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IAG.TO - Q3 2019 iA Financial Corporation Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Industrial Alliance Third Quarter Earnings Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded on Wednesday, November 6, 2019.

I would now like to turn the conference over to Marie-Annick Bonneau, Head of Investor Relations. Please go ahead.

Marie-Annick Bonneau - *iA Financial Corporation Inc. - Head of IR*

Good afternoon, and welcome to IAG's Third quarter Earnings Conference Call. Before we start, please note that all of our Q3 documents, including the news release, the slides for this conference call, the MD&A and the 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 public. The call will begin with prepared remarks followed by a question period, which is reserved for financial analysts. A recording of this call will be available for 1 week starting this evening. The archived webcast will be available for 90 days and a transcript will also be available on our website in the next week.

I also want to draw your attention to the word about forward-looking statements at the end of the slide package. A detailed discussion of the company's risk is provided in our 2018 MD&A available on SEDAR and on our website.

I will now turn the call over to our President and CEO, Mr. Denis Ricard.



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Denis Ricard - iA Financial Corporation Inc. - President & CEO

Good afternoon, everyone, and thank you for joining us on the call today. I will first go around the table and introduce everyone. Jacques Potvin, Chief Actuary and CFO; Mike Stickney, Chief Growth Officer; Alain Bergeron, Chief Investment Officer; Renée Laflamme, in charge of Individual Insurance and Annuities; Carl Mustos, responsible of our Mutual Fund Business and Wealth Management Distribution Affiliates; Sean O'Brien, in charge of our Dealer Services and iA Auto and Home; and Martin Belanger, responsible of our Group Businesses.

Now for the results. Q3 was quite a good quarter for iA as shown by the above target results that we reported this morning. Please refer to Slide 3. Reported EPS at \$1.72 and core EPS at \$1.77 are both above guidance. It is the second straight quarter that EPS exceeds guidance. Also, expected profit on in-force increased by 14% year-over-year, which is a good indicator of our capacity to generate growth. In a few minutes, Jacques will provide more detail regarding the contribution to earnings of each division.

I would also like to comment briefly on our ROE, a metric that I pay close attention to, as it is my view that a high ROE is key to EPS growth. The reported ROE of the trailing 12 months was 12.7%, while core ROE of 12.4% is at the top end of our guidance. As for the quarter, annualized ROE, it is above 13% for a second consecutive quarter.

A few words on our capital position now. At the end of Q3, our solvency ratio was 134%. With our risk profile, our target range for the solvency ratio continues to be 110% to 116%. Therefore, we currently have a potential capital deployment capacity of \$1.3 billion. And understandably, deployment of capital through acquisitions continues to be a priority for this organization. While acquisition are our first choice as to how to use excess capital, share buyback is another way to use it that benefits our shareholders, and subject to approval, it is our intention to renew our NCIB program for an additional 12 months.

I will conclude my remarks with a few words on PPI, the MGA consolidator that we acquired at the beginning of 2018. This quarter, we agreed on a final settlement of the purchase price. And at the same time, we reviewed the financial projections supporting goodwill. The outcome was a negative impact on third quarter results of \$8.5 million or minus \$0.08 EPS. The slight deviation from the acquisition plan is mainly due to the fact that until recently, PPI needed to integrate several MGAs. This exercise was more complex than anticipated, and the expected strong growth was temporarily delayed. Now that the integration process is complete, we can focus again on rapidly growing this distribution business.

PPI is a sound business, one of the top MGA consolidators in Canada. It is well positioned to play a key role in our distribution strategy and actively contribute to high success in the coming years.

I will now let Mike comment on the group Q3 business growth. You will remember that Mike was appointed Chief Growth Officer in August. In his new role, he oversees growth initiatives for all lines of businesses in Canada and in the U.S. Following Mike's remarks, Jacques will give an update on the earnings and capital.

On that note, I'll now pass it over to Mike.

Michael Stickney - iA Financial Corporation Inc. - Executive VP & Chief Growth Officer

Good afternoon, everyone. It is my pleasure to address you for the first time as Chief Growth Officer. In this new role, one of my priorities will be to support each Business Head in improving their business growth through sales increases as well as through acquisitions and other business opportunities.

Generally speaking, business growth was very good in Q3 as shown by the increase in premiums and deposits, an important growth metric. Premiums and deposits were up 15% year-over-year at \$2.7 billion.

Please refer to Slide 4 for the overview of sales by line of business. Sales for Q3 for Individual Insurance were \$47 million in terms of total premium, which is down 5% as compared to Q3 last year. Total premium sales are the sum of excess premium sales, which, by their nature, are more volatile,

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and minimum premium sales, which are a better indicator of our sales performance. We are, therefore, satisfied to see that minimum premium sales were up 5% year-over-year.

About Individual Wealth Management now. We continue to be a Canadian leader in seg funds. Gross sales were up 24% year-over-year, and we are still #1 in the industry for net sales, which are more than \$100 million higher than in the same quarter last year.

As you know, the mutual fund industry continues to be challenging. In this context, we had net outflows again this quarter. We are working hard to turn this situation around and the 5% year-over-year increase in gross sales is a positive sign.

Our group business sales were up compared to the third quarter of 2018. Employee plans and group saving retirement did particularly well with year-over-year increases of 37% and 38%, respectively. U.S. operations sales continue to have a strong momentum with a 23% increase in individual sales and dealer services sales grew 12% to more than \$117 million.

Finally, iA Home and Auto written premiums continued their steady growth and were up 10% year-over-year, showing positive upward trend from increased competitiveness of rates.

So overall, our top line results for the third quarter were very good and bode well for the coming quarters.

I will now turn it over to Jacques to comment on Q3 earnings.

Jacques Potvin - iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary

Thank you, Mike, and good afternoon, everyone. For a second consecutive quarter, profitability exceeded the guidance that we provided at the beginning of the year. Therefore, we are quite satisfied with our Q3 earning results. Among other things, our core EPS at \$1.77 was significantly above guidance and ROE continued to increase. In fact, all metrics, presented on Slide 5, compare positively with guidance provided at the beginning of the year.

As outlined by Denis, the expected profit on inforce, supported by good market performance was up 14% year-over-year for the third quarter. Items of note for experience gains and loss versus expected profits appear on Slide 6. As Denis has already commented on PPI. I will now cover the other items, which were mostly favorable and allowed us to report positive quarterly earnings results.

Policyholder experience is detailed on Slide 7. As you can see, Individual Insurance was positive, a gain of \$0.04 that can be mainly explained by favorable lapse and morbidity experience. Individual Insurance's positive experience was partially impaired by lower commission income from PPI. It is to be noted that we expect a similar negative impact of \$0.02 for the next quarter. Due to favorable longevity, experience from Group Savings and Retirement was also positive. On the other hand, there was negative volatility in experience for all 3 divisions of Group Insurance during the quarter, resulting in a loss of \$0.07 versus expected profit. Both U.S. divisions were also slightly negative this quarter, totaling a loss of \$0.02, which is due partly to mortality and partly to expenses.

Strain was slightly positive due to a positive sales mix. Indeed, we are quite satisfied that, again, this quarter, strain was at the low end of our target at only 2% of sales. Please see Slide 13 for more information on strain.

Now I will make some comments on taxes. I refer you to Slide 11. You will remember that we were unsatisfied with our tax situation last quarter, more particularly in relation with the tax impact arising from our status as a multinational insurer. I then mentioned that we will be working on optimizing our tax situation. It was then our belief that we would get benefits from this work only in 2020. Today, I'm happy to report that our tax optimization work provided results sooner than expected. Therefore, for Q3, our effective tax rate is at 21.6%. For Q4, we expect that our tax rate will be near the low end of our target range.



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Income on capital generated a gain of \$0.07, of which \$0.05 came from iA Auto and Home. iA Auto and Home earnings results year-to-date are outstanding and well above expectations. Finally, we also had market-related gains of \$0.05, coming mostly from the hedging program for seg funds.

Now let's move on to our capital position. As shown on Slide 9, our solvency ratio moved from 127% to 134% over the last quarter. This is due to the 2 following factors: first, we gained 6 percentage points when we issued \$400 million of subordinated debt in September. The additional 1 percentage point was generated organically. This brings our capital deployment capacity to \$1.3 billion.

Following the debt issuance in September, as mentioned on Slide 10, our leverage ratio remained low at 22.4% on September 30.

I will conclude with a preview of our year-end actuarial assumption review. Please note that the review is currently ongoing and that the final results are not yet available and will be communicated with our Q4 results in February. Nevertheless, at this stage of our work, we are confident that the total impact should be immaterial.

This concludes my comment. Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Meny Grauman from Cormark Securities.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

First question on taxes. You mentioned the tax optimization that you were guiding to for 2020 happened sooner than expected. And I'm just wondering what drove that, and if there's still more optimization efforts that you can deliver?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Jacques speaking. Yes, we will certainly continue to work on optimization. That's our job to do so. Like I said in my remark, we expect Q4 result to be at the low end of our tax range. So that would be something coming there for that.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

And in terms of what -- why is it -- why did it happen sooner than you expected? If you could give some insight into the process that allowed that to be delivered sooner

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

I would prefer to keep our recipe internally. So for the moment, what I could say, the team is working very hard to optimize the value to our shareholder. And it was a good surprise for us. When we dance on tax, we are not the only dancer. We dance on time with our friends from CRA. So sometimes we can receive answers sooner than expected.

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Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

I understand. I know your friend very well. On iA Auto and Home a very strong result. And I'm wondering if there's anything unusual there that you could call out. And basically, if you could explain what's driving that performance? We know that there's a hardening market across the country. Is it price increases? Or what's contributing to this performance?

Sean O'Brien - *iA Financial Corporation Inc. - SVP of Dealer Services*

This is Sean O'Brien. Yes, we're having an outstanding year in Home and Auto. And as you know, there's a fair bit of seasonality in this business. Typically, Q3 is our -- the best quarter where we take the losses in Q1 and Q4. And for Q3 this year, it's just the fantastic trends in the auto insurance, a pretty uneventful summer really in the home side. And combined, we're getting higher premiums and renewals are strong for the year, and it's driving for good records. Now that said, Q4 has kicked off with its seasonality last week with a storm in Québec, and that storm will probably contribute to about a minus \$0.04 event. But again, the trend is -- beyond that is -- continues positive.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

And then on PPI, I'm just wondering how the write-down impacts your distribution strategy. Is there any sense that, that distribution strategy is going to be tougher than you expected? Or that you have to pull back on that strategy?

Renée Laflamme - *iA Financial Corporation Inc. - Executive VP of Individual Insurance, Savings & Retirement*

This is Renée speaking. No, we're not calling back on that strategy. The strategy is still the same. As you know, PPI is a leader in distribution and has a strong competitive advantage in supporting the advisers. So we are continuing on with our strategy, and we're confident that we're going to be able to continue to grow PPI.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

And in terms of the explanation for the write-down, you noted a more complicated integration of MGAs that PPI is consolidating. That sounds just like it's a timing issue, but if you could go into more detail of what more fundamentally is -- has been the problem in terms of that integration in terms of creating that goodwill charge?

Renée Laflamme - *iA Financial Corporation Inc. - Executive VP of Individual Insurance, Savings & Retirement*

Yes. This is Renée speaking again. It did take a bit more time, and it was a little bit more complicated. Since 2012, we've acquired a dozen of smaller MGAs. A lot of them were integrated, but still a few of them needed to be integrated within PPI, namely Hollis insurance and others. And it took a little bit more time than expected and, of course, took a bit of the attention off growth to more the integration and making sure that things are solid and stand on a good ground, which is now behind us, and we're able to focus on the growth for the future.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

Is that more a technological issue when you talk about integration? Or what's the nature of that integration?

Renée Laflamme - *iA Financial Corporation Inc. - Executive VP of Individual Insurance, Savings & Retirement*

Well, it's a bit of everything. It's not only technology, but it's also the whole administration, the -- making sure that we have all the advisers settle well with -- it's -- behind the scenes, it's a little bit of a complicated work to be done. And you need to make this straighten. Keep in mind that right now an adviser can work with multiple MGAs and some advisers were with multiple MGAs. And now it's all settled.



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Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Meny, it's Denis Ricard. I'd like to add some comments on PPI. If we think about the strategy, why is it that we are in that business? I think that was your question. Is there a reason now to question that strategy? I would say there were 3 reasons, and they are still there. Remember that the first time that we were in that business is because we had those MGAs that used to send a lot of business to us, no succession planning. And so basically, at some point, we decided to protect our business to buy them. That's the first reason. The second is, when you look -- and it's related to the first. With the market as it is right now, there's room for -- to consolidate a lot of the MGAs, so that's the second. And the third one is the positioning versus the change in regulation or supervision of brokers in the future. All these reasons are still there. So for us, strategically, we are very well positioned with PPI, which is, I mean, the best MGA in Canada according to us.

Operator

Our next question comes from Gabriel Dechaine with National Bank Financial.

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

Just a quick one on the P&C business as a follow-up. Was there any prior year favorable development in the reserves? Or is it purely a low claims period that drove the result?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Jacques speaking. Gabriel, it's really a low claim, nothing on reserve at all.

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

Okay. On the outlook, so taxes, you got that resolution sooner than expected. I also want to ask about strain and the guidance associated with strain because even though there's been some ups and downs, for the most part, strain has been a positive factor, i.e., better than guidance in your results, it was this quarter, I believe it was last quarter and several others. I'm just wondering if that 6% strain to sales ratio target is -- where are you leaning on that? I know the year is not done, but I would like to hear your views on that.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Jacques speaking. Actually, for the quarter, it's an optional gain at issue. And when we think about that, in the past, which is competitive, I recommend we could never have guessed that one day we would have a positive strain. So now, we try not to have it. Actually, there's a limit to the level of conservatism that an actuary can put in a reserve. So we are really pleased with our product profitability. The product mix was favorable for a second quarter in a row, but we will see the product mix for Q4, what it will bring us.

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

Is the market dynamic favorable for you such that -- sorry, lapse had been an issue for you, looks like to be well in the rearview mirror now in the UL business, but other companies are struggling with lapse and term as well. So if there's some hardening of pricing in those markets, is that something that we could see benefit the strain line well beyond this quarter?

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Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Actually, when you're speaking about lapse on term product, that's something that in the past, we've been struggling to be competitive on in that market, because we were not expecting low lapses at renewable that our competitor did at that time. So as of today, we are quite pleased with the assumption we're using in our pricing. We're quite pleased with the experience that we're getting that is in line with our expected. So we're okay there.

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

Does that mean -- I'm talking about if competitors are forced to become more disciplined in their pricing, that could have an indirect impact on your sales and therefore your strain and maybe through term or maybe through the sales mix in UL. Is that a driver?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Like I said, when we look at our own pricing, we're quite comfortable with our assumptions. So it will be good if our competitor come with more conservative assumption and put it in the pricing. So it means that we will be more competitive. But for us, we are quite pleased with that. In the past, we were not that it was tough to compete in that product line. But now we are good, and we are okay with our pricing and strain positioning.

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Yes. It's Denis here. As Jacques mentioned before, there is a limit as to what kind of conservatism you can put in the reserve. That's one side. On the other side, there's also IFRS that is coming in a few years. And we know that in IFRS, insurers won't be allowed to front-end profit. So there is a fine line right now. I mean, it's -- so that's -- being at about 0% to 5% as we are right now, we feel is quite comfortable.

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

Lastly, on the group insurance business. You had strong expected profit growth across the company for a consolidated level and group is over 20%, but you also have had negative claims experience. I want to see what you have to say about the long-term visibility claims experienced this quarter. How you're viewing it in terms of being a one-off or maybe a repricing issue? And then how that affects your outlook for expected profit growth in 2020, will you have to lower the bar there?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Jacques speaking. About LTD, we really think it's a blip on the experience for that quarter. So we -- so far this year, we've been in the positive territory. So it's only a blip on the quarter. So we're quite positive for next year.

Operator

Our next question comes from Tom MacKinnon with BMO Capital Markets.

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

First question is with respect to PPI and the fact that you're thinking you're going to get lower commission income in the fourth quarter. Generally, fourth quarter is a pretty busy quarter for sales. So why are you forecasting lower commission -- the \$0.02 PPI hit in the fourth quarter? And how should we be thinking about that? Is that just unique to that quarter? Or will that trend continue through 2020?



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Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

It's Denis here. I think what you should think about here is the -- this is the difference between what we already put in the expected versus the reality that we think is going to unfold. So we are not saying that Q4 won't be a strong quarter. We're only saying that based on the expectation we had initially, it's like a minus \$0.02.

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

Okay. So you're just going to recalibrate that impact when you set your guidance or expected profit metrics for individual insurance in 2020. Is that right?

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

It is right.

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

Okay. I mean, going forward, as you amalgamate more and more of these MGAs, maybe we can get a little more disclosure on what the commission income impact is as opposed just embedding it in expected profit. That's just a comment. The next is with respect to tax, as you've got there faster, should we be thinking about tax at the top end or the middle end or the low end of this range for 2020?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

So far, we see that our guidance will probably remain at the same level, but I will confirm that in -- when we publish the Q4 results in February.

Operator

Our next question comes from Scott Chan with Canaccord Genuity.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Just with an increasing kind of capital base for deployment on the inorganic side, maybe, Denis, maybe you can update on the acquisition pipeline. Kind of the priorities that you kind of talked in the past, if anything has changed in terms of U.S., Wealth and MGAs?

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Sure. Sure. Actually, the simple answer, the short answer is nothing has changed in terms of our focus. I must tell you, we are quite busy in terms of looking at acquisitions. Our top priority is in the U.S. right now. There are several possibilities that, that could happen in the U.S. and also in Canada, the -- for tuck-in acquisition, for example, on distribution, certainly, or let's say, businesses that are less capital intensive. But certainly, we are quite active right now.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Okay. And maybe looking into 2020 -- '19 is shaping up to be an extraordinary year in terms of EPS growth. Looking at the 2020 with a higher base this year, do you think it's achievable outside of acquisitions to get high single-digit core EPS growth?



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Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

So if we think about next year, the -- we still believe that we can grow the EPS by 10% based on our guidance. So if you look at our guidance this year, and our metric won't change for the time being, we believe that we can achieve a 10% -- at least a 10% versus the guidance.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Okay. And just the -- last question, just on the mutual fund side, obviously, industry headwinds that's affecting your business. To get back into positive net sales, would you need more better industry participation? Or do you think kind of with your distribution affiliates, you can kind of convert some of these -- the AUA, AUM and get the net sales out that way?

Carl Mustos - *iA Financial Corporation Inc. - EVP of Wealth Management*

Scott, it's Carl here. Thanks for your question. Our long-term strategic plan here is to be able to earn the AUM growth at our affiliates without necessarily the market participation or the strength of the industry. We're just sort of working through some portfolio manager changes we made at the end of Q2 that have maybe added to our redemptions in that period, but are strategic remains in play. In Canada, we're quite pleased with the results that we're starting to see at this point.

Operator

Our next question comes from Paul Holden with CIBC World Markets.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Let's maybe continue with the individual wealth business for a minute. Hollis wealth, AUA was up roughly 2% year-over-year. I think that's probably below what you'd normally model in terms of regular growth in that business. Can you comment on that? And what your growth expectations for AUA would be over time?

Carl Mustos - *iA Financial Corporation Inc. - EVP of Wealth Management*

Sure. That's a good question. Our AUA growth, I don't have the exact numbers in front of me here to split out, but we were coming off the Hollis acquisition, where we had some attrition advisers. Then as we got into this year, we started to actually see some net recruitment that was improving it. But it's a business that you look for about 5% market growth and then organic growth on top of that. As we get past the Hollis acquisition, our retention remains high. We'd expect to be able to hit that on a longer-term basis.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay. And would you be able to provide some kind of rough ballpark estimate on what kind of AUA track adviser attrition has resulted in? And then second part of that is, can you confirm that, that number has now stabilized?

Carl Mustos - *iA Financial Corporation Inc. - EVP of Wealth Management*

Yes. And your second part is definitely stabilized, that we had -- our retention was well in the 90% -- over 90% of the assets from the acquisition and remains at that level. What we're now looking to do is to get into the recruitment phase and have net positive growth in our advisers, but it's definitely stabilized as a book of business.

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Paul Holden - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research

Okay. Good. And then, I mean, my last question on Hollis would be just because of the impairment charge on PPI, I mean, is there any thought or change in expectation regarding profitability out of Hollis?

Jacques Potvin - iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary

Jacques speaking. There's nothing pointing to that.

Paul Holden - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research

Okay. Good. And then I just have one other question, and that's related to the individual insurance sales and specifically on the excess premiums has been trending lower, but this quarter was a little bit of a sharper drop than we've seen in prior quarters. So any kind of comment there on why? And maybe what we should expect going forward for excess premiums?

Renée Laflamme - iA Financial Corporation Inc. - Executive VP of Individual Insurance, Savings & Retirement

Yes. This is Renée speaking. As you know, excess premiums are volatile. For this specific quarter compared to last quarter, we have 2 cases that really makes the difference, large cases at that same quarter last year, and they were significant. So this is the explanation. But volatility can happen, but there are 2 specific cases that we can pinpoint to.

Operator

(Operator Instructions) Our next question comes from Doug Young with Desjardins Capital Markets.

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

Just on the group -- sorry, on the group side. The U.S. operation, believe your target was for operating profit in 2020 of \$50 million. And correct me if I'm wrong, but it looks like you're going to hit that in 2019. Just thoughts on that, any plans to increase the targets or any expectation that this growth level will stall out here?

Michael Stickney - iA Financial Corporation Inc. - Executive VP & Chief Growth Officer

It's Mike Stickney. You're right. The 2019 profits are going well. And I haven't checked -- I always think in U.S. dollars, you're quoting me Canadian. But any rate, I suspect it sounds right. And I would expect it to grow -- 2020 to grow from 2019. We haven't -- we're going through our budgeting exercise right now. So obviously, I can't say more than that. But given the growth we've seen on the revenues side, it's only natural that the profits will continue to grow.

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

It is. And so it looks like you're going to be early in your target, and there's more expansion from that as we move forward. Okay. And then, Denis, you talked a lot about ROE at the beginning and your focus on ROE. It looks like the last 2 quarters, I mean, the ROE has been on a core basis around 13% to 14%. You're expecting 10% EPS growth and the math just dictates that your ROE should say above what your target is. Thoughts on that. And is there room to push your ROE guidance higher, especially if you start to deploy capital?



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Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

That is something that is on the radar. I'm not going to announce anything obviously today, but certainly, it's the direction that I want to bring to the organization. The EPS growth is very important, but there are 2 key metrics that are also important. One is the ROE, as you mentioned. And also the fact that we want to grow the size of the company. I mean, obviously, in terms of our market cap, we still have a long way to go to capture the same size of some of our competitors. But certainly, the size, the ROE and the resulting EPS is basically the 3 metrics that I keep focus on. We'll probably come back in February and see to what extent we want to change it.

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

Okay. So the fact isn't that you're going to migrate back down towards your ROE target. The fact is that if you continue to hit your targets in terms of EPS growth and whatnot, that ROE should naturally gravitate higher, is what I'm hearing from you.

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

It's funny you said it that way. The way I look at it is that if we achieve the ROE, we're going to get the EPS growth.

Operator

Our next question comes from Sumit Malhotra with Scotiabank.

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

Denis, let's stay with you and some of those medium-term objectives that the company lays out for us. One of the conversations we've had recurring basis since you took over was making the -- improving the profitability of the company such that less of the equity base is reacquired in growth, whether that's organic or acquisitive. I think it's fair to say that maybe that higher reliance on equity to grow in the past was one of the reasons that IAG has had a lower dividend payout ratio than your peers. You've got the ROE question a couple of times from The Street in terms of whether that can move higher. Heading into year-end and your review, is now retaining less earnings and paying out more via the dividend payout ratio something that's also on the list to review?

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

It is not my priority, and my priority is to deploy capital through organic growth and acquisitions. That's certainly the focus that we have. So -- and then we've got the NCIB that we can use opportunistically and also the dividend to some extent. But I mean, we'll still continue to aim for the 25%, 35% for the time being. So priority is acquisition.

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

All right. And on that front, let me lead right into that. So on PPI. So I just want a little bit more information to the extent you can on what causes the goodwill impairment charge now. As far as I can see here, you had this business under your ownership now for 6 quarters, which is not a overly long period of time. What is it in terms of -- what metric are you looking at in terms of is it individual insurance sales? Is it profitability coming out of the channel? What causes the impairment charge to be taken in such a relatively short period of time? And if I go back and look at the numbers, you're taking an \$8 million charge today, the goodwill that came along with this business was something like \$115 million. What should we be monitoring to see if there's improvement such that another charge is required?

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Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Okay. It's Denis here. I'd like to give you a short story on that. You may remember that in 2015, when we bought CTL, at that time, we had put, I think, it was \$60 million goodwill. And we also had a earn-out. The way it works is that what happened is that there was what we call the optimistic scenario that was put in the balance sheet, okay? But the reality was that it was a more realistic scenario that happened. So basically, we reduced both sides of the equation in the balance sheet. We reduced the goodwill by something like \$30 million at the time, and we reduced the earn-out that was supposed to be payable. And it was kind of a wash at the time. It was -- it's pretty close -- those numbers were close. I mean, the accounting, I would say, methodology or standard right now gives an incentive to management to put, let's say, I would call it the high goodwill value in the balance sheet and earn-out equivalent. And if they're not paid, it's being shaved out of the goodwill. And that's what happened here. I mean, basically, you protect yourself by having an earn-out formula. And so if the earn-out is not payable, you reduce the goodwill at the same time. It happened this time that it was not an equal amount. There was a big -- a bit of discrepancy. And accounting rules around the goodwill valuation can bring those types of things. The strategic value of the company could not be fully recognized in my mind. So, the way I see it is that it's normal that when you have an earn-out formula, after some time that if you don't pay the full earn-out, that the goodwill will follow. Maybe -- I hope I made myself clear, but I just want to say that it's normal that those things happen. Because if you don't do that, if you don't, let's say, put in the goodwill, the earn-out you're going to pay, what happens is that if for any reasons you're going to pay it, it's going to become an expense in your earnings.

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

Well, and to be honest, the CTL was in my mind because you're right, it was very similar that I think it was a relatively short period of time, maybe even shorter on that acquisition that you folks took a goodwill charge. So it sounds like it's the way that you are accounting for these transactions that is causing a quicker review or test of the goodwill than maybe we're used to seeing with some of your competitors.

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Yes. And another way to look at it is that we wish we would pay be the full earn-out, that would have been an extraordinary result, and we would pay the full earn-out, but the reality that you have to remember is that we protected the company by having that earn-out. And because the results were not as great as, let's say, the seller said that there would be, well, we're protected. But at the end of the day, in the balance sheet, you need to shave both sides of the equation. This time, the numbers were not equal. That's it.

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

Okay. And let me just take this a different attack, and I'll stop there on this stuff. You got a question about HollisWealth and that acquisition and it has anything to do with Hollis or not, obviously, the mutual fund net sales of the company haven't been where I think you'd want them to be. If looking at PPI and if the crude metric we're going to look at is individual insurance sales. Those have been, again, industry trend, but have been flattish. You go back to your Investor Day last summer, you talked about distribution as being a key part of the company's growth. When you look at these acquisitions, is there anything that's changed in your mind in how you're thinking about the capital deployment going forward? And what I mean by that is, are you looking at businesses that would have a more direct earnings contribution to you on day 1 as opposed to distribution base business that has to prove itself out on your platform?

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Well, whenever you go in any market, it's always very difficult to get a full recognition of profit in the first year. There's always, in the price embedded into that, some kind of growth, that if you don't do that, you don't -- you're never going to buy any business. So to your point, I think you should expect that any acquisition that would be, I'd say, a trend where the ROE at first is not that high, but it will increase up to your level and then go over the level that you aim for.



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

Last question, and I'll try to keep this one very brief. Group Insurance, it was touched on before the expected profits growth. To see expected profit in that business jump \$10 million from Q1 to Q3, which is almost a 50% increase, could you briefly explain to me what would be causing that level of expected profit change in a relatively short period of time?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

It's seasonality, for sure, that we have to keep in mind here. Also the growing on auto finance that is increasing the profit from one quarter to the other as well, but mainly seasonality that is playing here.

Operator

Our next question comes from Mario Mendonca with TD Securities.

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

I want to go back to PPI. I appreciate that it's not a huge business and maybe was never expected to contribute significantly to profits. But there are some numbers here that are large, like if the goodwill is, say, \$100 million to \$110 million, then the \$22 million write-off is about 22% of the goodwill or 20% of the goodwill. And similarly, if you compare it to the purchase price, you're approaching 17% of the purchase price. So where I'm going with this is if, in fact, the issue is just your eye was taken off the ball and because of all the other integrations and that issue is behind you. And why would you need to write-off 22% of the goodwill or 17% of the purchase price? It seems like an awfully big number in the context of an issue that's just, hey, we took our eye off the ball for a while.

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

So Mario, it's Denis. Here's the way I look at it. So first of all, I don't look at the \$20 million of goodwill write-down, because as I mentioned before, it's only the net that is important. Because the other part was just to protect the company against an experience or results that were not on par with what the seller thought that they would get. So to me, it's the only -- it's only the \$8 million that is really the loss that you should take into consideration. The second thing is the value in our balance sheet is not only the goodwill. It's the goodwill and intangible, and it's not only for PPI. It's for all the businesses that we bought over the years that are being put together into the MGA. And so the value that we had on our book before the write-down was \$275 million. So of all the MGAs that we bought over time, the residual value in our balance sheet just before the write-down was \$275 million. So we're talking about 3%. That's the way I look at it.

Operator

Mr. Ricard, there are no further questions at this time. Please continue with your presentation or closing remarks.

Denis Ricard - *iA Financial Corporation Inc. - President & CEO*

Thank you. Well, as you have seen, the results for the quarter have been pretty good. And I would -- and my note today by saying that when we look at Q4, we provided the market with some guidance. And we are, at this point, confident that we can be within the guidance that we provided to the market. So that ends my presentation.



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Operator

That does conclude the conference call for today. We thank you for your participation, and ask that you please disconnect your line. Have a great day, everyone.

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