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IAG.TO - Q1 2017 Industrial Alliance Insurance and Financial Services
Inc Earnings Call

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MAY 11, 2017 / 3:30PM, IAG.TO - Q1 2017 Industrial Alliance Insurance and Financial Services Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the First Quarter Earnings Results Conference Call. (Operator Instructions) As a reminder, today's call is being recorded Thursday, May 11, 2017. Now I would like to turn the conference over to Ms. Grace Pollock. Please go ahead, ma'am.

Grace Pollock - *Industrial Alliance Insurance and Financial Services Inc. - Director of IR*

Good day, and welcome to our first quarter conference call. All documents related to our results, including press release, slides, MD&A and supplementary information package, are posted in the Investor Relations section of our website at ia.ca. This conference call is open to the financial community, the media and the general public. The question period is reserved for financial analysts.

A recording of the call will be available for 1 week starting this evening. The archived webcast will be available for 90 days and a transcript will be available on our website in the next week.

I draw your attention to the forward-looking statements at the end of the slide package. A detailed discussion of the company's risks is provided in our 2016 annual report that is available on SEDAR or the iA website.



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I will now turn the call over to Yvon Charest, President and CEO.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - CEO, President and Non-Independent Director*

Good morning, everyone, and thank you for being with us today. All the members of the planning committee are present so Normand Pepin, Rene Chabot, Michel Tremblay, Denis Ricard, Renee Laflamme, Mike Stickney and Carl Mustos.

So we'll begin with some comments on growth and Rene will follow with the bottom line. We are quite pleased to say that business growth in the first quarter was tremendous across all segments, which is a great start for the year. Obviously, mutual funds stole the show with net sales of \$200 million compared with net outflows of almost \$300 million a year ago. This is our second quarter of net inflows and it is a testament of the hard work by our mutual fund team to improve fund performance as well as to position the right products for both our affiliated distributors and the broader independent network. We shall continue to work hard in the quarters ahead to build on the momentum.

Speaking of momentum, our seg funds continued to show the positive strength we have seen since the implementation of our wholesaling strategy 3 years ago. Both growth and net sales were up this quarter and we continue to maintain the #1 position for net sales in Canada.

Our group wealth operations also had a great quarter. Sales were up 42%, with most of that growth coming from accumulation products, which is very positive.

Moving on to the insurance sectors. Both retail and group segments delivered good results. And retail insurance, strong growth in the last quarter carried over into Q1, in part because of the new tax rules that took effect on January 1. Q1 growth also reflects new pricing put in place in the fall that took hold faster than expected.

In Group Insurance, I want to highlight the results of Employee Plans, which won significant new mandates in the quarter. Dealer Services also posted a strong quarter in both the creditor insurance and extended warranty segments, as did our Special Markets Solutions segment.

Finally, in our Auto and Home insurance business, written premiums were up by 13%, with most of the growth coming from new initiatives.

So overall for the quarter, premiums and deposits almost up \$2.8 billion, up by 42%, largely because of the strong inflows in our Wealth Management operations.

I'll save my last comments for book value per share, which was up by 15% over the last 12 months, including 11% coming from profit.

So on that note, I will now ask Rene to comment on our Q1 profit.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Good morning, ladies and gentlemen. Q1 was a pretty good start to the year. Reported EPS was \$1.03 and ROE was 13.4%, which compared favorably with the same quarter last year. If we exclude the 2 exceptional items, that is the 5-year extension of the tax on premiums and the HollisWealth integration cost, our reported EPS would be \$1.08, which is at the top of our guidance.

Item of note in the first quarter are detailed on Slide 6 and 7. You will see that positive and negative items offset each other. Market gain by unfavorable experience in individual insurance, the gain on strain by the one-time charge for the tax on premiums, and net gain in income on capital by the integration costs for HollisWealth.

By the line of business, results are as follows: Individual Insurance reported unfavorable mortality and lapse, representing \$0.15 EPS, basically divided 50-50, as well as the charge of \$0.04 related to the extension of the tax that I just mentioned a few minutes ago. This was partially offset



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by a market gain of \$0.02 on UL policies. Strain of new business came in at 6%, which was lower than expected for the quarter and added \$0.04 to earnings. For the year, our strain ratio is expected to average 6%, so it is definitely a very strong start to the year.

Our Group Insurance sector reported a loss of \$0.01 related to higher claim for extended warranty. Experience in Employee Plans, Special Markets Solutions and car loans came in as expected.

In Retail Wealth Management, the individual sector had a gain of \$0.09 from the dynamic hedging program, another \$0.03 from favorable longevity and lower expenses and a \$0.01 gain from higher MERs. The group wealth sector reported a gain of \$0.01 from favorable longevity. Other item of note in the quarter include a gain of \$0.04 from investment income on capital that was offset by lower result at iA Auto and Home for a loss of \$0.03 per share.

On a core basis, EPS was at \$1.07 according to our methodology and ROE was 12%. Both these measures are at the top of our Q1 guidance. Lastly, our solvency ratio at quarter end was 222%, reflecting movement in the macroeconomic environment in Q1. If we take into account the HollisWealth acquisition scheduled to close in Q3 2017, the ratio would be 208%. Along with our healthy leverage and coverage ratio that you see on Slide 10, our balance sheet is very solid.

That concludes my comments for today. Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll get to our first question on the line from Meny Grauman from Cormark Securities.

Meny Grauman - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

I wanted to ask about strain and just the outlook for strain. I think it's really the second year in a row where we haven't really seen the seasonality that we had seen in the past in terms of strain. And just wondering, your perspective in terms of that seasonality, is it just gone for good? And then in terms of looking forward, you had an outlook for strain for the year at 6% and given the strong start to the year, wondering if you believe that it's likely that it'll probably come in below that number that you suggested last year?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Meny, (inaudible) your question, Meny, so I will try to answer it in order. First, you talk about seasonality. So seasonality, I do believe that it's there and will stay there. It's just the fact that in Q1, our result is so good that we don't see it. We were expecting 15%, and we're getting 6% and there are 2 main reasons for that. First, our sales result in the first quarter are strong compared to what they are used to be. And second, we were able to -- we had a performance that had much better profit mix -- product mix, excuse me, than what we have usually. So both of these items were very strong contributor on the strain side. Finally, with respect to our guidance for the year, which is 6% for the whole year, it's sure that with such a quarter, we feel very positive about it. So we still stick to it, but we're pretty sure that we're going to go in the right direction on that metrics.

Meny Grauman - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

Thanks for that. And then if I can just ask in terms of the mutual fund business, definitely strength there in terms of net sales. I still see that the redemptions level is still quite high. I'm wondering if you could just talk to what you're seeing on the redemptions, any trends that you're seeing there? And what are the key reasons for what's going on in the redemption side?



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Carl Andrew Mustos - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Wealth Management*

It's Carl here. On redemptions, you have your usual higher redemptions in Q1. This a lot of activity throughout the industry as people rebalance and position for their future. And we also continue to feel the remaining drag on the Laurentian Bank assets as they drain off from the program.

Operator

And we'll get to our next question on the line from Thomas MacKinnon with BMO Capital Markets.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

Rene, I wanted to talk about the unfavorable lapse experienced in the quarter. If you can elaborate as to what products it might have been related to in the Individual Insurance side? Was it EquiBuild? Was it Term? Was it people lapsing earlier than you would've expected? Or was it people staying on longer than you would have expected? What caused this? And what should we expect going forward?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

So Tom, this is Level COI product as we are basically used to it. This is where we had adverse experience in the quarter. To be honest with you, I don't know where it is going to go. For me, at the moment, I just noticed that we had a bad quarter in that metrics in Q1. This is a new information. It could happen. We know that on the lapse side, most of the time it's more on the negative than on the positive, a bit different than the mortality. We just noticed that it happened in that quarter. So for us at the moment, we consider this as a fluctuation. And we'll stay tuned for the rest of the year.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

You did do some reserve strengthening with respect to lapse at the end of 2015. Was that for Level COI products?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Yes, you're right. We have done this in 2015. And you have seen that in 2016, we did not notice anything about it. So we see something in that quarter.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

And is it related to, like, your ultimate lapse rate? Is this just generally people staying on longer with this product than anticipated?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

We had not digged to it at the moment, Tom. It's a possibility. It could be the case, but we haven't digged to it at the moment.



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Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

And what would be your recommendation for people in trying to gauge whether, in fact, this would be recurring? We haven't seen any adverse lapse experience to really this kind of degree over the last several quarters. In fact, all of your policyholder experience has been positive. How should we take -- how should we think about the adverse lapse risk that you had in the quarter?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

I think at the moment, it's too soon to put a judgment on it. If you remember before the 2015 reserve increases, we had many sequential quarter of lapse adverse experience and I mentioned many times that I need to see these sequential quarter of lapse adverse experience before getting to any conclusion. So for me at the moment, it's just one quarter. I put it into the unlucky quarter til I see more recurring quarter with the exact same experience.

Operator

We'll get to our next question on the line from Gabriel Dechaine from National Bank Financial.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Just to wrap up the strain issue, could you give me the split between -- you said mortality and strain, between those 2 factors, the \$0.15, how is that split?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

It's not mortality and strain, Gabriel. It is mortality and lapse. For the...

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Sorry, lapse. Yes. The mortality and lapse.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Okay. So it's 50-50 basically, okay? And the issue is mostly in Canada.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay, all right. Then my bigger question is on the P&C business. \$11 million of loss this quarter pretax. Q1 is a seasonally weak period. But if I go back over the past few years, this business has done nothing but lose money. You've told me that you need to add scale to this business, move from \$200 million to \$400 million of premiums. How is that going to fix the issue of losses in this business? And second, should we expect another loss this quarter perhaps because of the flooding in Quebec?



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Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - CEO, President and Non-Independent Director*

So Gabriel, it's Yvon. The bigger question of P&C, we told you many times that we'd like to grow the business. We have been able to grow the business by 10% while the industry was growing at 2%. So clearly, I know we have been steadily first quartile in terms of the top line. We made the decision a few months ago to say that it was now time to rebalance the top line and the net income. So that decision has been made and you should see from the following quarters that there will be price increases. So that will deliver a better net income. So on the bigger picture, I'd like to reassure you because we are at the point where we do believe that the total premium income is good enough for us to make a decent profit, and that's where we are. In terms of Q2, I will let Rene talk about the first 6 weeks of the quarter.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

It's sure that the first 6 weeks were not pretty good. So we do expect that in the second quarter we will have -- we will probably miss our budget target in that quarter and we will give you additional color when we disclose Q2. So what Yvon mentioned in the price increases, we should start seeing some impact on this later on in Q3, Q4 and in 2018, basically. But the change of focus that Yvon mentioned here is very important for the future.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Could we delve into that a bit more? So Yvon, there's no -- is there no appetite for an acquisition in the space anymore? And are you -- I guess, it sounds that you're happy with your current book of business, the way -- it's size any way, you just need to reprice it, you don't want to grow it materially in an organic matter either. You just want to fix what you have, is that -- that's kind of what I'm hearing now.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - CEO, President and Non-Independent Director*

Yes, well, that's basically what I'm seeing for Quebec. And as far as outside of Quebec, we have always mentioned that we just love the business model we have in Quebec because 80% of the sales are coming from our other affiliated distribution networks. So our business model is different from the competition. Outside of Quebec, we will need kind of advantage like this for us to be active. But in Quebec you're quite right. We are at ease with the size. I think we now rank #8 in Quebec in terms of personal line premium income. So it's just a matter now of making sure that we could deliver more profit out of it.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

And I would like to add, Gabriel, to this, that if you remember the Investor Day presentation, we had a bucket where we said we were looking for some profit improvement in some segment, iA Auto & Home was identified in that bucket, we have had tremendous growth in that segment, now it's time to deliver more profit.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And actually, if I can sneak one more in here. Dealer Services, both in Canada where it looks like auto sales are peaking. It's that affecting your outlook for growth at all? And then on the inorganic side, so you've mentioned you might want to look at replicating that business via an acquisition in the U.S. where we're already starting to see auto sales turn. How does that affect the dynamic of your M&A appetite in the U.S.?



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Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - Executive Vice-President of Individual Insurance and Annuities*

I think I'm going to -- it's Denis Ricard here. I'm going to answer the first part of the question. In terms of the car sales, obviously, it's part of the business growth depends on the car sales, but you also have to understand that a significant portion of our business also depends on the used car business. I mean, 2/3 of the sales cars in Canada are done through the used cars and it is still a healthy business right now. So -- and there is still some business to pick up in the market. So yes, the sales industry is an issue but there is more than that. So at this point I would not to be worried about that.

Michael L. Stickney - *Industrial Alliance Insurance and Financial Services Inc. - EVP of US Development*

It's Mike Stickney here. On the, I guess, U.S. automotive situation, it is a market we're looking at. And I think the U.S. is quite different in this regard. I mean, if you look at the Canadian market and who's supplying the insurance, it's just a handful of companies. The U.S. is really fragmented by comparison. And so we think there's opportunities to make an acquisition there and build basically or grow the business through consolidation on that market.

Operator

We'll get to our next question on the line from Sumit Malhotra with Scotiabank.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

Rene, just to be clear on one point you made. Did you say that the Home and Auto segment, the result of the flood would most likely cause you to come in below the targeted range for Q2? Or were you just talking about budget specific to that segment?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

I was just talking budget specific to iA Auto and Home, only iA Auto and Home.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

Okay. So not the EPS range you give for the company as a whole?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Not at all. It's a very, very small portion of our business. And if you remember our disclosure last -- in the fourth quarter, we gave you the run rate on our income and capital and we gave you also the potential fluctuation that we may have in that run rate especially because of iA Auto and Home. So all my comments should be looked only with iA Auto and Home.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

No, I got you. When I think about the size of that business, even with the higher claims experience, I didn't think it would be big enough to change the numbers that much. I just wanted you to clarify that. Thanks. And then to go back to Individual Insurance, you gave us some good detail on the lapse side. Just switching to the other half, mortality, I mean, \$0.07, \$0.08 of experience loss there. It's a pretty significant number. And certainly, we haven't seen anything like that as far as individual insurance is concerned for a number of years. What was the specific issue there? And again, somewhat similarly, do you think it's going to have longer-lasting effects?



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Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

The last time we have seen it, Summit, was in the first quarter of 2015. That was the last time we have seen it. And you're right, that the last 2 years of Individual Life Insurance we had outstanding gains basically. So I would say 7 quarters were positive on the mortality side. So to have a fluctuation of that size is possible. It has happened in 2015. The current quarter fluctuation is lower than what happened in 2015 and I remind everybody that in the second quarter of 2015, we had a much bigger gain than the first quarter loss of 2015. So fluctuations are part of our businesses. We have been so positive in the last 2 years that it has a time that it has to stop, that's probably the quarter.

Operator

We'll proceed on the next question from the line of Doug Young with Desjardins Capital.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials & Insurance Analyst*

Just wanted to confirm or go back to the Individual Insurance and the lapse. Was that -- and I assume it's more people lapsing than you expected. But can you just confirm that, that's the case? And did it have anything to do, to your knowledge, just with the tax rules changes and the increased sales on that side of the business? Any thoughts on that?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

So Doug, it is the converse of what you say. It's lower lapses than what we expected because the Level COI policy, mostly UL Level COI policy, so it's lower level of lapses than what was expected. And I don't think it has any correlation or any connection with the change in the tax rules or something else.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials & Insurance Analyst*

Okay, just wanted to confirm that. And then just on maybe an overarching theme, the employee benefit sales, up 99%, just hoping you can give a little color on the makeup of those sales. Is it mostly Quebec? Is it outside Quebec? Are these larger accounts? And I guess a skeptic would say a few years ago, you had extremely strong employee benefit sales. And subsequent to that, you had some challenges on the employee benefit experience. And so I'm just trying to get a sense of what you've learned from that past experience and get some confirmation that we shouldn't see that same level of poor experience, though. So that's just kind of the nature of the question.

Renee Laflamme - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Group Benefits and Retirement Solutions*

This is Renee Laflamme speaking, so thank you for your question. So we've been working very hard, working with our distributors, aiming at our target market, increasing our target market in terms of size of clients but also looking at broader diversification. So, I mean, it's in Quebec and outside of Quebec. I would say we have great success in the West, great success in Ontario and in the Province of Quebec mainly. So it's all a combination of the work that has been done with the distributor in the marketplace, the education of our sales people and focus of consultants and strong brokers in Canada.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials & Insurance Analyst*

Okay. And maybe I'll follow up on that. And then just lastly, maybe Carl, I think, you mentioned that Laurentian Bank on the mutual funds side, redemption rates were higher related to that business. Can you quantify that? And how much in assets are left with Laurentian Bank channel?



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Carl Andrew Mustos - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Wealth Management*

Yes, to follow back upon that redemption question before, we've seen no real redemption issues on the broader complex, but the Laurentian was a bit accelerated in Q1. We were down to about \$500 million left in that channel.

Operator

And we'll get our next question on the line from Paul Holden with CIBC World Markets.

Paul Holden - *CIBC World Markets Inc., Research Division - Equity Analyst*

Two questions for you. So I guess the first is on Individual Wealth where you saw some nice tick up in AUM Q-over-Q and obviously, the positive net sales we've talked about. So given those 2 factors, I would've thought maybe there would've been some better growth in expected profit sequentially. So maybe you can talk about that and what it would take for expected profit to trend higher?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

But I think that our expected profit showed quite interesting -- very strong interesting growth for the quarter -- quarter-to-quarter. Not necessarily -- excuse me, year-over-year. So if you compare our expected profit this year compared to the expected profit the year before, you see that the growth is quite significant.

Paul Holden - *CIBC World Markets Inc., Research Division - Equity Analyst*

Okay. Sequentially within...

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

It's \$38.2 million compared to \$32.6 million, so this is the way you should look at it. Not quarter-to-quarter but year-over-year growth.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - CEO, President and Non-Independent Director*

Could you explain a bit more, Rene, why is it that sequentially, it's a bit down, but why is it that we have to go year-over-year?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

One of the reasons for it is the seasonality of our profit that we have and we know that in the first quarter, it's always a weaker quarter than the fourth quarter. So you have to put this into account. So that's the reason it's preferable to look at it year-over-year. And if you look at all our key core driving growth factors, you will see that they are very strong. The expected profit, every line of business has strong growth. The strain is way good, and the income and capital is also very positive, too. So our major core earning driver are strong. The only thing that we have this quarter is an unlucky spot on Individual Life Insurance, period.



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Paul Holden - CIBC World Markets Inc., Research Division - Equity Analyst

Understand, so it's seasonality. Got it. And then in terms of U.S. individual sales, the growth rate has slowed in each of the last 2 quarters. This is maybe a function of you hitting a ceiling in terms of your potential marketshare in that target market? Or can we expect sales growth to accelerate at some point going forward?

Michael L. Stickney - Industrial Alliance Insurance and Financial Services Inc. - EVP of US Development

It's Mike Stickney again. First of all, there's been a bit of currency fluctuation in there so our growth for the quarter was actually 3% if you compare U.S. dollars to U.S. dollars. Still a lot lower than what we would experience in the past. We made a decision about 6 months ago to introduce a fairly material product change to one of our term products. It was return of premium term product that had quite high strain and we were struggling with profitability on it, with lapse supported. And so we basically repriced it and that's the drag on the sales right now. So if you look -- a good indication is the first quarter, our -- as a percentage of total sales, the term is off about 7%. And so effectively, we've grown the rest of the business by about 10%. So I think the growth's going to be lighter this year and then we'll pick it up again as we move forward and get past this period.

Operator

And we'll get to our next question on the line from Mario Mendonca with TD Securities.

Mario Mendonca - TD Securities Equity Research - MD and Research Analyst

The earnings on surplus is awfully high this quarter, especially given the significant charge in Home and Auto. Were there any realized gains on AFS securities this quarter? You used to disclose this, but I just don't see it anymore.

Michel Tremblay - Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President

Thanks for the question, Mario, its Michel Tremblay. I don't remember exactly what the number is, but there was no -- based on my memory, there is no real gain realized during the quarter. Actually, we had even some losses. So I don't think the income is coming from special realized gains, it's not the case this quarter. I don't think so. You see the number, Rene?

Rene Chabot - Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP

No. I don't get it with my...

Michel Tremblay - Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President

Based on my memory, Mario, there is no big amount of realized gains during the quarter.

Mario Mendonca - TD Securities Equity Research - MD and Research Analyst

Then help me just think through that first line. I'm just trying to find the page in your presentation where you go through -- here it is. So you get a jump in investment income from \$29 million to \$39 million, that's the first line on Page 13 when you're talking about your income on capital. There's probably something sensible there that I'm just not picking up. And I just don't see how you pick up \$10 million there.



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Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Do you want to go, Michel or -- I just want confirm on the AFS gain, Mario, we have a loss of \$2 million in the first quarter, so it is not on the AFS gain, for sure. You have to keep in mind that we had issued some stock and we have made some very strong profit also in 2016, Mario, in your model and these 2 elements contribute also to improve our investment income.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

So you're saying the earnings...

Michel Tremblay - *Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President*

And maybe, Mario, if I may, it's Michel. I'm looking at the numbers there. Well, Q1 of 2016 was \$33.5 million. We're at \$39 million, so it's a significant contribution, of course, but bear in mind, we issued some capital and so on and so forth. So comparing Q4 with Q1 is not really fair. I don't remember exactly Q4 last year, but there might have been some losses late last year. So there's nothing that comes to my mind that is exceptional this quarter, except for maybe some special strategy that did turn positive. But out of the \$3 billion invested capital, I think the fluctuation of \$0.04 a quarter is not that a big number.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

So what special strategies added the \$10 million then? What sort of strategies would have increased your earnings on surplus or that investment income? Because the increase quarter-over-quarter is 34%. So it's just hard to sort of visualize what sort of special strategies would've driven a 34% increase in investment income?

Michel Tremblay - *Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President*

Yes, we don't compare with \$29 million, Mario, we'd compare with \$33 million, \$34 million. So \$4 million, \$5 million above. As Rene said in his report, the gain on investment income during quarter is \$0.04 compared to the budget. So compared to expected, it's only \$0.04. And as you can expect, almost all of the surplus is invested in fixed income securities. So it's our strategy is related to the fixed income market.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

So just so I'm clear. Investment income is earned on the surplus, right, the assets that are on surplus? That's a fair statement, right?

Michel Tremblay - *Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President*

That's a fair statement.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

Okay. So the earning -- the surplus that existed in Q4 presumably is the surplus that existed in Q1 plus with the distinction that you'd have to add some earnings less dividends. So like, I don't think I understand why you can't compare Q4 to Q1 when all you're talking about is surplus from one quarter to the next. Why is that not a good comparison?



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Michel Tremblay - *Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President*

The comparison is you'd compared with expected gain or expected income and last quarter for instance, we may have realized some losses and that may have reduced temporarily the income on capital this quarter. So the expected income on the quarter is approximately \$33 million quarter. So it's slightly positive because, again, of the special strategies on fixed income. Because again, bear in mind, Mario, in Q1 of 2016, it was \$33.5 million. So focusing too much on Q1 is not fair enough. You have to compare with kind of an average here.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

Okay. So can you describe the special strategies? Like, I just want to understand the...

Michel Tremblay - *Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President*

Yes, it's relative to fixed income portfolios. Do you want any more details? I don't think it's the place to talk about how we manage the surplus here.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Mario, Rene speaking. If I may to add you some colors. In Q4 of 2016, we had about \$5 million loss in terms of AFS gains. AFS gains and loss, it was \$5 million loss. In Q1 2017, it's \$2 million loss and we had issued stock at the beginning of December that helped us with some of the process in addition to what Michel mentioned to you.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

Okay. The next question, if I could. There was an \$11 million charge in Home and Auto this quarter. Like, I'm not sure about the timing of everything that's played out in the province. What was it about Q1 that would've made it so difficult? Because I really thought that the flooding issues occurred all in Q2. Or was there something that happened in Q1 that I'm not aware of?

Normand Pepin - *Industrial Alliance Insurance and Financial Services Inc. - Executive Vice-President and Assistant to the President*

I'll take that one. Well, usually in Q1, we always budget a loss. Because the Province of Quebec, as you know, the first quarter of the year is always tough. But the losses were larger than expected because there were more storms than we were expecting. We had a pretty good winter for skiing in Quebec, I can tell you this. But for Auto, it was not very good. And then also there were some losses, I would say, on, I would say, some losses on House, on coverage and on home and auto coverage that were larger than usual.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Mario, when we published our run rate last year and we mentioned we could have a \$5 million fluctuation, we had a strong Q1 in mind.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

I see. Okay. And so looking out into Q2, is it conceivable that Q2 could be even worse than Q1, considering everything that's played out?



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Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

This is not my expectation, to be worse than Q1, because usually Q1 is tough. And if you look at our rolling information, you will see that the last 3 years, Q1 were quite tough. I am not expecting to have a great Q2, for sure. We know that there is an amount -- there's going to be an additional amount at claims than what we are used to have, but I'm not expecting it to be as worse as Q1 for sure.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

And then just sort of, finally, Rene, this whole lapse experience and level cost of insurance, you owe -- is it fair to say that you just, at this point, either haven't had the time or don't have enough information to offer us -- you haven't really been able to drill down enough to answer things like is it a particular cohort, is it new sales, is it an old, like, very old business or is it particular to an age or distribution channel? Is it just too early to answer that question because I don't want to pursue it if that's essentially the answer.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

It's too early to give you additional color because we haven't dug to it. The only information we know is that it's the same block of business that we act on in 2015. This is what we know at the moment, and that's it.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

And what was that in '15 again? Refresh my memory?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

It was a Level COI, UL policy and all the lapse supported policy basically that we issued til the mid-'80s.

Mario Mendonca - *TD Securities Equity Research - MD and Research Analyst*

Okay, so it's very old business?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

It is from mid-'80s to 2015 basically. All these policies that have been issued. And we haven't dug to it to see where it is the issue. But we know it is in that pool of portfolio. So you're right, it's too soon right now to give additional color. At the moment, I really treat it as a fluctuation. Remember, we have that dinner with all the people, Mario, and you told me how come you have all these experience gains and I tell you one of the reason was that I was lucky. So I'm unlucky this quarter.

Operator

(Operator Instructions) And we'll get to our next question on line from Nick Stogdill with Credit Suisse.

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Nick Stogdill - *Credit Suisse AG, Research Division - Research Analyst*

Just, first, a quick follow up on me, the mutual fund redemptions on the dollar side. You said it's seasonally higher in Q1. So is it more appropriate for us to look at it as a percentage of the gross sales? Is that a better way to frame it?

Carl Andrew Mustos - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Wealth Management*

Yes, I think that's fair. As a percentage of gross sales and then also with the Laurentian factor as well.

Nick Stogdill - *Credit Suisse AG, Research Division - Research Analyst*

And the Laurentian factor as well, okay. My second question, on the -- you called it slightly higher than expected claims for extended warranties in the Dealer Services. What caused that to go higher? Is there any cyclical to these claims? If you were coming off, again, 5 or 6 good years in auto sales and as you get older cars in the road is that something that could push claims higher going forward?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - Executive Vice-President of Individual Insurance and Annuities*

Well, I guess it's like Rene just said. It's Denis here. We've been unlucky, so it's only fluctuation.

Nick Stogdill - *Credit Suisse AG, Research Division - Research Analyst*

And so what could cause it to move higher? Is there anything in particular to call out from a longer-term perspective? Or it just, it fluctuates?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - Executive Vice-President of Individual Insurance and Annuities*

I mean, this block of business, extended warranty, has been very profitable for us. And we have not seen a deterioration of our mortality -- sorry not mortality, but experience of the -- on the warranty side. So I mean, nothing more to say at this point.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

Okay, if I may add-on, on this. I think what people should retain is the fact that on the group segment, the key element of the quarter for us is the fact that group Life & Health is now back on track. That's the key element. This is the work we have done in the last 2 years and we see them that they bounced back after a kind of fluctuation we had in Q4. That's a very positive sign for us. It is totally aligned with the plan that we try to implement and we are very pleased with this. The car dealer situation is very small situation from one quarter to the other.

Nick Stogdill - *Credit Suisse AG, Research Division - Research Analyst*

Okay, one more small one. In the supplement, it shows a jump in delinquency in the insured mortgage loans. Anything to call out there? I guess, is it one property? Where's the geography? And maybe what type of property was it or is it multiple properties?

Michel Tremblay - *Industrial Alliance Insurance and Financial Services Inc. - CIO and Executive Vice-President*

Yes, thanks for the question. It's Michel Tremblay. There is no trend there that you can notice from this number. It's still a very small number. So -- and you cannot detect a trend or a direction that should deteriorate over time. I think it's stable and this blip right now is not an indication of any deteriorating trend, sorry about that, okay? Is that correct as an answer?



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Nick Stogdill - *Credit Suisse AG, Research Division - Research Analyst*

Sure.

Operator

We'll get our next question on the line from Darko Mihelic with RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets, LLC, Research Division - Financials Analyst*

I just wanted to ask, with respect to your communications with brokers and whether or not you may be communicating with them about potential price changes and that will be coming up with maybe towards the end of this year or into next year as a result of LICAT. Has any of that been occurring for your company?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

No, because currently, the LICAT situation is a neutral position for our company. So we don't see any reason why we should do.

Darko Mihelic - *RBC Capital Markets, LLC, Research Division - Financials Analyst*

So at this stage, you're anticipating that there really wouldn't be any pricing changes with respect to any of your products as a result of LICAT? Is that a correct characterization?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - CFO, Head of Information Technology & Legal Services, Chief Actuary and EVP*

That's a correct characterization.

Operator

And Ms. Pollock, we have no further questions at the time. I'll turn it back to you.

Grace Pollock - *Industrial Alliance Insurance and Financial Services Inc. - Director of IR*

Thank you. So that will conclude our conference call today. If you have any further questions, you can always reach us at (418) 780-5945. Thanks a lot.

Operator

Thank you, everyone. And ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask you to disconnect your lines. Have a good day, everyone.



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