

Sagikor Financial Company Ltd.

Second Quarter 2022 Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

Meny Grauman

Scotiabank — Analyst

Darko Mihelic

RBC Capital Markets — Analyst

PRESENTATION

Operator

Good afternoon. My name is Joanna and I will be your conference operator today. At this time I would like to welcome everyone to Sagicor Financial Company's Second Quarter 2022 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, please press star followed by two.

Thank you. Mr. George Sipsis, SVP, Corporate Development and Capital Markets, you may begin your conference.

George Sipsis — Senior Vice President, Corporate Development & Capital Markets, Sagicor Financial Company Ltd.

Hello, everyone. Thank you for joining us today to discuss Sagicor's Q2 2022 results. Our quarterly results, including the financial statements and the MD&A, along with a link to our live webcast is available on our website on the Investor Relations tab on our website at sagicor.com.

I would like to begin by referring you to the cautionary language and disclaimers in our materials and public filings regarding the use of forward-looking statements and the use of non-IFRS financial measures and ratios, which may be mentioned as part of our remarks today.

Unless otherwise noted, all dollar amounts referenced will be in US dollars, consistent with our reporting practice.

Joining me today is our Group President and CEO, Dodridge Miller; Andre Mousseau, our Group COO and CFO; and Anthony Chandler, our Chief Controller. We'll begin with prepared remarks by Dodridge and Andre followed by a Q&A session.

With that, let me pass the call to our Group President and CEO, Dodridge Miller.

Dodridge Miller — Group President & Chief Executive Officer, Sagicor Financial Company Ltd.

Thank you, George, and thank you, everyone, for taking the time to join us today. As is customary, I will give some brief remarks focusing on our overall performance in the quarter, a brief comment on the operating environment and on our outlook going forward. Our COO and CFO, Andre Mousseau, will then provide you with details on our financial and operating performance.

For the last six months and in particular during the last quarter, our operating environment reflected a more normal approach to business activity. While adopting various forms of a hybrid approach to work, a greater percentage of employees have returned to the office. This is very much an evolving situation and we expect adjustments as we go forward.

The economies in which we operate continue to grow, although the rate of growth has slowed in the face of rising inflation, increasing interest rates and, in general, a challenging global economic environment. Within this context, Sagicor delivered a very solid performance for the second quarter of 2022.

Total revenue increased 30% over the second quarter of 2021 to reach \$672 million. During the quarter, the group grew total net premium revenue by 68% with growth across all lines of business with the largest growth occurring in annuities, which grew 119% year over year, driven by very strong sales in our Sagicor US segment. Net income to shareholders was also very strong at \$35 million during the quarter, an increase of 280% year over year.

The group's financial performance during the second quarter was particularly heartening given the prevailing challenging economic environment. Asset price volatility, driven by geopolitical instability, inflationary pressures, and rising interest rates drove mark-to-market losses on Sagicor's balance sheet. At the same time, that asset price volatility enabled Sagicor to invest new policyholder funds at robust investment spreads, generating significant net income, as I mentioned earlier, particularly in our US segment.

Turning to our outlook, we expect the rest of the year to remain challenged by the uncertain economic environment with continued but slower growth in our key operating market.

I would like to take this opportunity to welcome Ms. Lynda Gauthier to our executive team. Lynda joins us as our new Group Chief Risk Officer and Chief Sustainability Officer in what is a critical role in guiding the group's enterprise risk management efforts as well as coordinating our response to ESG strategies and disclosure. Lynda brings a wealth of knowledge and experience to her new role. Welcome, Lynda.

With that, I now turn the presentation over to Mr. Andre Mousseau. Thank you.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

Thank you, Dodridge, and hello, everyone.

Q2 was certainly an interesting quarter. In aggregate, we had solid net income, but the asset price volatility in the quarter led to some unusual results. Net income to shareholders was \$35 million in Q2, a 280% increase compared to the second quarter last year. The main positive driver was very strong sales of annuities in our Sagicor Life USA segment at significantly higher than budgeted invested spreads. Sagicor Life and Sagicor Jamaica also had good quarters as economic activity rebounded in the Caribbean. On the other hand, lower asset prices and higher interest rates presented themselves as negatives on the income statements, on the segment income statements I should say, including Head Office and across our balance sheet as unrealized losses through OCI.

At Sagicor Life, our operating segment in the Southern Caribbean, total revenue was \$130 million, a 6% increase year over year, mainly due to 10% year-over-year growth in net premium revenue. We had \$11 million of single premium annuity sales and \$6 million of annual recurring new business sold in the quarter. Net income to shareholders was \$12 million, an increase of 74% year over year as the segment's strong top line revenue translated into solid profitability during the quarter.

At Sagicor Jamaica, total revenue of \$160 million decreased 9% year over year measured in US dollars, mainly due to realized and unrealized losses on financial assets carried at fair value through profit and loss. Our share of Sagicor Jamaica's net income increased by 9% year over year to \$8 million.

Sagicor Life USA had a record quarter. This segment's growth in profitability is consistent with our strategy to grow our US business to scale by adding fixed annuity liabilities that we are able to invest at attractive spreads. We were able to drive \$420 million of new annuity sales, up from \$364 million in the previous quarter. Overall, our US business posted revenue of \$408 million, which was up 97% compared to Q2 of 2021. As a result of the present value of anticipated profits from the significant volume of new annuities sold had favourable investment spreads, the segment generated a record \$72 million of net income in the quarter compared to \$16 million for the same period in the prior year. Now a significant amount of this excess return is going to go back into the contractual service margin to be amortized over the life of policies under IFRS 17, so this segment will look quite different next year. But what IFRS 4 accounting is telling us is that the business we wrote and invested this quarter will be quite profitable.

On the other hand, volatility hit our income statement in a handful of places, most notably in the Head Office segment. We took a \$15 million non-cash charge related to the revaluation of a call option in our favour deemed to be embedded in our top company notes. This has been written down now to virtually nil, so this will not recur. Also, we took a \$19 million mark-to-market loss on our holdings of Playa Hotels and Resorts. We continue to have conviction in the value of Playa and believe that our ownership stake has intrinsic value significantly in excess of its current market price.

Our total comprehensive loss to shareholders this quarter was \$42 million as the strong positive net income during the quarter was more than offset by the impact of rising rates leading to decreased asset values, including our assets backing capital. We had no material impairments or increases in expected credit losses in the quarter, so we would expect to make all of these OCI losses on assets back over the lifetime of the assets.

We repurchased 780 thousand shares at a discount to book value through our normal course issuer bid in Q2. Our book value per share was US\$7.51, or C\$9.63. Our MCCR was 211% as our capital in our life insurance subsidiaries declined, but is still a strong number and above our internal targets. We would, however, expect that that number would improve later in the year with certain initiatives that we have underway. We also declared a dividend of \$0.5625 per share to be paid in the third quarter.

One note on a specific initiative, I mentioned briefly IFRS 17 a moment ago. Our implementation plan for that accounting change remains on track and we would expect to provide a briefing to our investors in the fall detailing specifics around the anticipated impact to our balance sheet and income statement.

With that, I'll turn it back to Dodridge and George.

George Sipsis — Senior Vice President, Corporate Development & Capital Markets, Sagicor Financial Company Ltd.

Thank you, Andre. And with that, we are now ready for the Q&A session. Operator, please open the lines to the analysts for their questions.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star followed by one on your touchtone phone. You will hear a three-tone

prompt acknowledging your request. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

First question comes from Meny Grauman at Scotiabank. Please go ahead.

Meny Grauman — Analyst, Scotiabank

Hi. Good afternoon. Andre, in your comments you talked about certain initiatives to boost your capital ratio. Hoping you can go into a little more detail in terms of what you're referring to.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

Sure. So, thanks, Meny. In terms of the initiatives, we're exploring third-party reinsurance transactions. As you can see, we've grown our US balance sheet very significantly over the last six to seven quarters and we've retained 100% of that business, and so I think we would be looking to do a little bit of reinsurance that would take some of the tail deductions to MCCR off the books and access a little bit of cash, which will run its way through the MCCR.

Meny Grauman — Analyst, Scotiabank

And do you have any guidance on the timing of something like that? Would it be later this year or into next year?

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

I think it's pretty straightforward, so this would be a 2022 initiative.

Meny Grauman — Analyst, Scotiabank

Okay. And then I know you mentioned that you'll be providing more guidance on IFRS 17 in the fall, but in terms of just, maybe at a high level, the expected impact on your capital ratio from the transition to IFRS 17, do you expect any change there? And if you could comment on the volatility as well as a result of that change.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

Well, in terms of capital ratios, which are you specifically thinking about?

Meny Grauman — Analyst, Scotiabank

So I'm just wondering, so your overall capital ratio, like is that going to change under IFRS 17 in any material way up or down and is it going to become more volatile?

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

Well, if you're thinking about debt to total capitalization, I think that all of the frameworks that we're looking at will include the CSM in capital and so that's how our ratings agencies are looking at it, and so, by taking the portion of equity that moves into CSM as part of the capital, that is going to significantly mute volatility around our debt-to-capital ratio. I think our balance sheet will move around

under IFRS 17, but the largest piece will be the creation of CSM. And, as you've seen in our results, we do get a meaningful portion of our net income through profits from new business and so much of that over the last few years will be put into the CSM. And then we'll count the same piece of profit twice ultimately.

In terms of volatility, we're still working through that. I think, in principle, you would think of IFRS 17 as closer to cash earnings and, as long as you get the asset movements right, actually reduce earnings volatility. We're working through that now to make sure we do the right elections on how we treat our assets and we're getting interesting real-time testing of that as we're working through our 2021 numbers under IFRS 17, as obviously there's been a lot of asset volatility. So that will be part of what we come back to you with later in the fall.

Meny Grauman — Analyst, Scotiabank

Okay. And then just turning to the US segment, a very strong result. I'm trying to understand if there's anything unusual in the results this quarter, especially relative to assumption changes. And then I know you're not providing guidance, but given the moves that we've seen in the US business, trying to understand how sustainable the level of profitability is for the second half of the year and looking out to next year. If there's any sort of help you can provide on how to think about the US business given the big ramp-up we've seen.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

Sure. So we're very pleased with what we were able to achieve in Q2. It's very much on strategy. That said, we did get some specific tailwinds in the second quarter that you wouldn't expect to get every quarter, and so I would caution you not to expect \$70 million of net income out of that segment every quarter.

The tailwind was the rapidly increasing yield environment and what we found was that crediting rates on annuities in the second quarter through the competition were not moving up nearly as quickly as asset yields and so we saw a particular point in the market where we were able to invest those funds at significantly wider spreads than what we have in our models and were able to do so basically being flat from a credit point of view, not pushing any further from a credit risk point of view.

So there were no changes in the underlying actuarial assumptions. I think that typically comes for us in the third quarter. But we did benefit from a unique environment. And because the environment was so positive, we did source more premiums than we would have budgeted on a quarterly basis. So what we've seen so far in Q3 would suggest that we are having a good Q3 thus far, but I would say that the level of profitability in Q2 was unusual.

Meny Grauman — Analyst, Scotiabank

Got it. Thanks so much.

Operator

Thank you. Ladies and gentlemen, as a reminder, if you have any questions, please press star one.

Next question comes from Darko Mihelic at RBC Capital Markets. Please go ahead.

Darko Mihelic — Analyst, RBC Capital Markets

Hi. Thank you. I just wanted to revisit capital for a moment. It was only a few quarters ago, I think, where you sort of exited the life, the term life, and I'm not sure if you'd reinsure that or not, but what I'm really interested in understanding is, forgetting MCCR, I just want to understand from an RBC ratio point of view, with strong sales, is this the sort of pressure that's causing you to revisit and would you be willing to talk about like where your RBC ratio is and sort of how much capacity and runway you have with respect to the capital requirements in the US? I just want to make sure I understand, because your sales numbers keep running higher, which is good, presumably, but are you now hitting the constraint of the amount of capital and would you be required, without reinsurance, would you be required to put more capital into the US business?

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

Sure. So, we write to a 300% RBC in the US and so there can be a little bit of variability around that quarter over quarter, but at the end of the year we aim to be a little bit above that and so that's the number we manage to. With this growth, I mean you understand the way the RBC works where it's heavily tweaked to the amount of business that you've written in the last 12 months, this sort of growth takes capital in. I think our business, on a flat basis, is cash positive, but we're investing capital in it and we would expect to invest capital in it before the end of the year to get to a 300% RBC at the end of the year, taking into account production in Q3 and Q4.

In terms of sustainability, our business plan shows enough capital to continue to support this growth, and that's through a combination of the capital that we have at the top company and then reinsurance, which allows you to unlock some of the capital that you've invested and back more growth.

Darko Mihelic — Analyst, RBC Capital Markets

Okay. So I think I get what you're saying and I guess the follow on to that is just better understanding for me then, with all of this growth, it sounds like you just had very good spreads coming through in the US business, with good sales obviously, but really spreads improved materially, and so what I want to get at is have we sort of hit that scale component in terms of your production where there would be, or have we not hit that and, in other words, could we see even improved profitability as you scale up that business? I hope you understand—do you understand where I'm going with that? I'm just trying to understand if this is just purely an environment thing or was it also the fact that you hit a point in your sales numbers where it's starting to also bleed through because of scale.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

I think it's both. So, as I talked about on the last one, to the last question, we did have an unusually positive environment for investing and so we were able to flex production higher and take advantage of that. But, you know, the results are better this year than they would have been last year because we have more assets earning spread on the balance sheet that can be reinvested back. So, we are not at scale yet. I think we're certainly in a better spot than we were even just a year ago, but our sense is that the

economics will just get better and better as we add more assets to that piece of the balance sheet. So I think there are further improvements that can come as we continue growing this business.

Darko Mihelic — Analyst, RBC Capital Markets

Okay, thanks for that. And just to clear up a couple of other loose ends for me, are you guys, just if you can remind me, do you do an assumption review in Q3 and are there specific parts of the business that you review? Because it's been a pretty volatile environment, I'm just curious if there's anything that might be on the horizon with the assumption review we should be aware of.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

We do do Q3, kind of consistent with the market in Canada, you try and get it done in Q3 so that it's out of the way by the time you get to the year-end audit. We don't have anything that is showing up that we see as unusual right now that we know is going to change. That said, everyone's talking about mortality in the context of COVID, people are talking about lapse in persistency in the face of continuing economic activity a little bit below potential, so we're going to look at everything in Q3.

Darko Mihelic — Analyst, RBC Capital Markets

Okay. Thanks for that. And just lastly, Andre, for me, the revaluation of that call option, which cost you \$15 million, so therefore it's been written down to zero, is there anything that would ever, like can you just explain to me the call option and how it works? Like I'm just wondering if it ever gets written back up.

Andre Mousseau — Group Chief Operating Officer & Chief Financial Officer, Sagicor Financial Company Ltd.

It could get written back up. So the bonds that we raised last year are due in 2028 and we have the ability to pre-pay them starting, I think, three years after issue with declining pre-payment penalties. And so that is deemed an asset in our favour and it could have real economic value for us, you know, as we push to grow the proportion of our assets in the US, for example. It's our aspiration to, at some point in the next few years, get to investment grade. Once we become investment grade and we have a receptive bond issuance window, we would expect to refinance our debt. So it could have some value one day.

A year ago, our bonds were trading above par, which implied that we had a significant embedded value within that call option to go and refinance them at some point. As interest rates have gone up, our bonds have traded below par. I don't think it has anything to do with credit, I think it's just about market yields. So, to the extent market yields change direction, theoretically we could see that go back up again. And just to clarify, I think I said it went to virtually nil. I think there's \$2 million still of embedded asset option value in our numbers at the end of the quarter.

Darko Mihelic — Analyst, RBC Capital Markets

Okay. That's a good explanation though. I understand it. Thanks for that.

Operator

Thank you. There are no further questions, you may proceed.

George Sipsis — Senior Vice President, Corporate Development & Capital Markets, Sagicor Financial Company Ltd.

Thank you, operator, and thank you, everyone, for joining the call today. A replay of this call will be available for one month on our website and a transcript will be posted as soon as it's available. If you have any additional questions, please do not hesitate to reach out to any one of us. And with that, thanks again for your participation and interest. Have a great day, everyone.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and we ask that you please disconnect your lines.