. As I said, there are several factors. One is the structural changes we have made to the business over the last four years, such as rationalising our agency network, and this is ongoing. Second, there are things we have done that would probably not have done without the COVID crisis. We decided that given the current environment we do not want to put new salespeople in places where there is a higher risk. Third, as I said, there is just the natural fact that people are no longer travelling and things of that nature that are COVID-related. When it comes to what that means for the future, some of these things will be permanent and hopefully some will come back because we will get out of this crisis.

In terms of the exposures I will say that this is a never-ending job. I think the key word I have insisted on for the last four years, which I think is starting to become reality, is agility. We are going to be doing the right thing where it needs to be done. As you know, the second phase of the crisis is still to be spelled out, so we have done what we think we needed to do up to this stage but we are not going to take our eyes off the ball. We are not going to hide behind government schemes that will be here for a while but will then go away. We are going to continue to manage exposure, but I am not going to give you a forward-looking statement on where that will end. I will tell you more on the Q3 and Q4 earnings calls.

Benoit PETRARQUE (Kepler Cheuvreux) My first question is on your GDP growth forecast. The ECB has given a forecast of minus 8% for the full year 2020 where you have minus 4%, and they have plus 5% in 2021. The minus 4% seems quite optimistic, so what is your view on that? Will a more negative GDP forecast have an impact on your combined ratio and potentially, provisioning? If we see Coface downgrading the 4.4%, will that lead to higher provisioning in the coming quarters?

Second, on the claim activity on a monthly basis, have you seen a peak of the claim activity already? Was that in June or is it still in front of us? Can you comment on this peak claim activity? It would be very useful if you could provide some data on monthly frequency.

Third on the pricing, you talked about a small positive, still early signs and not being in the repricing situation yet but how much repricing do you expect and, considering the government schemes, can you freely reprice?

Fourth, on the net earned premium, which is obviously down, it is a transfer mechanism but is the Q2 level a good run-rate for the coming quarters? I think most of the schemes started during the quarter, so I wondered if this was still a big pressure on the net earned premium?

If you have time, it would be great to have some more comments on page 32 where you present the schemes and hear a bit more about the differences between them.

Xavier DURAND (CEO, Coface) Let me start with the question on GDP. What we have here is the global GDP outlook, including a lower number for Europe and advanced economies and a better one for emerging markets and some areas are still growing. I would just caution that you are comparing apples and apples here. Second, regardless of all this, I would just insist on my earlier comment that this GDP drop is unprecedented. I do not think we have seen anything like this since the Second World War, but at the same time we have not seen government reactions like this since then either. There is a bit of a disconnect between the headline number and what is really happening on the ground.

That leads to your second question, which I think I just answered. The claims activity is not correlated to the GDP drop as you would expect if there was no government support. Government measures are working, so it is hard to say when the peak of claim activity will happen. As I explained, I do not think this crisis is over. Today, a good chunk of our losses are linked to reserves we set-up for the New Year 2020. We are being reasonable in the way we do this. We have kept the same metrics and methods, but there is clearly a lag between the GDP and the way the markets in reacting, in particular because of the government schemes. They have been put in place in so many countries, with so much money, I think we are talking about close to USD 10 trillion at this stage.

When it comes to pricing, as you point out, this is not pricing season for us. I think the jury is out in terms of where this goes because a big chunk of the pricing will go towards the end of the year. As I said, I am not going to make forward-looking statements, but we will apply the same principles we have been advocating for the last four years. There is no change in what to expect from Coface - but where the economy, the competition and government schemes stand at the end of the year are all yet to be determined.

In terms of the net premium, the same forces will be at play as we go forward. You will have the new business, pricing - which we have seen is better than before but still not a big positive - then the activity of our clients, which I think is the big driver here. We expect the drop in GDP we have been talking about, so we will still have that.

Carine PICHON (CFO, Coface) I think the question was also on net earned premiums, on cession rates, so I can take that. Page 17 shows the H1 results, so the premium cession rate is for six months and the schemes were implemented in Q2. If you want to see something that is more in-line with the impact of the schemes you have to look at Q2. It will also depend on what happens with the upcoming schemes that will be implemented. On slide 7 you can see the impact of around 50 of total exposure for the 11 schemes signed. We are still under discussion for 14% to 16% additional schemes, including large countries such Italy and Poland. Every time a new scheme is finalised, we issue a press release about the main financial features. It will also depend on the speed and the nature of these schemes.

Xavier DURAND (CEO, Coface) There are two kinds of schemes as seen on page 32. One is what they call top-up, which basically says that if we are insuring a limit today and we want to reduce that limit tomorrow, the government is proposing to the client that they step in to maintain some of that limit on their own account. That is a line by line, client by client kind of thing. A number of countries have chosen to go down that route, starting with France in the first scheme, but Israel, Portugal, Slovenia and Canada are also going that way. It is clearly a lot more cumbersome to manage. It is slow and clients have to pay a premium, so the impact of these programmes tends to be less massive on the economy than the other kind of programme, which is actually the one that Germany initially put forward. That basically takes a quota-share of our business where they take 65% of our premiums and 90% of our claims for things related to COVID. That scheme has pretty much been copied or cloned by other countries including the Netherlands, the UK, Belgium, Denmark and lately France has recently added this system to the existing quota-share. That is how it works but they all have slightly different tweaks, so I would just point out that for Coface it is another sign of our ability to execute because it adds complexity to our business. We have to manage all these different things in compliance with all the rules that pertain to them but the business has actually been good at putting all this stuff in place, managing it and publishing the numbers and doing everything we need to do from a reporting standpoint. Again, to me it is a good sign that the business is executing well.

David BARMA (Exane BNP Paribas) My first question is a follow-up on one of the points discussed earlier, on the extensions to the government schemes. I just wanted to check the mechanisms there because I understood that exposure cuts would take a couple of months to feed through your P&L. When we are thinking about 2021, does that mean that by September or October you will need to have a view aligned with the regulator in terms of what is happening, on whether the schemes are standard or not?

Second, on the solvency movement, could you please remind us what the impact of the government scheme is on the solvency movements and what items is driving that?

Last, what is driving the level of recoveries in Q2 specifically and should we expect the numbers to normalise as the share of the 2020 vintage with the higher share of bankruptcies feeds through?

Xavier DURAND (CEO, Coface) When it comes to the government schemes you are right to point out that it takes a couple of months or whatever number, to adjust to the new reality for our business. It is an operational question and a contract timing kind of question. I think the governments will probably want to provide the market and themselves with some kind of a view as to what is going to happen next towards the end of the year. I cannot tell you whether that will be September or November; we are in politics here. For me, the situation can vary depending on what the real state of the economy is at that time and then what governments are going to decide. In any case, Coface is going to have to be ready either way, so you have to count on yourself before you can count on others and that is the way we are going to approach it philosophically, while complying with everything we told everyone we would do. That is the mind-set we have to keep.

Carine PICHON **(CFO, Coface)** The second question was the impact of the government schemes on solvency and it is a little less than eight points. At the end of June, it was 191% and if you exclude eight points it comes back to 183%. That is the impact of the government schemes, the fact that we are protected by them. It is a range from strict impact that we have signed in most places with the government.

Xavier DURAND **(CEO, Coface)** The governments take part of the risk and we do not have to allocate capital for that part.

Carine PICHON **(CFO, Coface)** We have capital relief.

Xavier DURAND **(CEO, Coface)** On the recovery, you are right to point out that in all past crises there is a correlation between the crisis and the level of recoveries you get on past vintages. I do not make forward-looking statements here, but it will also depend a bit on the outlook.

Edward MORRIS **(JP Morgan)** My first question is can you just clarify if there are any conditions attached for Coface in participating in these government schemes? Do they place any requirements on you, either in terms of capital management or anything else we need to think about?

Second, I noticed that you show solvency ratio of 191% or 183% excluding the government schemes. I wondered why you quoted this figure excluding government schemes. Is it because you could choose to opt out and it would give you more freedom in some way? How and why should we think about this 183%?

On the 50% of exposure not covered by government schemes, presumably you have taken much more drastic measures in managing exposure for the half of the business that is not covered. Could you talk a bit about how you are managing the risk on that half of the business?

Last, your loss ratio peaks in the quarter have obviously increased and you said that was really due to reserving prudence rather than seeing any claims at this point. I am interested whether you think that the loss picks you have done for Q2 are a good proxy for the rest of the year? Are these loss picks intended to reflect your current view of the claims environment we will see as we move forward, or should we expect loss picks to continue to deteriorate before they start to get better?

Xavier DURAND **(CEO, Coface)** Government schemes. Let me ask what would it be would it be if you did not have the government schemes? Are you doing okay because you are getting a subvention from the government, or are you standing on your own feet? I think you have the answer here and we just wanted to clarify that government schemes do help in this case.

Second, the goal of these government schemes is to avoid a liquidity crisis. Governments are obviously very keen on making sure that insurers do not massively withdraw limits and their support is there to help us not to have to do this given the circumstances. We have entered into requirements that are very public because all these government schemes are, is that we would not go into massive reduction plans, computer-driven blind if you will. We have to have logic for where we need to adjust exposures. I think that there is broadly a recognition, and every scheme is different, that if a risk is bad, nobody wants to take it, not us, nor the client which usual retains a part of the risk themselves. Nor does the taxpayer just want to give money to things, so there are all manner of nuances in terms of what the requirements are here.

Are we being more drastic in the 50% not covered? We have been quite homogeneous in the way we have thought about the business. The fact that there is a government scheme might tweak the competitive dynamics in the market a bit. It might make some insurers bolder about trying to win new business or things like this, so we have to be tactical, smart, agile and watch everything carefully. However, essentially, we are adjusting the risk where we think it needs to be adjusted because we know that these schemes are not going to last forever.

On the loss picks, it is the central scenario on a range of scenarios of what we believe needs to be booked based on our current reserving methodologies, which we have not changed and that reflect a fair estimate of where we think in that central scenario of things should be. Again, this is an exercise that we have to keep doing every quarter as things develop.

Hadley COHEN **(Deutsche Bank)** A quick follow-up question on the solvency side. Can you just explain what the moving parts are in the own funds versus last year? I heard the obvious market-to-market effects, but I was not sure what you were building in in terms of your assumptions around claims experience. Is that just what you have seen so far this year and what you have booked already, or are you building in more than that with insolvency?

Carine PICHON (CFO, Coface) In fact, there are two main reasons for this change. First, there is the re-evaluation of the financial portfolio because as you know, we are at market value in solvency own funds. Because of the decline and even after the rebound we are still a bit down compared to the beginning of the year and it has a negative effect on solvency. Second, there is the fact that for solvency equity we put the best estimate of the provision so it is based on the loss ratio as of today. Therefore, we have reviewed this, which leads to the fact that the reserve level has increased. That is what you see in that solvency. It is mainly a review of anticipated claims.

Benoit VALLEAUX (ODDO BHF) First, regarding new production we have seen a strong increase in H1. I just wanted to know where you are gaining clients and more specifically whether or not you enjoyed some strong growth in North America or not in the current environment?

Second, do you see further potential cost efficiencies due to home office work? Maybe after cleaning your portfolio you may have a more regional approach and close some local offices?

Third, coming back to solvency, you gave sensitivity to an economic crisis once every 50 years. At the end of June, which was a negative impact of minus 16 percentage points, versus minus 21 percentage points at the end of 2019. It seems that it is based on your 191% solvency margin, taking into account the government schemes. I just wonder what this sensitivity would be if government schemes were excluded, that is if we look at the 183% you gave as a solvency at the end of June.

Xavier DURAND (CEO, Coface) In terms of new production, we came into 2020 without anticipating COVID, so we had the Fit to Win plan we just came out of. We were going into Build to Win and executing on that strategy and had got momentum. All the actions we were taking are continuing and so I think that you see some of that in the numbers. Of course, we adjust our underwriting to the reality of what is out there, and we are not going crazy and writing business that makes no sense. What you are seeing here is the result of this strategy.

In terms of cost efficiency, it is an interesting point. I think we have learned in this crisis that we could all operate from home. We would never have tried something like this under any circumstance in the prior world, but with COVID we did not have a choice. We have realised that it is possible, so we are now trying to think through what of that can be permanent and what will have to go back to face-to-face, offices, etc. I do not think we have the answers because it is way too early. While we know that we can work from home in crisis mode for three or four months, what it means for the long-term, what activities can be done remotely and what is done better face-to-face, still needs a lot of learning. I would also say that there may be some office efficiencies, but I guess that a lot of people are going to be looking for renters at this stage. Second, when you work from a distance you also need to invest in technology. Does that translate into a net-net cost down? Maybe. I do not know, and it is way too early to say. I would not expect a radical change in the business because even if we wanted to do something radical, we are tied into leases and other things that are multi-year. It is an interesting debate, but I do not expect a revolution in the short-term.

Carine PICHON (CFO, Coface) Your other question was about the gap between the 191% - or the 183% let's say -, without government schemes and the sensitivity we have provided on page 24 with 175. It is clear that the difference between both ratios is less than it could have been in previous years because we had already started to have some increase in claims, so you could say we are already in a crisis. The gap in sensitivity is lower because we are in-between a very good situation last year and a one over 50 year's crisis equivalent. I hope that is your question.

Benoit VALLEAUX (ODDO BHF) It is clear but what is the impact of the government schemes within the 175%? Is there a great impact?

Carine PICHON (CFO, Coface) Okay, I get your point. I would suspect it's the same, I have to check, but I suspect it is quite similar because it is quota-share. I will follow-up with Thomas to check that.

Thomas FOSSARD (HSBC) I know you do not like to comment much on specific names, but I was just wondering if you were exposed to losses regarding Wirecard? If that is the case, will you be able to transfer the losses, or 90% of them to the German government, or is there an issue with the underwriting year and the government scheme will not apply?

Xavier DURAND (CEO, Coface) As you say, we do not like to comment, but I do not think that is a topic for Coface.

Thank you all for being with us today. Obviously, we are progressing through this crisis and learning as things go forward. We are feeling good about the execution. There is a lot of uncertainty out there and lots of moving parts, so we will update you on the next chapter of this story, I think on 29 October for the third quarter income call.

(End of transcript)

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FINANCIAL CALENDAR 2020 (subject to change)
9M-2020 results: 29 October 2020 (after market close)

FINANCIAL INFORMATION
This press release, as well as COFACE SA's integral regulatory information, can be found on the Group's website:
http://www.coface.com/Investors

For regulated information on Alternative Performance Measures (APM),
please refer to our Interim Financial Report for S1-2020 and our 2019 Universal Registration Document.

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