

Financials Group

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Investment Pitch: Industrial Alliance

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Pitch: Industrial Alliance

Desautels Capital Management

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Pitch: Industrial Alliance

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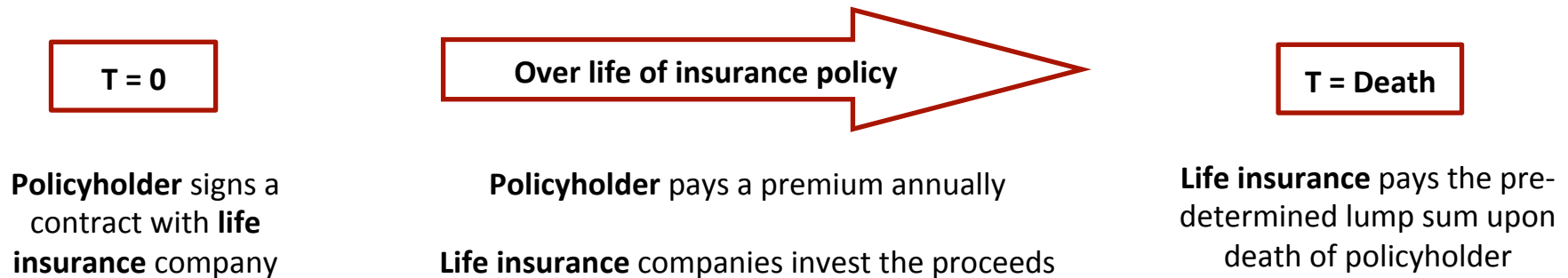
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Life Insurance Primer



How Does the Business Work?



Business Model

- Insurance companies have a relatively low risk business model within the financial industry
- The majority of their investments are backed by the proceeds from policyholder liabilities, which are long-term stable sources of funds. Therefore, insurers have the ability to hold assets to maturity
- The majority of their assets are held in investment-grade bonds
- Lifecos generally have a mismatch in asset-liability duration with longer liability duration than asset duration

Type of Assets and Liabilities

- **Assets**
 - Mainly **bonds**
 - Stocks
 - Real estate
 - Public equities (i.e. infrastructure)
- **Liabilities**
 - Mainly **insurance contract liabilities**
 - Unearned premiums
 - Debentures

Type of Products

- **Whole life insurance:** guarantees the premiums you pay and the amount paid upon your death
- **Universal life insurance:** combines life insurance with an investment account. A portion of premium is allocated to your life insurance and a portion to investments
- **Term insurance:** provides life insurance policy coverage for a certain period of time
- **Health and disability insurance:** protects you against the financial consequence of an illness or an accident

Strain

$$\text{Strain} = \text{First Year Premium} - \text{Acquisition Costs} + \text{Best Estimate of Reserve} + \text{PfAD}$$

- First Year Premium = Premium received from insurer
- Acquisitions Costs = Commission + Administration Cost
- Best Estimate of Reserve = Liabilities an insurance company is legally required to maintain on its balance sheet to meet expected future claims
- PfAD (i.e. Provision for Adverse Deviation) = Buffer to each assumption used to project cash flows. Usually negative

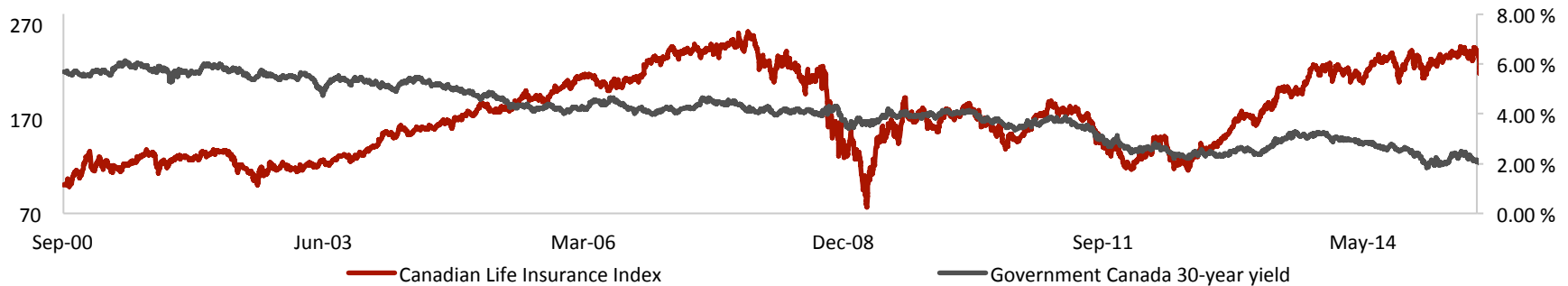
Key Definitions

- **Sales:** the sale of new policies (premiums) will have minimal impact on current earnings. For most life insurance lines of business, the bulk of collected premiums relates to policies that were sold years earlier
- **Reserves:** life insurance companies are required to maintain many different types of reserves, the most important of which relate to policyholder benefits
- **Lapsed policy:** an insurance policy that has ended because the policyholder stopped paying premiums
- **Morbidity:** refers to the occurrence of accidents and sickness in a given population
- **Mortality:** life expectancy based on a 5 year rolling average
- **Initial reinvestment rate:** the reinvestment rate of assets in the initial 20 year period
- **Ultimate reinvestment rate:** the reinvestment rate of assets beyond the 20 year period
- **Minimum capital surplus and requirement (MCCSR):** Total Capital (Tier 1 + Tier 2 capital) / Capital Required (Determine by regulatory agencies by applying factors for specified risk components to on and off-balance sheet assets or liabilities) - required ratio is 120% in Canada

Life Insurance 101

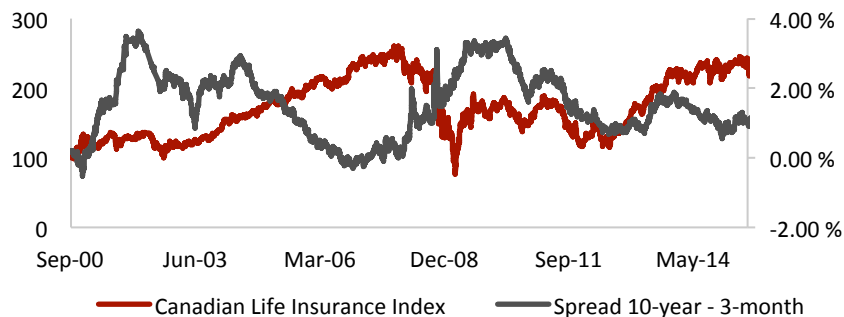
Theoretical Valuation Drivers vs. Real Life Impact on Market Performance

Interest Rates



In theory, interest rates directly impact the expected investment returns life insurers earn on the premiums they invest. We will dive deeper into this assumption in the pitch

Yield Curve



Life insurers sell longer-term products, which are more attractive when the yield curve is steep. They also have an asset-liability mismatch (i.e. longer liabilities)

Source: Bloomberg, Industrial Alliance Annual Report, Street Research.

Other External Macro Factors

- **Corporate Credit Spreads:** Life insurers underperform when there is credit spread widening. Changes in spread suggests a change in outlook for credit losses. Although insurers suffer mark-to-market losses, these losses are not realized as bonds are held to maturity
- **Mortality:** Mortality rates significantly impact life insurance. Insurance products benefit from lower mortality while annuity products benefit from higher mortality
- **Lapse Rate:** Reserves put aside to cover future liabilities assume a certain lapse rate. If the policyholders behavior changes, the assumptions and reserves are impacted

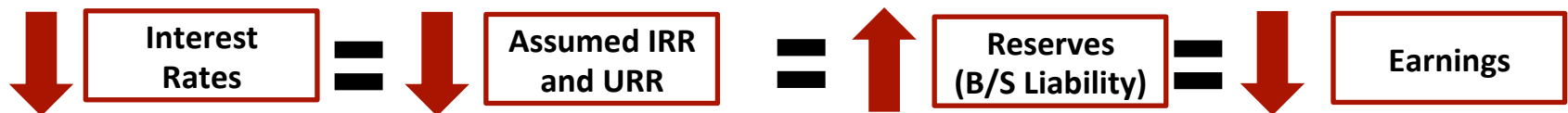
Interest Rates

- A life insurer's direct exposure to interest rates comes from the **fundamental mismatch** between (a large portion of) its assets and liabilities



Cause: Lack of longer duration investment products (liabilities > 40 years, assets ≤ 30 years)

- While the duration mismatch **does not impact cash flows over many years**, until the mismatched portion of the assets backing the liability are rolled over, the **accounting impact will occur much sooner**
- The **discount rate used to adjust reserves** is based on future rate scenarios. Theoretically, there are an unlimited number of scenarios, but under the deterministic methodology, the Canadian Institute of Actuaries (CIA) mandates a number of prescribed scenarios, and lifecos must use the most conservative one



Consequence: CIA asks life insurers to re-assess reserves periodically and increase liabilities to policyholders if there is a downward adjustment in the IRR or URR assumption when calculating policy liabilities. **Increase in policy liabilities (reserves) is expensed and therefore has a direct impact on the earnings figure**

Company Overview



Company Overview

Summary



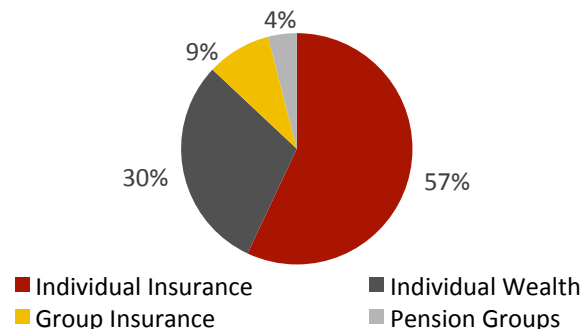
Key Information

- Industrial Alliance is an insurance and financial services company headquartered in Quebec City
- Credit rating profile, S&P: A+
- Business segments: (1) Individual Insurance, (2) Individual Wealth Management, (3) Group Insurance, and (4) Group Savings and Retirement

Share Price (\$)	\$39.59	
52-Week High (\$)	\$49.07	
52-Week Low (\$)	\$38.33	
Div. Yield (%)	3.0%	
FDSO	101	
Market Cap.	4,018	
Cash	530	
Debt	846	
Preferred Equity	375	
Entreprise Value	4,709	
Valuation (x)	2015E	2016E
P / E	9.5x	9.1x
P / B	1.1x	N/A

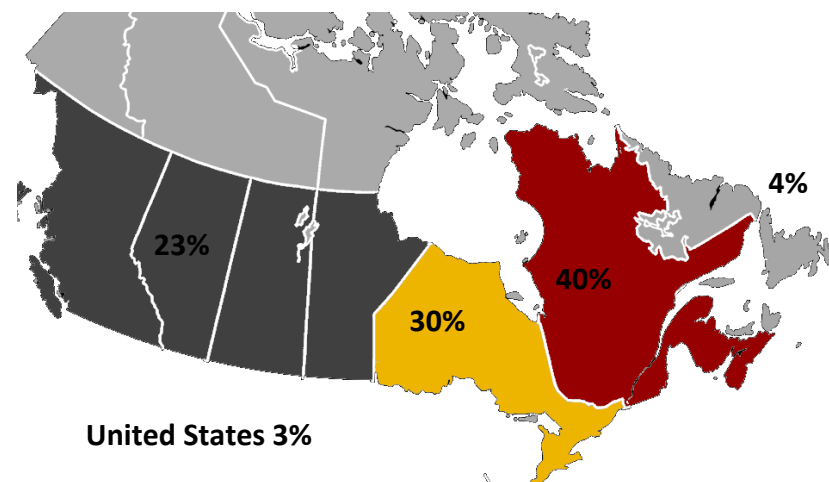
Source: Company Fact Sheet 2015Q2, Capital IQ on September 18, 2015.

Earnings Mix



Net income: \$400mm

Operations Throughout Canada



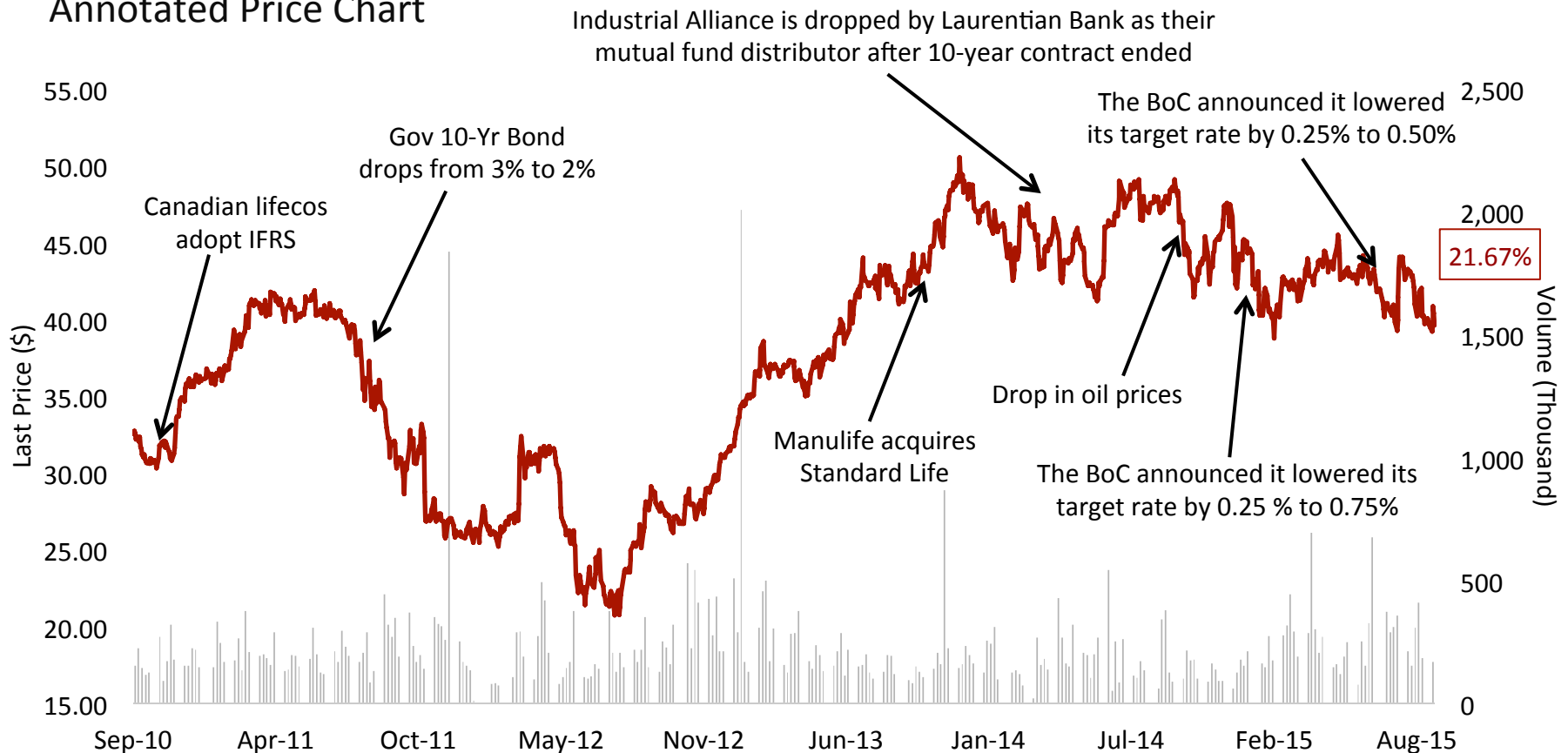
United States 3%

Company Overview

Market Update



Annotated Price Chart



Source: Bloomberg as of 09/18/2015.



Company Overview

Management Team & Ownership



Name	Position	Relevant Background Information
Yvon Charest	President and Chief Executive Officer	He served as Executive Officer of IA Clarington Investments Inc. Mr. Charest has spent his entire career at Industrial Alliance
Rene Chabot	Head of IT & Legal Services	Held current position since 2010
Michel Tremblay	Chief Investment Officer	Mr. Tremblay serves as a Member of the Office for President of National Bank of Canada (FI). His previous positions include COO of Personal and Commercial Banking and Wealth Management and Senior Vice President of Personal Banking and Wealth Management of National Bank of Canada
Manon Gauthier	Vice President of Accounting and Taxation	Ms. Manon Gauthier serves as the Chief Financial Officer of HAHN Investment Stewards & Company
Denis Ricard	Head of Group Insurance Dealer Services & IA	Held current position since 2010. Previous positions include Senior Vice-President and Chief Actuary of Industrial Alliance Insurance and Financial Services; Vice-President, Marketing Individual Insurance and Annuities of Industrial Alliance Insurance and Financial Services. He joined Industrial Alliance in 1985
Gary Coles	Senior Vice-President Group Life and Health Administration	Mr. Coles has been Senior Vice-President of Administration of The National Life Assurance Company of Canada, a subsidiary of Industrial Alliance Life Insurance, since February 2004 and served as Vice President - Systems and Services - The National Life Assurance Company of Canada
Clement Gignac	Chief Economist and Senior Vice-President	Held current position since 2012. Mr. Gignac serves as the Chief Economist and Vice-President of National Bank of Canada. Previous positions: Equity Analyst of National Bank Financial, Inc., Research Division. He spent the majority of his career at the National Bank
Gerald Bouwers	President of Western Canada Operations	Held current position since 2012. He has been with IAG since 1995
Alnoor Jiwani	Senior Vice-President of Business Development and Finance	Previous positions: Chief Information Officer of Brookfield Real Estate Services Limited of Brookfield Real Estate Services Inc. and was responsible for defining and executing global IT strategy at both Corporate and individual Business unit levels

Top Owners	
Caisse de dépôt et placement du Québec	9.48%
Pyramis	4.52%
RBC GAM	3.15%
Brompton Funds	1.52%
CIBC Asset Management	1.34%

Management Ownership	Value (mm)
Yvon Charest, CEO	\$4.8
Normand Pepin, EVP and Assistant to President	\$2.4
John LeBoutillier, Chairman of the Board	\$1.4
Pierre Brodeur, Chairman of Human Resources	\$1.2
Michel Tremblay, CIO	\$1.0

Majority of management team has been with IAG for 10+ years, demonstrating commitment to and a deep understanding of the firm

Source: Annual Report 2014.

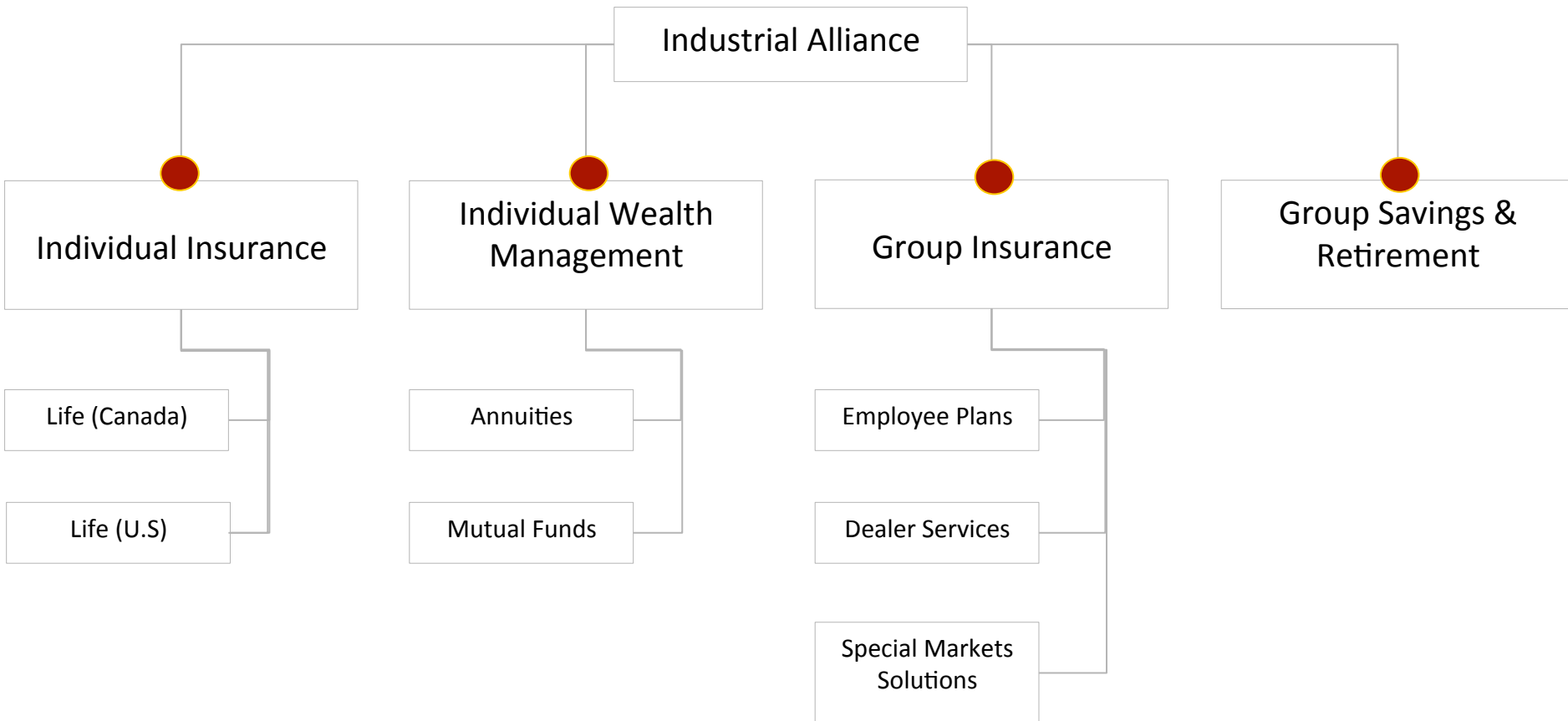


Segment Overview



Business Segments

Four Revenue Streams



Personal Financial Services

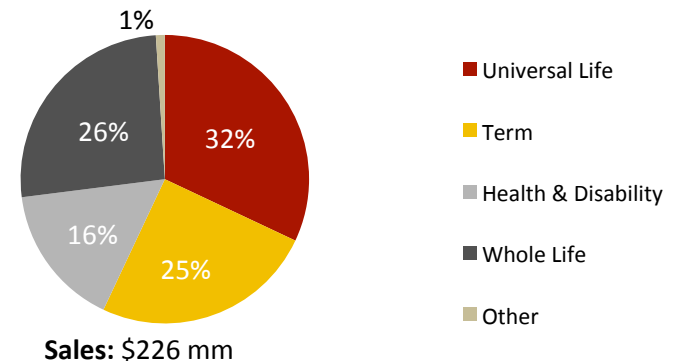
Individual Insurance



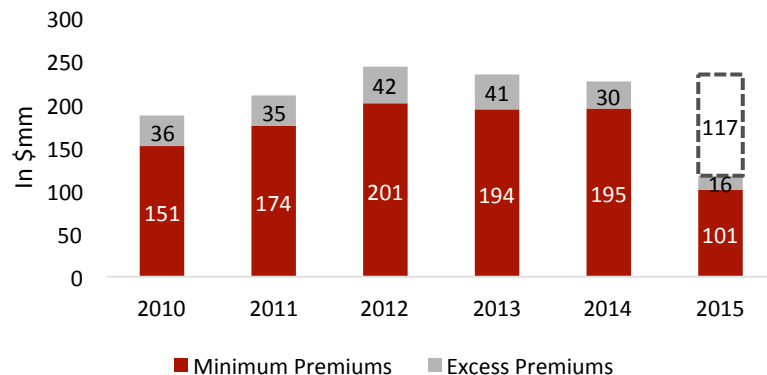
Description of Sector

- IAG distributes a wide range of life (universal, permanent and term), critical illness, disability, and mortgage insurance products
- The company distributes its products through networks of licensed representatives.
- Ranked 2nd in Canada for Universal Life policy sales with 16.1% market share

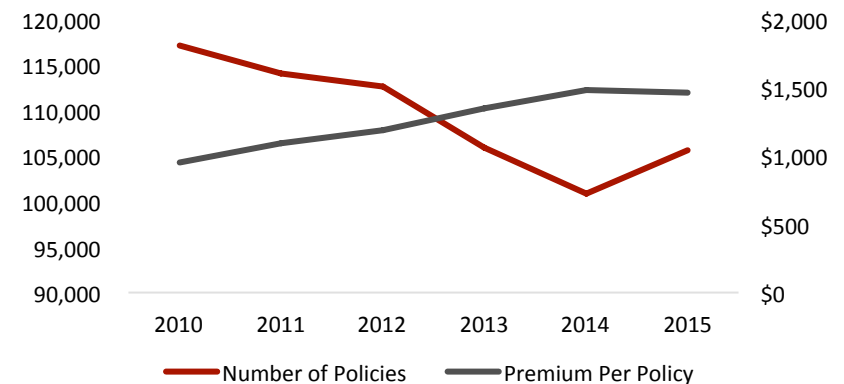
Sales by Product



Newly Added Business



Premiums Versus Policies



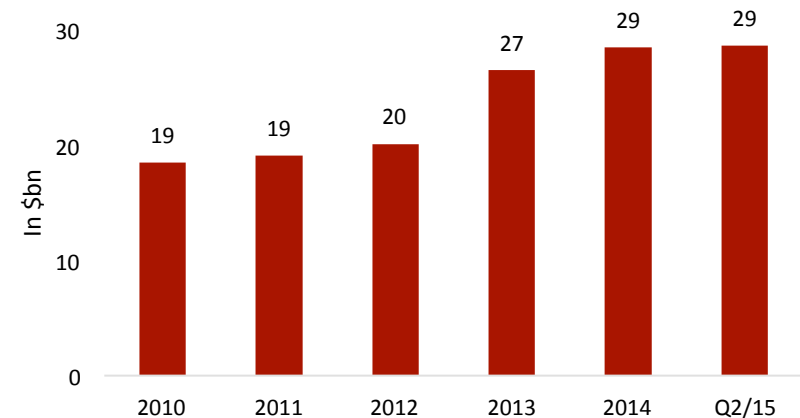
Source: Company Fact Sheet 2015Q2, 2014 Annual Report, Company 2Q 2015 Filings.

IAG has adjusted their pricing by increasing premiums in response to the low rate environment

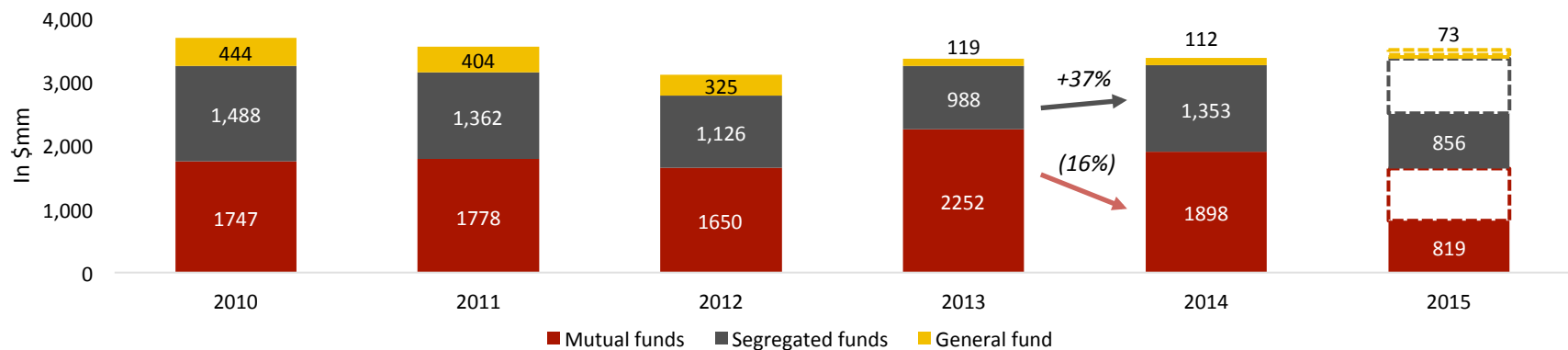
Description of Sector

- IA offers savings and retirement products, including mutual funds, segregated funds, and annuities
 - 400+ different funds
 - Revenue generation from management fees
 - Segregated funds are investment funds managed separately from those of the company. They offer a guarantee on capital in the event of death or at maturity. 91% hedged as of 2014
- Company's total assets are either under management (AUM) or administration (AUA)
 - Subsidiaries managing AUA include INVESTIA, FundEX, iA Securities and T.E. WEALTH

Asset Growth



Sales Trends



Source: Company Fact Sheet 2015Q2, 2014 Annual Report, Company 2Q 2015 Filings.

Group Financial Services

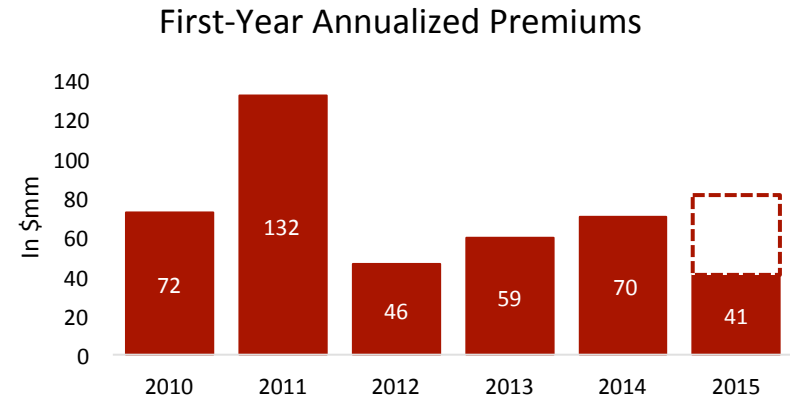
Group Insurance



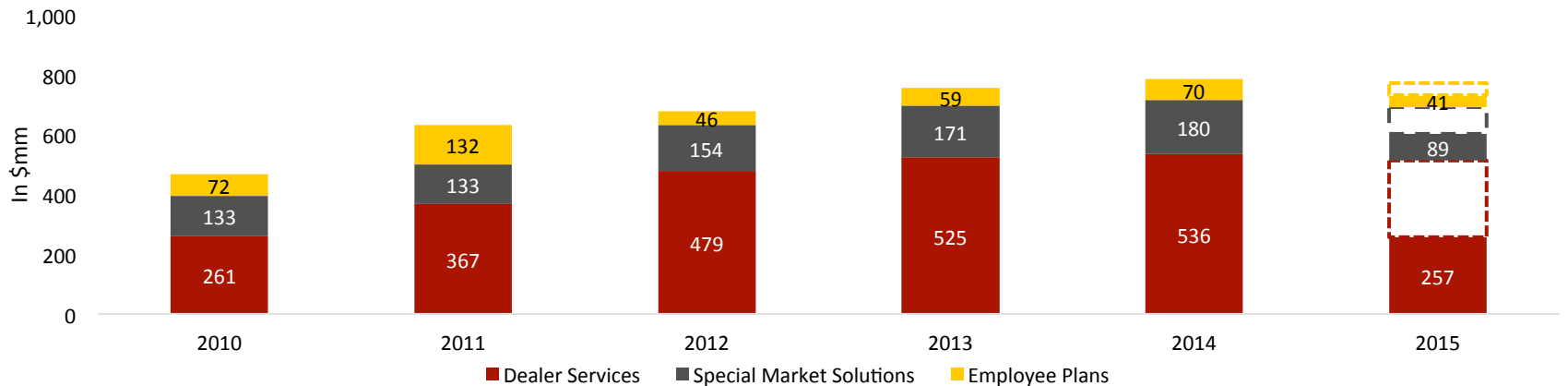
Description of Sector

- The Company offers three main products to businesses and groups through the Group insurance sector, which includes three main divisions:
 - Employee Plans
 - Dealer Services
 - Special Market Solutions
- Gross sales growth is primarily dependent on the size of the company's distribution network and quotation success rate

Employee Plans Growth



Business Growth



Source: Company Fact Sheet 2015Q2, 2014 Annual Report, Company 2Q 2015 Filings.



Group Financial Services

Group Insurance Continued



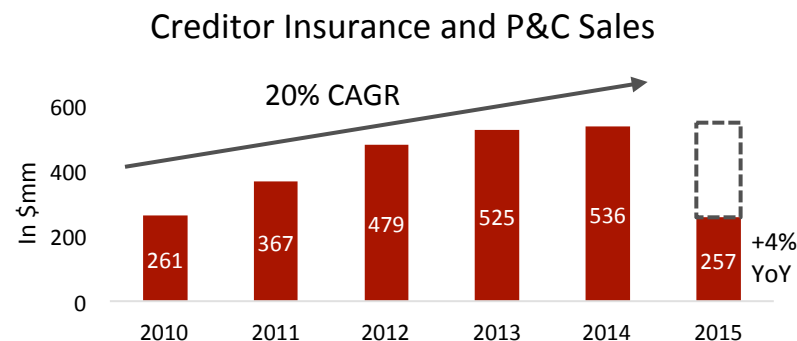
Dealer Services – Key Information

- Segment includes creditor insurance (life, disability and critical illness) and property and casualty
- Sales Growth is the main profitability driver for the Dealer Services division
 - Reliant on the number of new vehicles and the expansion of the distribution network
- In Q4 2014, Honda Canada selected IAs as a partner to white-label Finance and Insurance products sold through their dealerships network

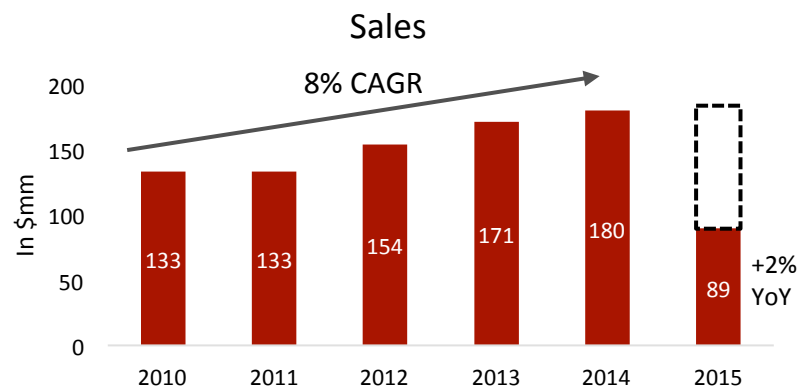
Special Markets Solutions

- Division of Industrial Alliance that specializes in niche insurance markets that are not well served by traditional group insurance carriers
 - Offers accidental death & dismemberment insurance, travel and health insurance through distribution partners and other niche products
- Has its own sales staff located in Vancouver, Calgary, Toronto and Montreal

Dealer Services Growth



Special Markets Solutions Growth



Source: Company Fact Sheet 2015Q2, 2014 Annual Report, Company 2Q 2015 Filings.



Group Financial Services

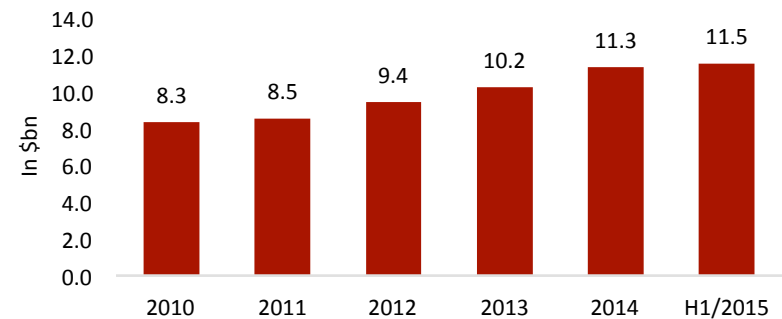
Group Savings and Retirement



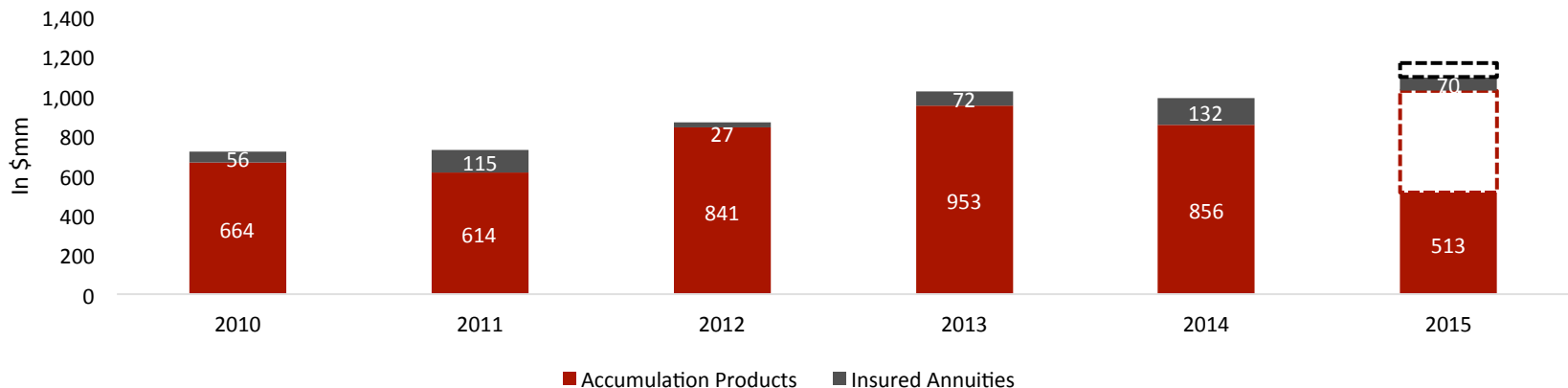
Description of Sector

- Group savings and retirement products can be broken down into two categories:
 - Accumulation products (savings products)
 - Disbursement products (insured annuities)
- Business line's products are marketed through specialized brokers and consulting firms

Steady Growth in AUM



Group Savings and Retirement Premiums



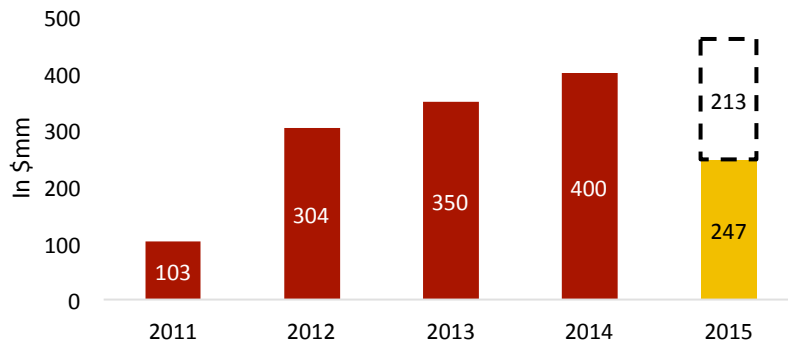
Source: Company Fact Sheet 2015Q2, 2014 Annual Report, Company 2Q 2015 Filings.



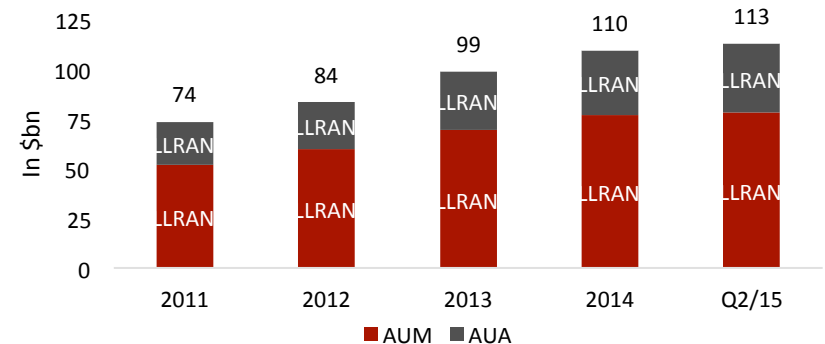
Company Overall

We Like the Company's Story

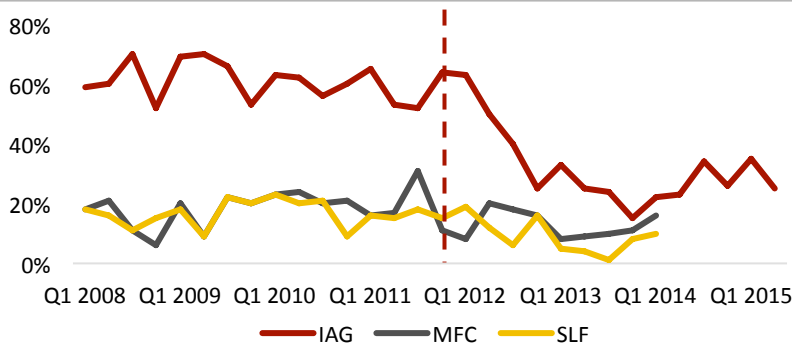
Net Earnings Continuously Increasing



Growing Asset Under Management



Strain Promises Delivered



In mid-2012, Industrial Alliance management set a goal to reduce strain by half.... They delivered their promise

Earnings Commentary

Yvon Charest, President and CEO (Q2, 2015):

"This quarter was without a doubt among our best on record. Profit exceeded our guidance by a generous margin and business growth showed good momentum."

Yvon Charest, President and CEO (Q2, 2015):

"Our balance sheet remains solid and we have significant capital to support our internal and external growth initiatives."

Source: Company Fact Sheet 2015Q2, Company Presentation September 2015.

Industry Overview



Changing Household Demographics

- Industry **negatively impacted** by lower household formations, lower birthrates, later family starts
 - **Aging population** (baby boomers) positively affects conventional life insurance products (more premiums paid), but negatively affect annuity products
- These trends lessen the need (and demand) for traditional insurance protection
- Therefore, the biggest driver of lifecos' sales going forward will be tax and estate planning needs, **as lifecos offer products that are tax advantaged** vs. bank products

Product Shift Driven By Crisis

- Number of price increases, particularly for domestic non-term insurance products
- Lifecos are **favoring products** that have lower risk, **less guaranteed returns** and lower capital requirements

Increasing Burden On Households

- Budgetary considerations, low investment returns and rising health costs have led to increased responsibility for retirement benefits towards employees from employers
- Presents opportunity for **lifecos to expand group benefits business** and to sell defined benefit solutions that help employers de-risk their pension plans

Customer Preferences Change Post-Crisis

- In Canada, **number of policies being sold is falling** and the **mix of sales is also changing**
- Customers are attracted to participating products because they are less volatile than comparable alternatives given their guaranteed cash value
- Lower oil prices are forecasted as net positive for the increase in P&C demand

In addition of the financial crisis and the low interest rates period, lifecos faced headwinds coming from a deterioration in household demographics in the past 5 years

Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research.

Framework Overview

- In 2011, Canadian life insurers switched from GAAP to IFRS
- Pending a revised IFRS 4 on the valuation of insurance contracts, existing national standards apply – in Canada, the Actuarial Standards Board's Statements of Practice (ASB) provide the basis for Canadian GAAP
- All Canadian insurers are monitored through OSFI and ASB, except for Industrial Alliance, who is monitored by AMF

Life Insurance Regulatory Framework

- OSFI revealed its vision for the sector in 2012 through this report, which outlines three key initiatives that are to be introduced in 2018 and be fully implemented by 2018:
 1. Revised risk management and corporate governance guidelines
 2. Revised regulatory capital requirements
 3. Information transparency

Keep CALM and Carry On

- In Canada, ASB requires that the basic valuation methodology for life insurers is the Canadian Asset Liability Method (CALM)
- Basic principle: asset cash flows are matched to liability cash flows and reserves are put aside to cover liabilities
- Insurers must set aside buffers (in addition to assets) to each assumption that is used to project cash flows, known as Margin for Adverse Deviations (MfAD)

Ownership Restrictions

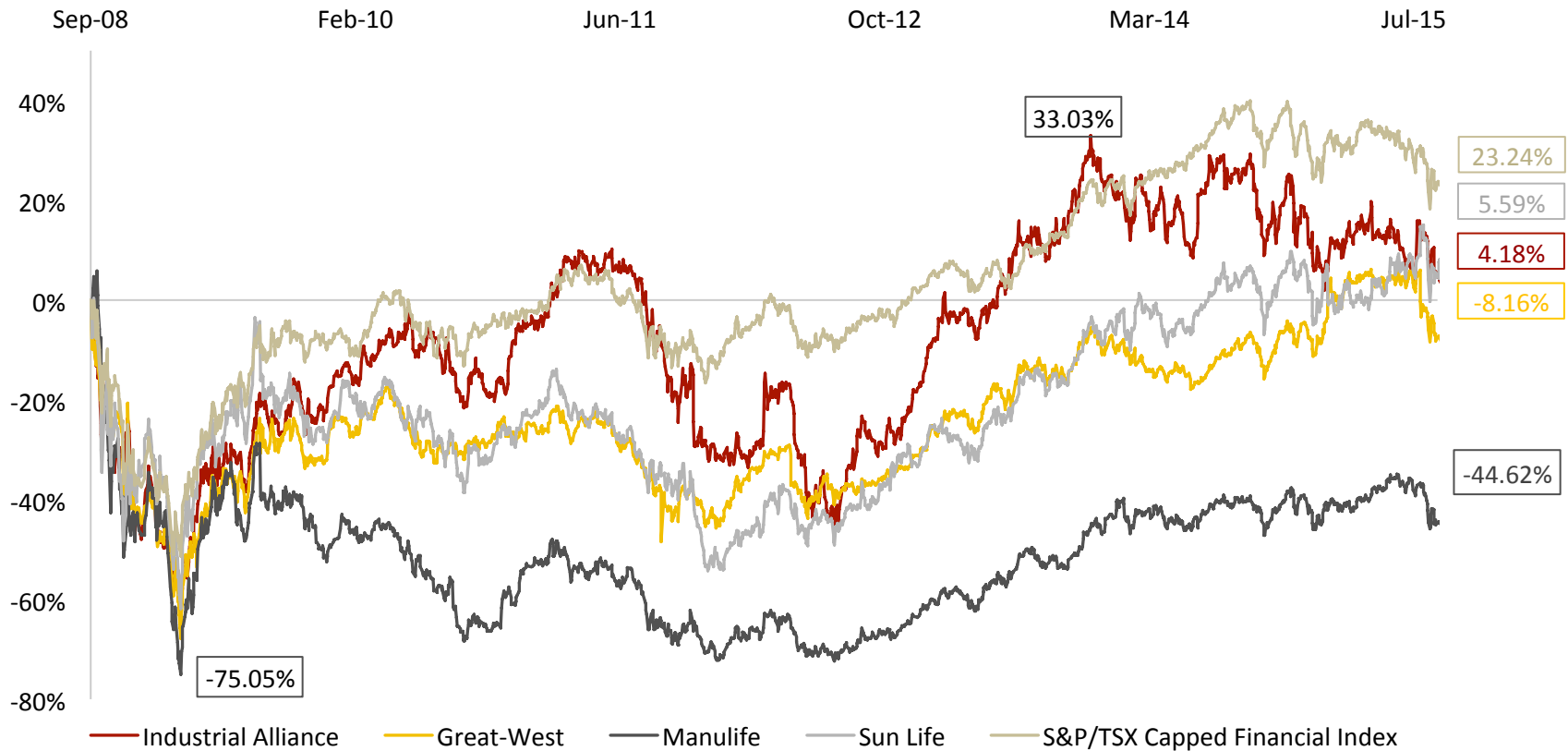
- Approval by Minister of Finance is required for proposals to acquire shares of an insurer (> 10%)

Take-away: the life insurance sector in Canada is very well regulated and supervised

Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research.

Industry Overview

Industry Performance Since Crisis



Not only were lifecos hit harder than bank stocks, they also stayed down much longer. Impacted by falling equities and historically low rates, Canadian life insurance companies were forced to rethink their business model

Source: Bloomberg.

Investment Thesis



1 Investor sentiment driven by macro environment; business fundamentals overlooked

- Market consensus driven by (1) theory, (2) empirical study and (3) Japan
- Interest rates will continue to be relevant; however, their importance will decrease in driving future lifecos performance in Canada

2 What is the market missing? Canadian accounting policy

- Canadian lifecos punished compare to U.S. and E.U. due to more stick accounting regime
- Despite stronger business fundamentals, Canadian lifecos trade roughly in-line with their U.S. counterparts

3 Market overreaction to one-time headline event

- In 2014Q2, Industrial Alliance lost Laurentian Bank as one of their mutual fund distributor due to end of ten-year contract
 - Lead to important funds' withdrawals and net negative sales
- Mitigant: Possibility to make acquisition in the wealth management sector + strong other business segments

4 IAG trading at an unwarranted discount despite stronger business fundamentals

- Discounted on a P/B and P/E basis despite in-line ROE and conservative business model
 - The company has recently diverged from his historical trading range with peers on a P/B and P/E basis
 - We feel the market may currently overlook Industrial Alliance due to low interest-rates period consensus, its lower dividend payout and the recent one-time headline event

Bonus: Balance out the FIG portfolio with a Canadian life company

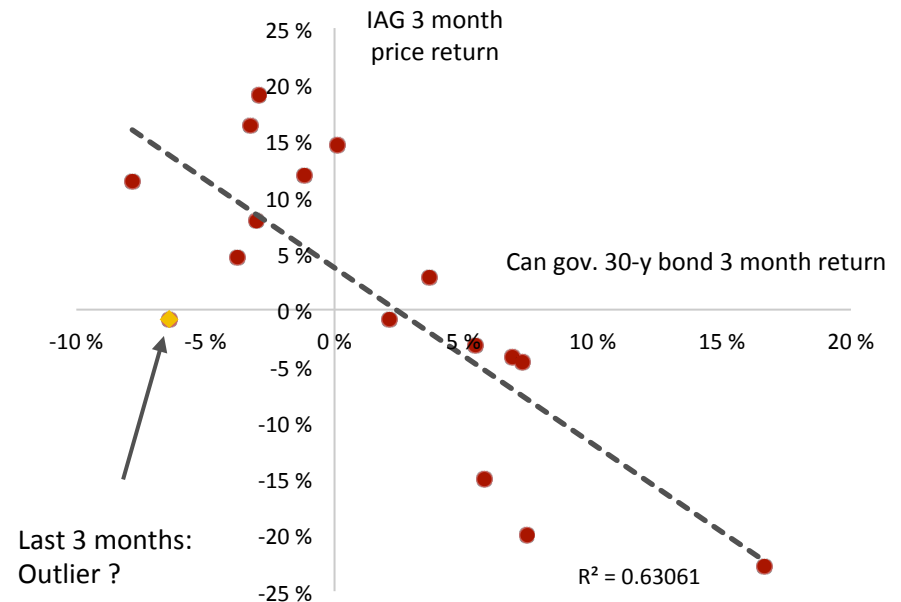
1 Macro: Interest Rates & Life Insurers

Why does the Market Gives so Much Importance to Rates?

More Theory on Interest Rates

- The level of interest rates matters to insurers to the extent that their **promises to policyholders depend on their ability to earn certain rates of return**
 - May have offer policyholders explicit guarantees (i.e. 3% p.a.) or implicit guaranteed (assured lump sum for given premium)
- **Exact matching of assets and liabilities** across the balance sheet **is unlikely** to be possible nor effective economically
 - Given absence of long-term assets and complexity of products
- Effects of rates on life insurers are accentuated when:
 - Guaranteed investment return
 - The investment risk solely bears on life insurer
 - Policyholder have options to vary premium amounts and therefore increase them when markets have fallen
 - The company does not have the rights or flexibility to reprise in-force policies
 - Liabilities and assets are unmatched and the company does not take advantage of hedging to mitigate this mismatch

15y of Empirical Data Supports Theory



The theory and empirical studies are strong enough to support the market consensus that interest rates have historically been a very important driver of lifecos earnings and consequently market returns

Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research.

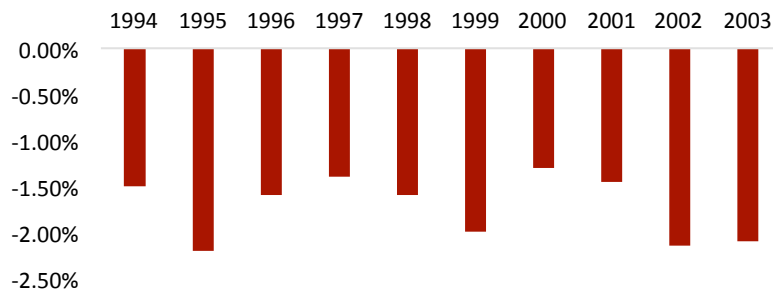
1 Case Study: Japanese Life Insurers

A Bubble and Its Consequences

What Happened in Japan?

- **Asset Bubble burst** in 1990 after years of exuberance and tightening of monetary policy in 1989
- Life insurers in Japan **started earning negative investment spreads** in the 1990s, a trend that continued until 2014 and is still ongoing for some insurer
- It led to **bankruptcies** of many life insurers: Nissan Mutual being the first life insurer to fail since WWII on April 1997, followed by Chiyoda Mutual Life Insurance, Kyoei Life Insurance and Toho Mutual Life amongst other

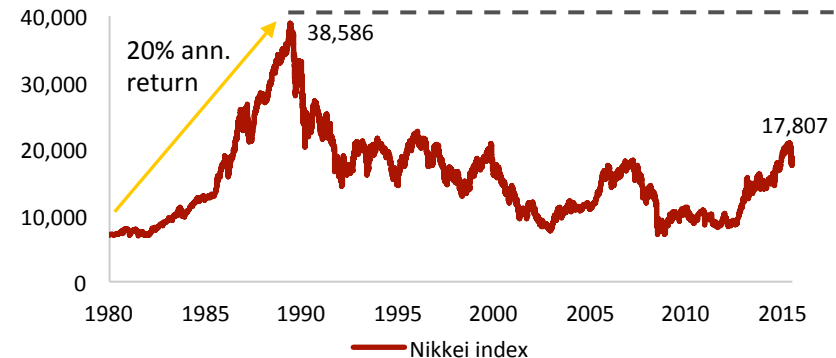
Negative Investment Spread



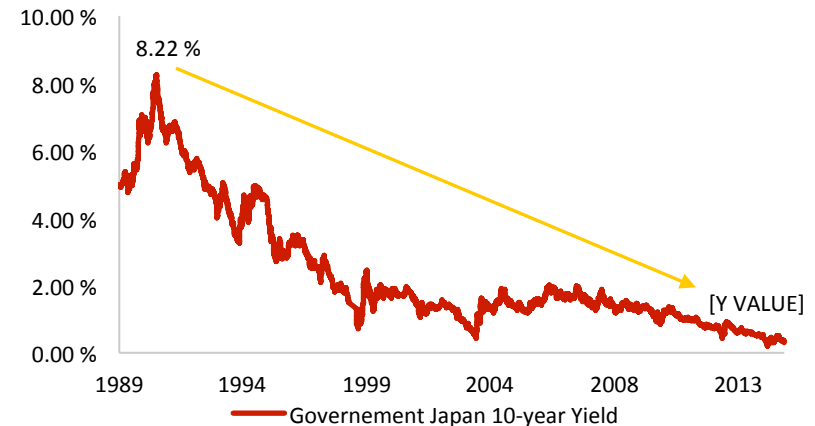
Negative investment spread lasted for more than 20-year for Japanese companies

Source: Merrill Lynch Primer.

Asset Bubble



Extremely Low Interest Rate Period



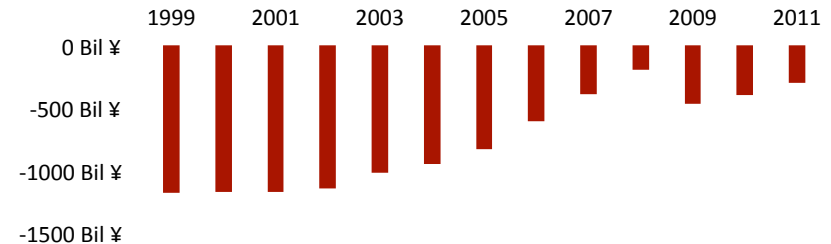
1 Case Study Cont'd: Japanese Life Insurers

Learning Curve

What Does the Data Show?

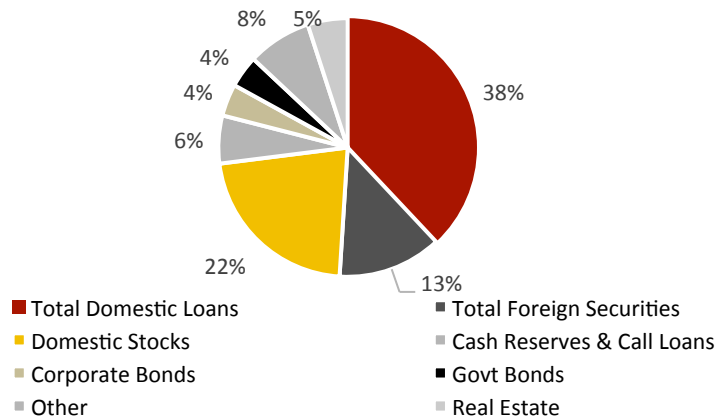
- Negative investment spreads were prevalent before extreme low levels of interest rates in early 2000
- The negative spreads were driven by:
 - Risky investments
 - Aggressive product design
 - High guaranteed rates (i.e. 6% at some point) to both gain and protect market share
 - Lower surrender rates than anticipated

Overcoming Negative Investment Spread



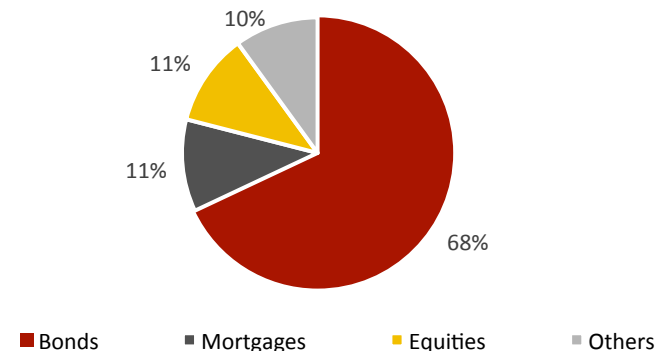
Despite declining interest rates, Japanese insurers were able to improve their investment spreads through higher product pricing demonstrating lifecos can overcome low rates

Japanese Life Insurers Allocation - 1990



Source: Company Fact Sheet 2015Q2, 2014 Annual Report, Company 2Q 2015 Filings.

Industrial Alliance Allocation - 2015



George Santayana, Spanish Philosopher:
 "Those who fail to learn from history are doomed to repeat it"

1 Rates: Not the Captain of the Boat Anymore

Increased Focus On “Micro”



The “New Normal”

- Prominent Economists, such as Paul Krugman and Larry Summers, pushed the view that interest rate will stay low permanently. We are entering a “new normal”
- IAG’s management started to realize this in 2012

Industrial Alliance (2012 Annual Report):

“At Industrial Alliance, we believe that low long-term interest rates are here to stay – and management is executing accordingly”

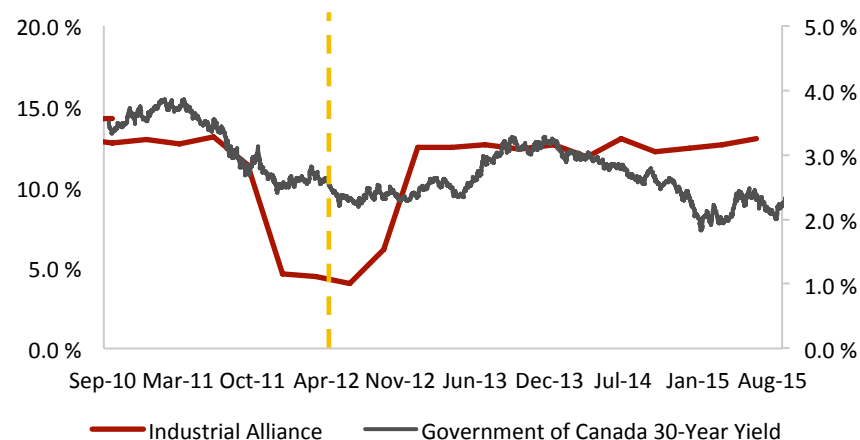
IAG’s Specific Measures

- Given their view on low interest rates, Industrial Alliance management took many measures since 2012 to reduce reliance of their business model on interest rates
- New pricing in retail insurance products
 - Premium/Policy has been increasing steadily over past years
- Reduce cost of writing new business in retail (i.e. strain)
 - Reduced from 48% of sales in FY2011 to 25% in FY2014
- Divest U.S. Annuity Business (interest rate sensitive)
 - Sold U.S Annuities Business in 2012

New Product Mix for the Industry

- Canadian Lifecos are favoring products that are less sensitive to interest rates:
 - Shorter duration products – ideally less than 20 years
 - Products with adjustable terms such as group insurance
 - Investment products with low or no guarantee, such as mutual funds

Strong and Sustained ROE as a Proof



While our thesis is that rates will be a less important catalyst for future stock market gains in the space, we are not arguing that they will be irrelevant. We are arguing that lifecos mitigated the majority of the impact



2 Accounting Regime Differences

Canadian Lifecos Punished Due To Strict Accounting Regime

Accounting Sensitivity to Rates

- Canadian accounting and regulatory standards have required companies to **respond to shifting interest rates** on a quarterly basis, resulting in **higher volatility in reserves**
 - Changes in current market rates are reflected in reinvestment rates. Reinvestment rates are required to converge with market rates over time
 - Despite stronger fundamentals, investors have punished Canadian lifecos

Diverging Accounting Policies

International Monetary Fund (March 2014):

“Canadian insurers have been subject to greater balance sheet pressures than competitors in some countries with similar models, including the U.S. and EU, reflecting the greater sensitivity of Canadian accounting standards to change in interest rates”

Always best with an example:

In 2012, when rates fell significantly, ManuLife chose to disclose accounting both with US GAAP and IFRS.

	<u>Net Income (Can\$ mil)</u>	<u>Total Equity (Can\$ bil)</u>
IFRS	1,736	25.8
U.S. GAAP	2,557	41.8

Source: IMF Report.

Interest Rates Going Forward

- Revaluation losses resulting from past interest rate reductions have been recognized and sensitivities to future trends reduced through hedging
 - Insurers now stand to gain from gradually rising interest rates, as reserve accounting gains are set to provide an added boost (because reserves will be released to earnings)

Catalysts: Replacing IFRS 4

- Replacement of IFRS 4:** the Canadian Accounting regime is already one step ahead of accounting regimes used in Europe and the United States
- As investors realize the Canadian accounting regime is conservative and other regimes begin converging the Canadian regime, **Canadian Lifecos will get a multiple re-rate**
- In addition, the current Accounting Regime fails to credit companies with highly diversified investment portfolios, a factor prudent to meeting future liabilities while minimizing losses during economic downturns

2 Accounting Regime Differences

Similar Valuation Across Borders Despite Stronger Canadian Fundamentals

Valuation

(in local currency)			Market		P/E			ROE	MCCSR	Div. Payout
Region	Metric	Ticker	Cap	Beta	P/B	TTM	NTM			
Canadian	Mean				1.4 x	11.5 x	10.4 x	12.7%	228%	38%
	Median				1.3 x	11.9 x	10.7 x	12.8%	226%	41%
American	Mean				1.1 x	12.8 x	9.8 x	7.5%	0%	29%
	Median				0.9 x	12.1 x	8.7 x	9.7%	0%	24%

So What?

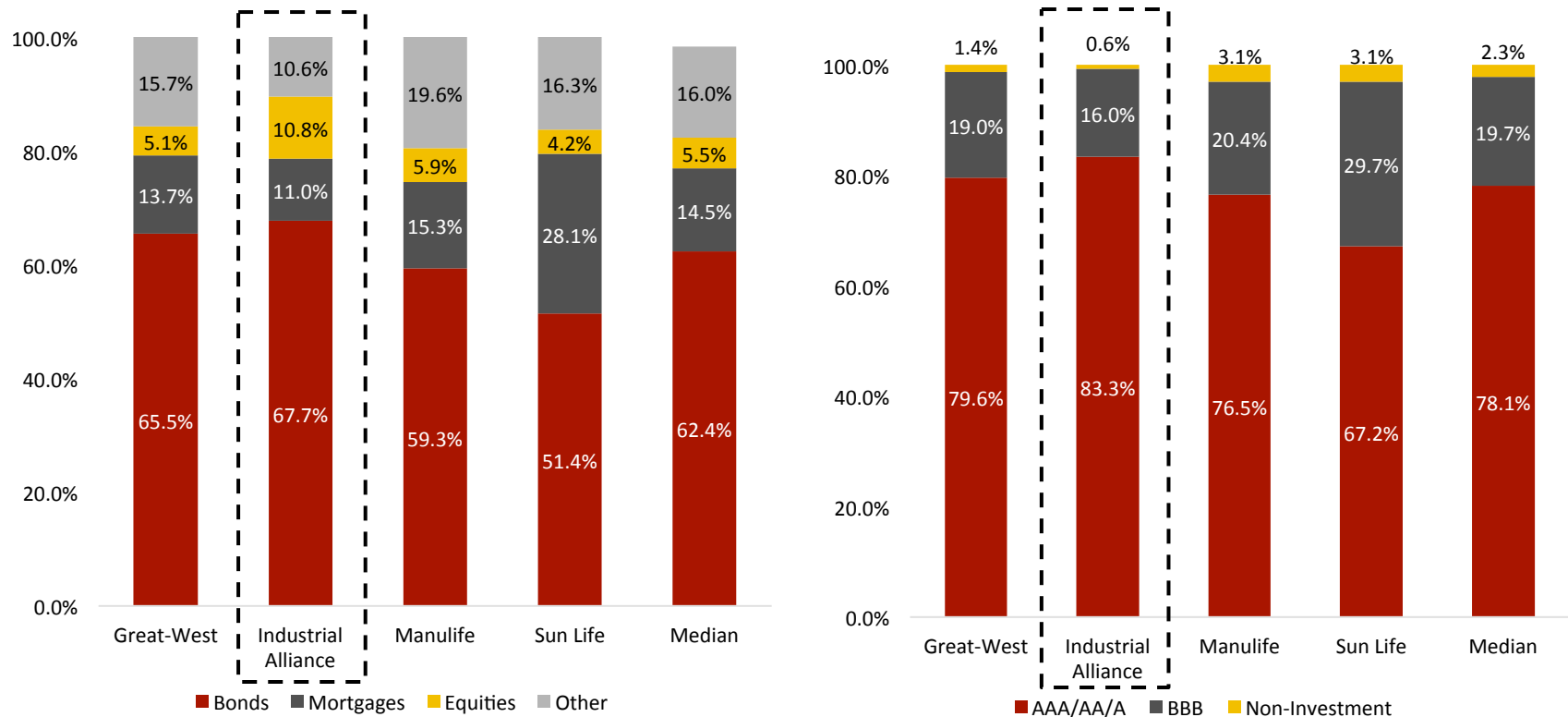
- ROE is the best gauge of performance for life insurers
 - Canadian Lifecos' ROE is ~300bps higher than their US counterparts
 - However, Canadian Lifecos trade in-line on a TTM P/E perspective and at a slight premium on a P/B basis
- It is important to remember that Canadian Lifecos have already accounted for lower interest rates through significant increases in reserves. This has impacted both their income statement and their balance sheet. As such, Canadian lifecos warrant a higher multiple relative to their U.S. counterparts

Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research.

2 Accounting Shortfalls

What don't accounting standards show?

Conservatively Managed Portfolio



Current accounting regime fails to credit companies with highly diversified investment portfolios, a factor prudent to meeting future liabilities while minimizing losses during economic downturns

Source: Company Fact Sheet 2015Q2, Street Research

3 Unwarranted Valuation Discount

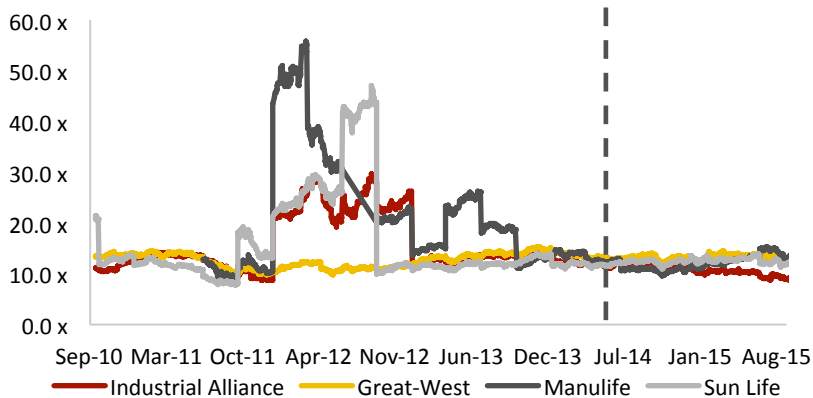
IAG Trading At Discount Following Loss of Laurentian Bank



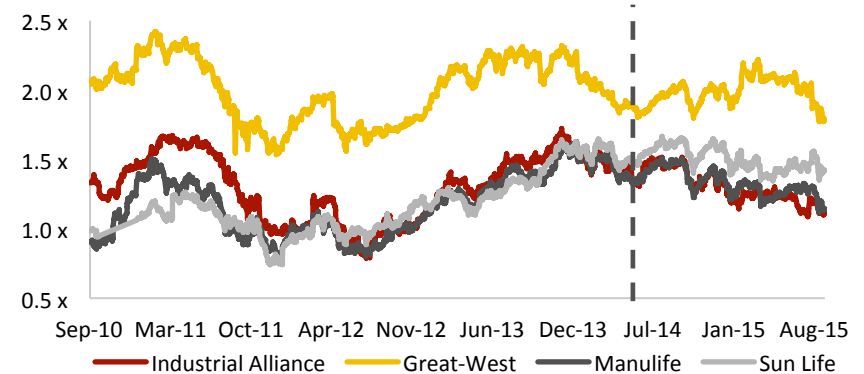
What Happened?

- In 2014, Laurentian Bank discontinued their contract to distribute IAG's Wealth Management products
- Since the announcement, Mutual Fund business has been experienced outflows
- Laurentian Bank represented less than 10% of mutual fund assets of IAG

P/E Relative Trading



P/B Relative Trading



IAG Looking To Acquire Distributor

- To turnaround the falling mutual fund sales, IAG has publically announced a strong interest in acquiring a Wealth Management manufacturer and distributor
- Based on analyst estimates, IAG has excess capital of \$675mm which it could use towards an acquisition
- An acquisition would serve as a catalyst and IAG would again trade in-line with its peers

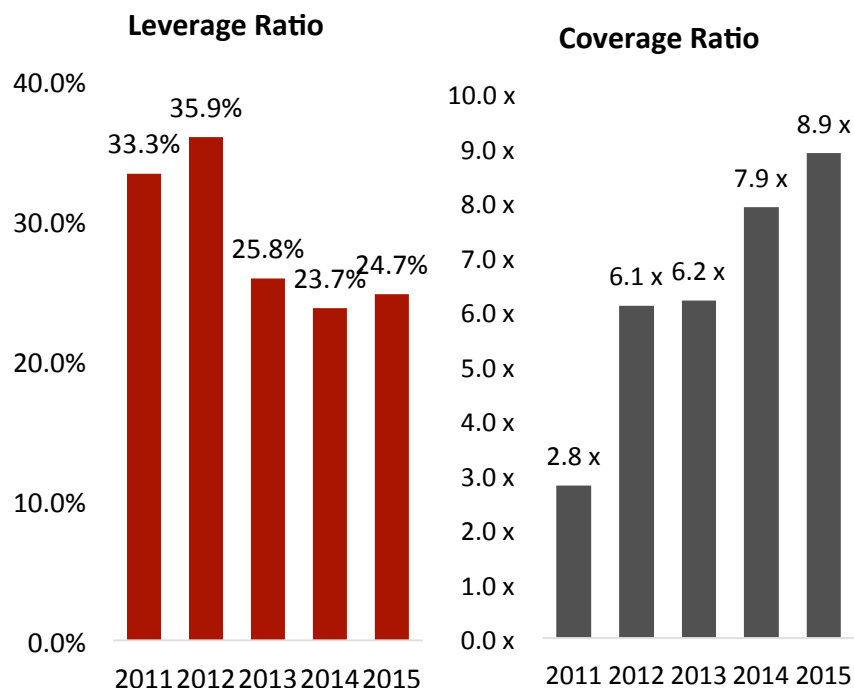
Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research



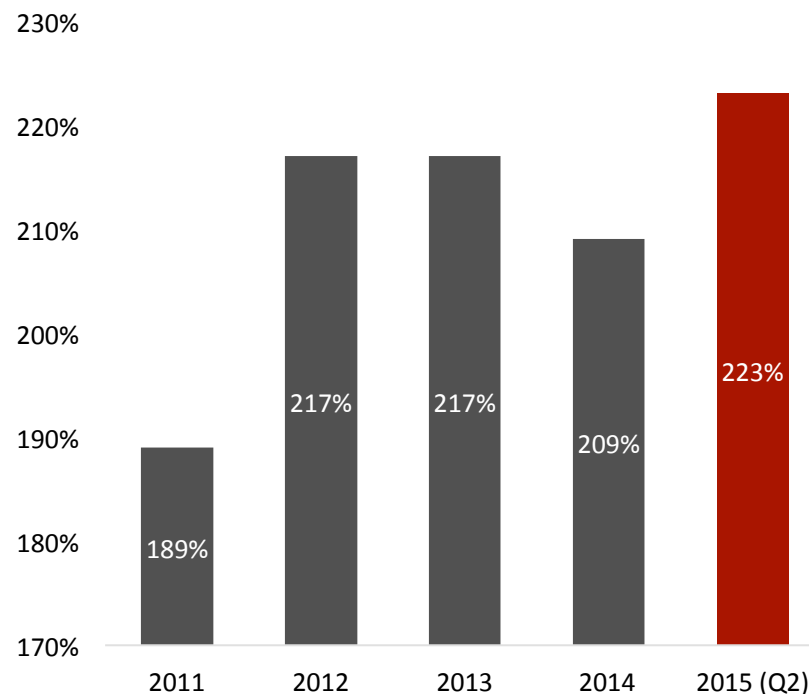
3 Acquisition of Mutual Fund Distributor

Flexibility for Acquisition

Reduced Leverage



MCCSR Well Over Requirement of 120%





Since 2011, the life insurers in Canada have been going through a massive deleveraging cycle. This now gives Industrial Alliance flexibility for capital redeployment, including its intention to buy a mutual fund distributor

Source: Company Fact Sheet 2015Q2, Bloomberg

4 It Always Come Down to Valuation

Discount as Synonymous With Buying Opportunity

<i>(in local currency)</i> Canadian Lifecos	Market Cap	Beta	P/B	P/E		ROE	MCCSR	Div. Payout
				TTM	NTM			
Great-West Lifeco	32,303	0.86	1.8 x	11.9 x	11.1 x	15.8%	229%	47%
Sun Life Financial Corp	25,371	0.93	1.4 x	11.9 x	11.0 x	12.7%	223%	43%
Manulife Financial Corp	40,252	1.19	1.1 x	13.2 x	10.3 x	9.4%	236%	40%
Industrial Alliance	4,017	1.13	1.1 x	8.9 x	9.2 x	13.0%	223%	25%
								
Mean			1.4 x	11.5 x	10.4 x	12.7%	228%	38%
Median			1.3 x	11.9 x	10.7 x	12.8%	226%	41%

<i>(in local currency)</i> American Lifecos	Market Cap	Beta	P/B	P/E		ROE	MCCSR	Div. Payout
				TTM	NTM			
Metlife Inc	68,329	1.30	0.8 x	7.8 x	7.6 x	10.0%		24%
Aflac Inc	32,370	1.01	1.4 x	9.6 x	9.1 x	15.3%		26%
Unum Group	10,261	1.12	0.9 x	20.2 x	8.3 x	4.3%		64%
Torchmark Corp	9,323	0.88	1.6 x	14.0 x	12.5 x	12.0%		13%
Stancorp Financial Group	6,345	0.75	2.2 x	18.7 x	19.4 x	11.0%		22%
Lincoln National Corp	15,709	1.41	0.8 x	8.0 x	7.3 x	9.5%		14%
CNO Financial Corp	4,520	1.25	0.8 x	12.1 x	12.0 x	6.5%		16%
Prudential Financial Inc	44,976	1.27	0.8 x	12.6 x	7.2 x	6.0%		42%
Genworth Financial Inc-Cl A	3,153	1.68	0.2 x	-	4.5 x	-11.0%		-
Principal Financial Group	18,625	1.24	1.5 x	12.0 x	10.3 x	11.8%		36%
								
Mean			1.1 x	12.8 x	9.8 x	7.5%		29%
Median			0.9 x	12.1 x	8.7 x	9.7%		24%

Industrial Alliance trades at a discount to Canadian peers on all valuation metrics despite an above average ROE

4 It Always Come Down to Valuation Comparables

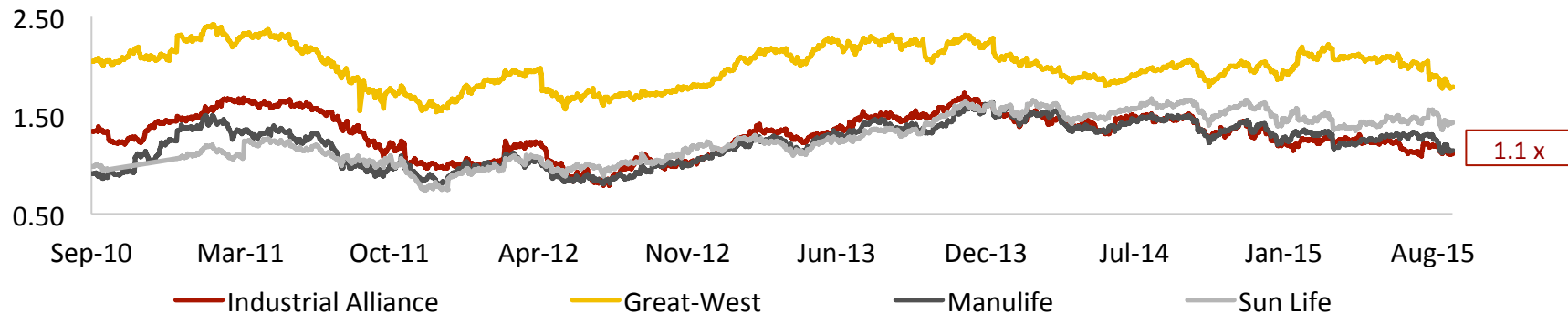
	Industrial Alliance	Manulife	Great-West Life	Sun Life Financial
Enterprise Value (mm)	\$4,708	\$55,943	\$41,665	\$25,205
Net Income (mm)	\$400	\$3,501	\$2,602	\$1,762
Return on Equity	13.0%	9.4%	15.8%	12.7%
Revenue by Geography	<p>97% 3%</p> <p>■ Canada ■ US</p>	<p>53% 25% 22%</p> <p>■ U.S. ■ Canada ■ Asia</p>	<p>45% 36% 19%</p> <p>■ Canada ■ EU ■ U.S.</p>	<p>41% 47% 6% 6%</p> <p>■ Canada ■ U.S. ■ Asia ■ Corporate</p>
Revenue by Product	<p>57% 30% 9% 4%</p> <p>■ Individual Insurance ■ Individual Wealth ■ Group Insurance ■ Pension Groups</p>	<p>51% 25% 22% 2%</p> <p>■ U.S. - Life & Health ■ Canada - Life, Group Benefits ■ Asia - Life & Wealth ■ U.S. - Annuities & Pensions</p>	<p>36% 15% 15% 11% 8% 11%</p> <p>■ Insurance & Annuities ■ Reinsurance ■ Group Insurance ■ Participating Account ■ Wealth Management ■ Individual Markets</p>	<p>33% 34% 13% 9%</p> <p>■ Insurance Canada ■ Life - Asia & U.K. ■ Protection Prod. ■ MFS</p>
Growth Strategy	<ul style="list-style-type: none"> Continues to shift its business mix away from traditional insurance products and toward wealth management as well as more non-traditional areas Focused on the niche low-to-mid income segment in U.S. 	<ul style="list-style-type: none"> Scaling back long-term care business and raising prices Increased focus on group benefits and wealth managements in U.S. Significant presence in Asia and other markets 	<ul style="list-style-type: none"> Historically focused on acquisitions to grow They have relied more on organic growth since 2008, despite their acquisition of Irish-Life in 2011 They are currently focusing on their digital services capabilities 	<ul style="list-style-type: none"> Focused on group benefits business in the insurance space Crown jewel is U.S.-based wealth manager MFS Investment Management Significant presence in Asia; number one market share in Philippines

The entire sector has been going through a deleveraging cycle, which now gives them flexibility for potential acquisitions and capital redeployment to shareholders

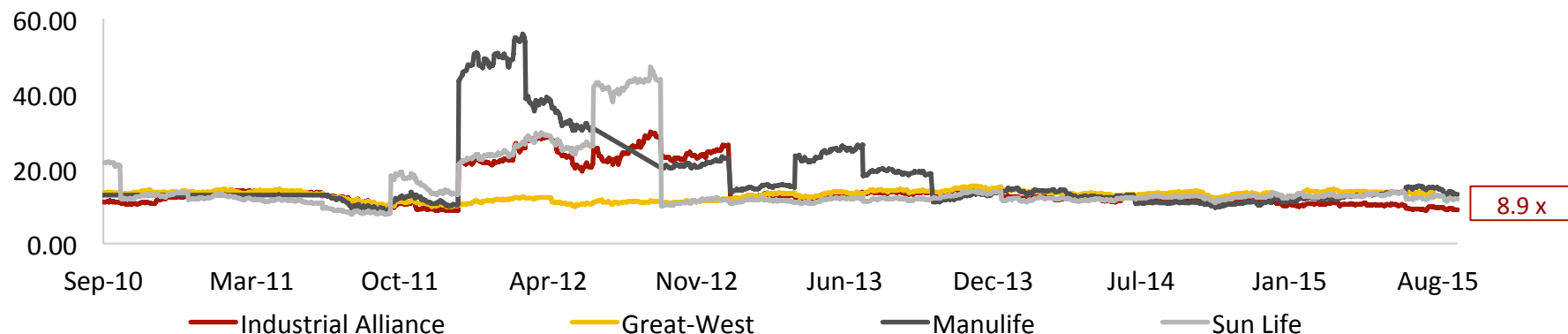
4 It Always Come Down to Valuation

Historical Trading Multiples

IAG Used to Trade at a Small Premium on P/B Basis to Manulife and Sun Life



Started Trading At a Discount on P/E Basis to 3 peers



The four publicly traded lifecos are still trading below pre-crisis level (2001-2007): P/E of 12.9x and P/B of 2.2 x.

Source: Bloomberg

4 Precedent Transactions

Acquisition - Three Largest Lifecos

Clarica – Sun Life (2001)

- Sun Life acquired Clarica for **\$7.2 bn** using cash and stocks
- Clarica provided life insurance products and health insurance products (critical illness), and had a wealth management division

CEO of Sun Life regarding rationale of transaction :

“[Clarica provides Sun Life with a] lower cost structure, increased revenue and expanded distribution capabilities”

Canada Life – Great West (2003)

- Great West purchased Canada Life for **\$7.3 bn** using stocks
 - Largest integration in Canadian life insurance industry
- Company’s ROE: 13.8% year of acquisition
- Canada Life provided insurance and wealth management products mainly throughout Canada, US, UK and Ireland

Great West makes the strategic decision to acquire their smaller competitor to cut down on costs and become an even larger player in the insurance industry

Standard Life – Manulife (2014)

- Manulife acquired Standard Life for \$4 bn (Cash)
- Standard life provides long term savings, investment and insurance products to their clients
- Company’s ROE: 13.9% year of acquisition

CEO of Manulife regarding rationale of transaction :

“One of the key reasons we were interested in this company is its people in Quebec. We want to increase our presence in the province”
– Other reasons being cost cutting and synergies

Hopefully Industrial Alliance – X

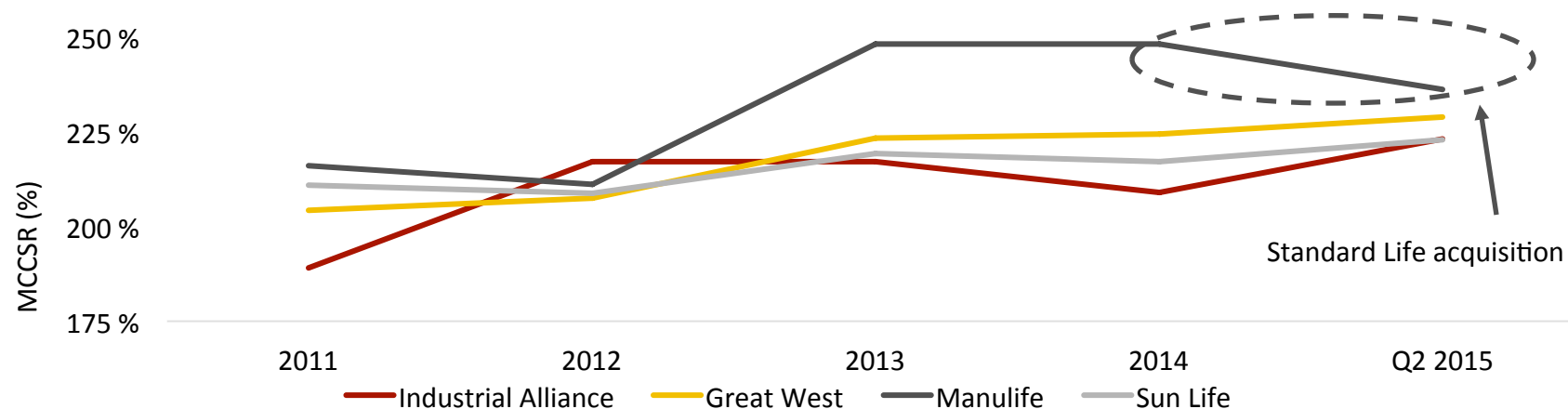
- Why is it an interesting target?
 - The **sector** has historically seen many consolidations and **acquisitions are the way to grow**
 - We see Sun Life or Great-West as most susceptible buyer in order to catch up with Manulife’s acquisition of Standard Life (a company with a profile very similar to Industrial Alliance)
 - **Industrial Alliance is the only player left to be bought** as it is the smallest player with around 10% market share
 - The **Competition Bureau** did not oppose Standard Life Transaction

Source: Sun Life press release, Great West press release, Wall

4 Precedent Transactions

Acquisition - Three Largest Lifecos

Important Deleveraging Cycle in the Industry



Very Interesting Precedents Multiples

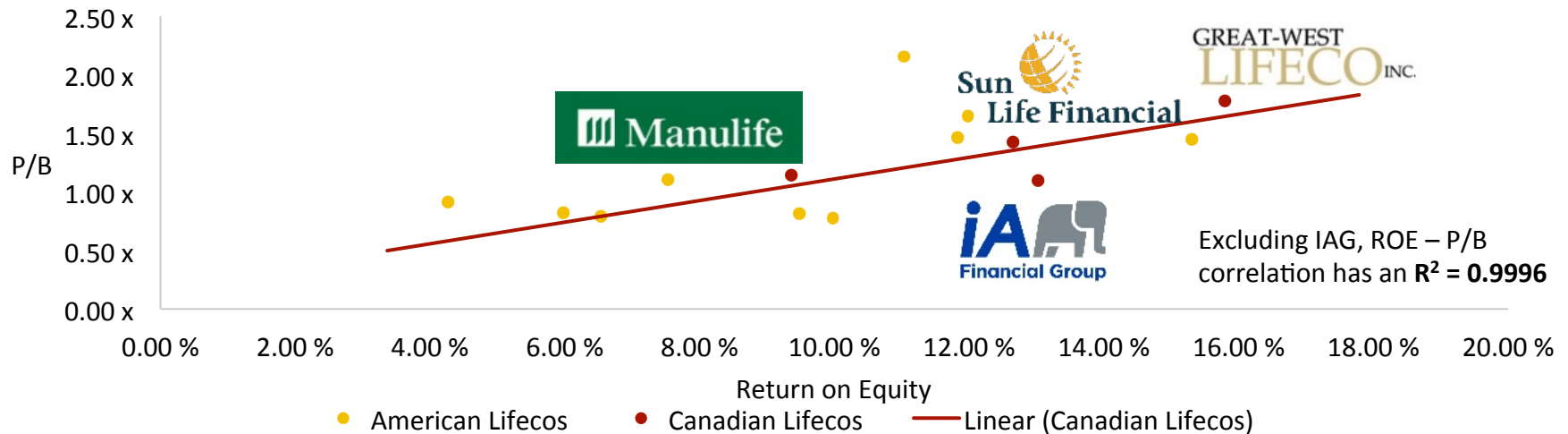
Year	Acquiror	Target	Price	P/BV	P/TB	P/E
2001	Sun Life Financial	Clarica Life	C\$6.9	2.0x	2.4x	15.8x
2003	Great West Lifeco	Canada Life	C\$7.3	1.9x	2.1x	14.5x
2014	Manulife Financial	Standard Life	C\$4.0	2.0x		17.3x
Mean			C\$6.1	2.0x	2.3x	15.9x
Industrial Alliance Current Trading Multiples				1.1x	1.4x	8.9x

Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research

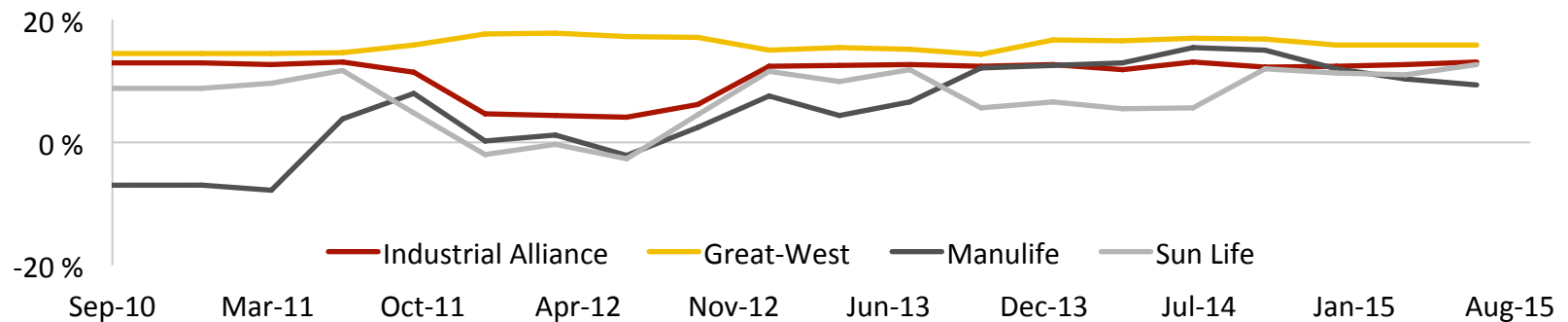
4 It always come down to valuation

Importance of ROE

Return on Equity Dictates Valuation



Stronger and More stable ROE than Manulife and Sun Life

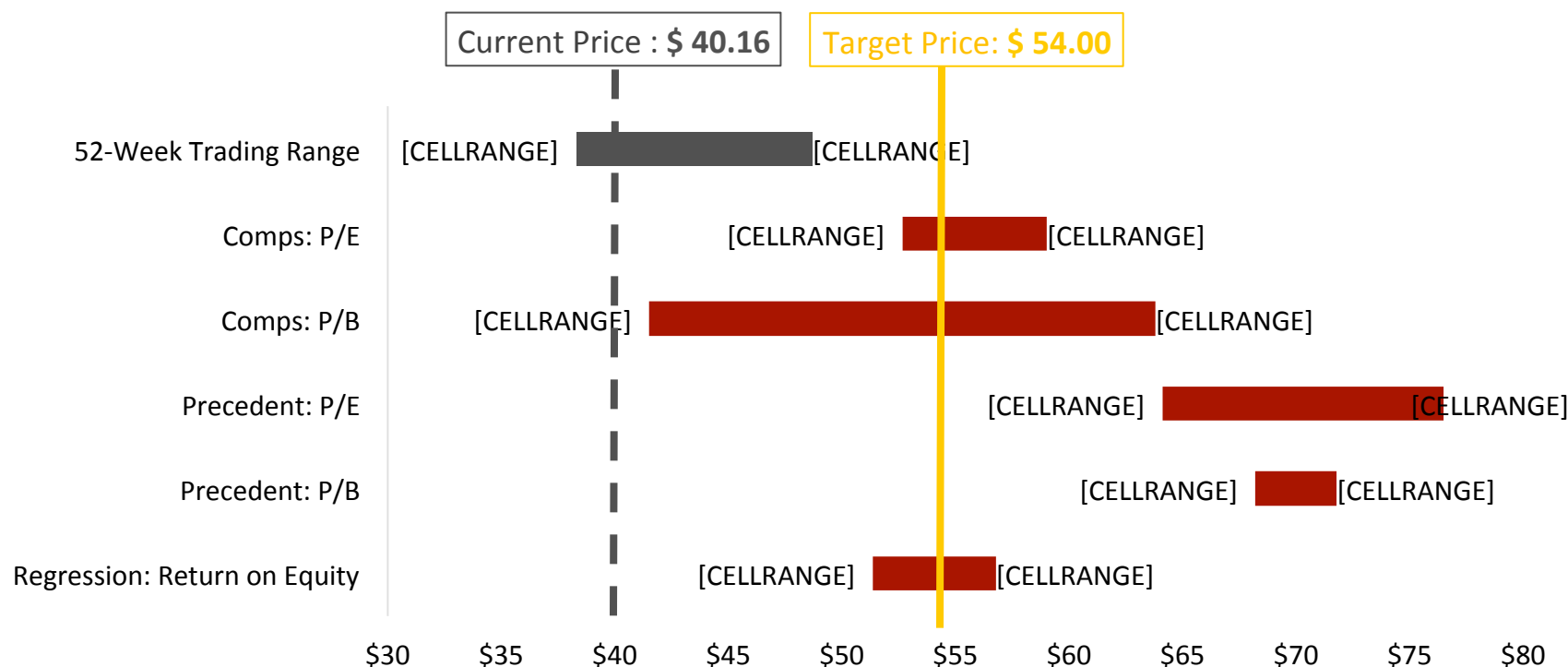


Source: Bloomberg

4 It always come down to valuation

Price Target

Football Field Analysis



*We recommend a **buy** with a target price of \$54.00 implying an **upside of 35%***

Source: Bloomberg September 21, 2015

Risks & Catalysts



Risks

- **Interest rates** fall further
- Global equities suffer another downturn
 - 25% drop in Canadian equity markets would decrease net income by \$77M (16%)
- Changes in regulatory requirements
- **Less demand** for insurance products driven by **less attractive pricing**

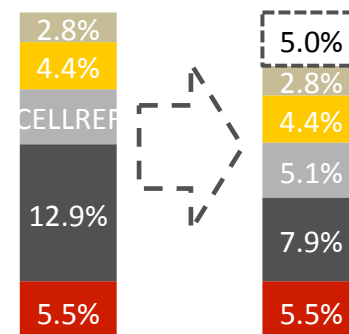
Catalysts

- **Replacement of IFRS 4** and convergence with conservative **Canadian accounting standards**
- Increase in interest rates
- Acquisition of a wealth management distributor
- Industrial Alliance being the **target of an acquisition**
- **Increase in dividend** (i.e. currently lower dividend payout ratio than peers) or **share buybacks** amid current over capitalization

Recommendation & Price Target

- Recommend allocation: **5 % of the overall portfolio**
- Current Price: **\$ 40.16**
- Price target: **\$ 54.00**
- Upside: **34.5%**

- iShares S&P/TSX 60 Index ETF
- iShares S&P/TSX Capped Financials ETF
- Wells Fargo
- New York REIT
- Intesa Sanpaolo
- Industrial Alliance



Source: Company Fact Sheet 2015Q2, Bloomberg, Street Research