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PRESENTATION

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

All right. Welcome back. Our last presentation before lunch, which I'm sure everybody is eager to attend. But before we get to that, I'd like to welcome Tim Deacon to the stage, Sun Life's Chief Financial Officer, first time at our conference. So we always appreciate that. Tim, welcome to the stage.

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Cheers. Well, thanks, Gabe, and it's a pleasure being here. It is my first time and it's been a great session so far.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Well, the reason it's the first time is because you're almost at a year mark as CFO of Sun Life. Maybe natural place to go, I guess, is your impressions of the job and the organization.

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Sure. So I'm coming up on my first lap around the Sun, figuratively and literally. So it's been quite an exciting experience actually coming in, and I guess a couple of observations I have is just how fantastic a franchise it is. We just celebrated 160 years in business last week and 25 years as a public company since demutualization.

And there's very few Canadian companies with that sort of tenure. In fact, they're dwindling by the week it seems unfortunately, but at 160 years, that's two years before Canada was even formed as a country. So if you think of the history and longevity as a country, it's a true honor and privilege to be in the CFO seat, especially at that kind of milestone.

It's a great franchise. The strategic decision Sun Life made well over a decade ago to position itself into capital light, low-interest rate sensitive businesses was quite strategic and timely, and its pivot into private asset management, the growth that we've had in our private businesses, the acquisitions that we've been making, it would be impossible to replicate those acquisitions, certainly at today's multiples.

I think that the Canadian business leading position, 23% ROE, double-digit growth in a mature market. It's quite a great franchise in our home territory. In the U.S., the largest dental benefits provider, top 10 group benefits provider, largest independent stop-loss provider. And then in Asia, eight markets, four of them fairly mature, and four of them with great scaling opportunities. 25% of our business is tied in individual traditional insurance. So that's really low market rate sensitivity. It's fantastic.

But I think probably most the distinctive feature that's really resonated with me in the last year is the culture and just how inclusive and welcoming it's been. To be an executive team member and to be welcomed in immediately and then, I faced a very difficult quarter. It's unusual for Sun Life in the first quarter of last year.

We had an earnings miss and how apologetic my peers were and how terrible they felt to put me in the hot seat. I was only four weeks in. So the books had already closed. So I felt I was cramming for an exam that I'd skipped all the classes for and just how supportive they were to get me onboard.

I hear often leaders talk about culture being a secret sauce for them, but I think the biggest test of that is when you speak to your partners and people you work with in the industry and how many people have come up to me since taking this role, unsolicited and just saying how much of a pleasure it is to work with Sun Life to partner, a true strategic partner. I mean, it doesn't get better than that in terms of the testament. So yeah, it's been a great, very busy first year.

QUESTIONS AND ANSWERS

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Well, having followed the company for over a decade, the cultural shift at Sun Life is certainly something I'd agree with and attest to. You did touch upon a lot of themes that play into my question list, but one of them that is an obvious one to pursue is the acquisition strategy of the company.

If I tie it to the Investor Day messaging, 20% ROE goal. Your internal capital generation or excess capital generation cumulatively means you're going to have a lot to deploy.

I guess where are you targeting, but also is now the right time to be making an acquisition? There's some group issues in the group business in the U.S. and the stop-loss business. Should you be focusing on those or can you do both?

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Sure. So I mean it's been quite actually fascinating coming in and observing Sun Life outside of the industry for the three years that I was in the pension world before joining Sun Life and getting back into the insurance industry. And certainly, have been on quite a large acquisition spree. It's almost been $6 billion of capital deployed in M&A either already spent or committed for the remaining buy-ups of the private asset affiliate companies that we've acquired.

And that's been a fortunate position of the excess capital and the great capital generation that Sun Life has had, and that's really built great capabilities in great high growth spaces. But the targets that you spoke about that we shared at Investor Day last fall are not dependent on M&A. So while we've done a lot of acquisitions to date, our strategy is not dependent on that.

And I think when I look at our spaces we're in, the private assets, the bancassurance in Asia, the health and benefits space in the U.S. I think we have all the core ingredients that we need to be able to deliver on our plans. And so, if I was thinking about future acquisitions, our priorities for capital deployment remain consistent. It's really firstly to organically reinvest back in the business.

We have a sizable investment project portfolio which competes for capital internally in terms of business case, in terms of what has the best ROI, but we need and will continue to make further investments in digital and AI. So that will take the first priority.

The second priority is maintaining a very strong dividend payout ratio. We've been maintaining that within 40% to 50% of earnings quite consistently. And then the third becomes inorganic deployment opportunities, and that's really between M&A or share buybacks, and we've not historically been all that active in share buybacks.

I think our philosophy is we'd rather deploy that and invest that in our own capabilities rather than shrink our company, but in certain markets like the one we're currently in, we see that actually as a very attractive use of capital. So we've been very active on that share buyback, and we'll continue to be.

And so, then M&A, our criteria is the same. It would have to be accretive to our medium-term objectives. So that's not always easy to do when you have a 20% ROE target to be able to have that in a medium term. It's got to be core to our strategy. So it's got to be expanding in the spaces that we're already in.

And then we also have to be able to execute on that, and that comes both with integration, which we have a good track record on, but it's the ongoing execution of our goals against our targets. You mentioned the U.S., so the U.S. dental business was probably our second largest acquisition in the history of the company that was made in '21. It's a great business. It's allowed us to catapult ourselves to serve 35 million Americans.

It gives us great access to selling more commercial business and opportunities because we have a platform for that. But we had some challenges coming out of COVID, and that set us back a little over a year in terms of what our trajectory was.

So I think we'd want to demonstrate that we're still on track for our USD100 million earnings target for that in '25 before we'd add a lot more capability or scale to that business. So we want to make sure that they can execute.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

I guess the other way to ask the M&A question is that, in the past there were kind of gaps in the lineup whether I look at the asset management side where SLC built up different verticals if you will, and then in the group business, there was some scale, regional and dental. I mean, it doesn't seem apparent that there are any gaps in the lineup as there used to be.

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

No material gaps. So how I'd think about opportunistically, if we had something that was an adjacency. So I'll use private assets as an example. So BGO is our real estate arm and they're about an $80 billion third party asset management. Very great strength in core and core plus, but increasingly more into value-add real estate development opportunities.

We've been having a lot of success in cold storage, for example, data centers are a hot commodity just given the AI and computing power and demand. If we found a strategically aligned good fit, digestible, adjacent tuck in acquisition that filled in some of those extra gaps that met the criteria that I spoke about, for certain we would be interested in pursuing that.

But it's a tall bar to be able to meet all the criteria that I just laid out. So we're also patient and thoughtful about deployment of capital and it's not burning a hole in our pocket because we have other uses for that capital as well.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Okay. Good to know. Now as far as the operational side of the business, we can't have a Sun Life discussion without some of the issues with the group business in the U.S., whether it's dental or stop-loss, but to start with dental. I guess we have a much better picture now of what happened and where the trajectory is going, and we've seen some improvement there.

It's more related to regulation, and there were some comments on the Q4 call about the risk of Medicaid cuts and Dan was talking about how your position and is it the story simply that you're providing dental - primarily covers youth and young people, so it's not top of the priority list for Medicaid cuts and that means the risk is de minimis.

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Yeah. Broadly speaking, I mean the challenge as we are all living in this current environment is the variability and the uncertainty of the decisions coming out of the U.S. It's really hard to predict, but if you think about Medicaid as a program and its needs, it's pretty fundamental to the American population.

There really hasn't been a lot of direct rhetoric on dental. If you think of Medicaid, the medical costs are the large majority of the costs, and we don't participate in that space. So the dental costs and the programs under Medicaid and Medicare are much smaller in terms of size and scale first of all.

And then the point you touched on, I think is the most relevant that the member base that we serve predominantly in Medicaid in the U.S. in dental is youth. So it's pediatrics. And the types of areas that have been discussed for cuts in Medicaid are for able-bodied adults, and it's more around the classification of who's eligible for that.

And when you look at that type of population with the types of definitions that they're showing, it'd be low single digits of percentage of our membership base that would be impacted on that. So never say never. It's not totally off the table for that, but if there was an area to be targeted, it would be a small percentage.

And then we have to remember that Medicaid is set by the states. So it's not a unilateral federal decision to be able to make those cuts. It would have to navigate through the state populations, and there's a very large divide we see between blue states and red states in terms of how they approach and think about these things too. So that would be a very difficult task to materially change the demographic and the profile. But again, back to kids, we think that's not a huge or material area of vulnerability for us.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Fair points. Now then the stop-loss business and just give a bit of a background or timeline as far as I see it. We started to see some of your peers experiencing higher claim trends midpoint of last year, and it seemed to be Sun Life was not experiencing those issues until Q4 rolled around and now we saw like claims ratios go up, talking about discipline, more discipline on pricing now. So what's changed or was this already in your sight line?

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Sure. So I mean just for context, stop-loss, a critical part of the U.S. benefits medical ecosystem because 65% of employer's self-fund their own health benefits, meaning that they'll cover the cost for that and because the costs of drugs and medical treatments have been going up in one direction pretty consistently.

It becomes more and more costly for employers to provide this. So it's a really important space to provide coverage for and over half the American population get their benefits through their employer. The rest of the population back through Medicaid that we spoke about before. So a really important segment, it's growing. It's growing in need and demand, and the costs are going up.

What was unique for us and the industry in the fourth quarter last year was the severity of claims. So you referenced there was pretty widespread increase in frequency, which we saw as well, but we had already priced for a large portion of that increase because we expected through COVID people weren't getting medical attention.

They couldn't get access to medical care obviously during lockdowns and when the restrictions eased, there was labor shortage in hospitals. There weren't enough doctors or nurses to kind of fill the backlog. So people weren't using their care. They weren't going on claim. They weren't hitting stop-loss thresholds. So we knew that that would not persist.

And so, we started to price in assuming that would come back. And we saw the claims utilization rates kind of normalizing back to pre-COVID levels, but what we all missed was the severity. And the nature of stop-loss is you have to accumulate the claims up to a certain threshold until it hits a deductible.

So by definition, it's back ended and this is annually re-priceable businesses. So it creates some variability for these types of events, but the nice part is you get to reprice that quite regularly. And so, we had already started to put price increases through, but when the severity hit in the fourth quarter, we hadn't fully priced in for all of that.

So we signaled on our earnings call that we'd increased prices 14%. We have another 2% to go to get back to our target margins. So the business is still profitable, still had healthy margins, just not at our desired target margins and certainly not as high as they were in COVID when people weren't claiming.

So then the question is what drove that severity, and we spoke about three main drivers, one being late-stage cancer diagnosis. As you can imagine during COVID, people weren't getting the preventative screening for cancers that they should have or could have.

And then once the restrictions lifted, that backlog, they couldn't get access. So the unfortunate part is that people were being diagnosed later in the disease, and that becomes more costly because of the surgeries involved as well as the high-cost cancer drugs that are required.

We think that’s transitory. We don't see any environmental or seismic shift in the U.S. where there's a step-up rate in cancer diagnosis. So we think that's a backlog coming from COVID. And so, again, we've priced in for a good chunk of that, with 2% more to go.

The second was a higher birth rate in the U.S. The U.S. birth rates were up 4% year on year, which was quite unusual. We think that's a mini baby boom post COVID. There's no social policy that we're aware of in the U.S. that's encouraging higher birth rates that would have a sustained 4% or more increase.

So again, birth rates caused more premature births or more neonatal care, which were very expensive to hospitals, et cetera. And then the third trend was increase in medical costs, which we do not see dissipating. We see that going up. Hospitals in the U.S. were subsidized until the end of '23.

And then in '24, those subsidies ended and while they're meant to be non-for-profit, they were very much commercial enterprises in the U.S. And so, we saw a large uptick in billing practices as did the whole industry and those got backlogged and we got inundated with claims in December and that's really what caught us all by surprise.

But we expect that to work through in the next part of the cycle. 90% of the claims come in by the fifth quarter, which will be the first quarter for this year. So we'll have a lot more clarity on that and the outlook, and we think we're well positioned.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

So you've repriced by 14% already. So that's reflected in the book and just another 2% is needed, which signals to me that I shouldn't really --

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Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Yeah. All else being -- the loss ratio is your losses divided by your premiums, and the losses, we're not seeing a sustained increase for the reasons I described, and your denominator is increasing because we've already captured 14% step up as of January 1 this year. So all else being equal, the loss ratio will improve and stabilize.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

The US business sucks the air out of the room, but you've obviously got a large Canadian group business as well. And I'm just thinking about that one in terms of macro trends. Canadian unemployment is not particularly strong at the moment. The economic outlook overall is not very strong.

So is there a topline issue that is just restricted growth at the moment? And given the weaker status of the economy, sometimes that also has an impact on claims behavior. Is there any trends there that you're noticing?

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Sure. So I take it in both pieces. So like many with all the tariffs and trade wars and rhetoric, instantly as financial institutions go into scenario planning and modeling and desktop and tabletop exercises so that we've been immersed in that, ever since the election was coming up.

And like many of our peers, our implications of all of this are second order, right? So we're not directly subjected to the tariffs at this stage, but it would be more around the macroeconomic points that you touched on, and employment rates is probably the most material one on our group benefits business.

And so, the challenge we have is that economists, and I'm sure you've been hearing lots in the various discussions -- have such a wide range of unemployment expectations, anywhere from 100,000 job losses to 1 million, and that's unemployable employee base of 20.5 million in Canada. So pick a number, if it's 250,000 job losses, call it auto sector or others, are most directly impacted.

Our group benefits businesses quite diversified by industry. So we're not outsized exposure to any one industry first of all. So that diversification helps. But if it's 250,000 job losses, that equates to about a 1.2%. increase in the unemployment rate. So you go from 6.8% to 8%.

That overall is not material to our business. So overall in the topline, it would have to be pretty pervasive, severe, mass job loss, and permanently sustained for us to have a material impact on our group businesses.

So then the second feature is the claims that you talked about and one of the things that we have noticed even through COVID is mental health needs. So in times of uncertainty and stress, the need for mental health supports increased, and that obviously impacts claims, and that's part of the coverage that many companies have been offering as part of their group benefits providing.

So we would expect some uptick in that. So if that went up a third, 40% even just in terms of claims and needs and usage, that would have some impact. But again, this business also reprices. So we would be able to capture that in the fullness of time and wouldn't expect material degradation in the underlying --

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Gabriel Dechaine - *National Bank Financial Inc - Analyst*

The other claims behaviors I was thinking of, and it doesn't sound like it's an issue, that is some people tend to develop a back problem when they're worried about layoffs, right? That's not really in the mix?

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

So LTD trends both in Canada and the U.S. have been becoming more and more favorable in part because people can work from home, right? So the need to come into office for corporate jobs anyways has in part been the trend.

Part of that's led to exuberance in the pricing in the U.S. where people have factored that in as being sustained lower LTD and it's made it very competitive. We've not participated in that. We've been willing to sacrifice sales for that reason. So there is that risk for LTD claims, but there's uncertainty in that.

And then there's also making sure you have good underwriting and proof of disability, and we've been investing heavily to actually help people get back to work through their care management, through access to healthcare and how to navigate that. So we've had good competitive advantages in helping on the LTD side as well.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Going back to some of your earlier comments about the asset management business and the acquisitions and the SLC business in particular, can you remind us the buyout timing and size? And then more importantly, what's your growth outlook for these businesses post buyout?

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Sure. So we have two remaining purchases to make for our private asset managers, and they're both occurring in the first half of next year. So this is BGO, our real estate arm. We have a minority stake in that business. We actually report 80% of their earnings. So when we complete that buy-up, we'll get a 20% lift even though our minority stake is lower than that.

And the second one is Crescent, which is our high-yield fixed income private credit business, and that's one of the oldest private credit businesses in the markets, over 35 years old, about $40 billion of assets under management. So both of those will be done in the first half of next year.

The estimated remaining purchase price is about a little over $2 billion, $2.1 billion as at the end of the fourth quarter. The unique nature of how those deals were structured is we locked in the multiple for those businesses at acquisition. So the variability in the purchase price is based on the trailing two years EBITDA, leading up to that purchase, and we only have one year left.

So we have pretty reasonable certainty in terms of that purchase price. And that's why at the beginning of my comments I made that those would be very difficult to replicate because those multiples will be in the low double digits, low-teens and in some cases, you read the headlines, they're north of 20 times earnings right now in terms of multiples. So that's the remaining buy-up.

In terms of growth thereafter, we signaled at Investor Day our outlook on earnings growth of 20% of fee-related earnings as well as underlying net income. We're looking to grow our AUM at least 15% and achieve a fee-related earnings margin of 35%. So we see really sizable growth coming out of the power of those franchises.

But what we haven't done yet, and it was a bit surprising to me coming in to Sun Life is we really haven't leveraged the power of those asset managers as a platform. They're all run independently and autonomously. So we've given them seed capital to help them grow and scale quicker, and that's really what's been helping to contribute to the growth.

But we've not brought those asset managers together to harness as a platform. So if you think about multi-asset solutions, combining public and private assets, we read a lot about that in the press in terms of big acquisitions people are making. Back to your earlier comment, we have all the manufacturing componentry we need to be able to compete credibly in that space.

Ultra-high net worth, we're one of the largest writers of ultra-high net worth insurance products globally. We have a great client network that also has wealth needs, and we have the solutions that they would be needing.

Our Asia distribution network has not been penetrated in terms of wealth management distribution of our own products. So all of those are upsides over and beyond what our Investor Day targets signal because it hadn't contemplated the coming together as a platform which is imminent for us given the buy-ups are coming up.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

You mentioned the -- just the sidebar question. I guess, you mentioned the growth for fee income expectation. What about performance fees? Every now and then those could be positive surprises, right?

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

So great nuance. So because these are in the private asset space. Performance fees are an important component, but the way we structured our buy-ups, all the previous carried interest and performance fees accrued to the previous owners. So this is all going to be on subsequent fund launches and because we're still early in that track record, those won't kick in for about another seven or eight years.

So they won't be meaningful contributors. They're not baked into any of those Investor Day targets, but they will eventually come more meaningfully into play. And we generally think about sharing our carried interests 50:50 between investment teams and the house. So we will participate in that upside, but they do create variability, and it is back ended in terms of the way the accounting works for that.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Glad I didn't extend my model that far yet. Just last question on the different type of investment, your capital fund there. We had a tailwind from rate hikes. Now rates are cut on the returns in your short-term portfolio. Have you done any tactical repositioning there that could soften the blow, I guess, from the down trend in rates.

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Yeah. So you're referring to our earnings on surplus asset portfolio. Yeah. Our book was very short, and I think I was sharing on the call, about 40% of that asset mix was in short duration and we had an 80 basis point hit. So that is a decline in the run rate earnings, but we are seeking to optimize that.

We're seeking to deploy that in longer duration. We're bifurcating that surplus book. Part of it is for cash needs to pay our dividend. Part of it is for collateral needs for our derivatives, and then the rest is longer term investing, and I would say that was sub optimized.

And so, we are finding great deployment opportunities. So I would expect that yield to come back over time but not immediately. So I'd say in the second half of this year, we'll start to get better yield accretion assuming all else being equal in the current yield environment.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

So would it be a third, a third, a third, of those components you mentioned like the cash for dividends, the hedging, collateral, and then the long term --

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Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Broadly speaking, it was probably more in the short cash in the fourth quarter, hence why it was 40% really short rate, but I think that's a rough rule of thumb to use.

Gabriel Dechaine - *National Bank Financial Inc - Analyst*

Okay. Well, that's a wrap, Tim. Thanks for taking the time. Great catching up and enjoy the rest of your day. Enjoy lunch, everybody.

Tim Deacon - *Sun Life Financial Inc - Chief Financial Officer, Executive Vice President*

Yeah, likewise. Thank you very much.