

## Sagicor Financial Corporation

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### Company Overview

The Sagicor Group is a leading provider of insurance products and related services in the Caribbean region. It also provides insurance products in the United States of America (USA) and banking services in Jamaica. The main business lines are life, critical illness and health insurance, annuities and pension management, asset management, together with property and casualty insurance. The customer base is predominately individuals but certain lines are marketed to employers to provide employee benefits, and to commercial enterprises to provide property and casualty coverage.

Sagicor operates in 22 countries in the Caribbean, the USA and Latin America. Primary insurance subsidiaries and the corresponding regions for SFCL include Sagicor Group Jamaica Ltd. (Jamaica and Cayman Islands), Sagicor Life Inc. (Barbados and Trinidad and Tobago), and Sagicor Life USA (U.S.). Aside from these main subsidiaries and regions, the company also has insurance operations in many of the Eastern and Dutch Caribbean islands and select Latin American countries.

### Barbados Default?

On the 9<sup>th</sup> of March 2017, Moody's Investors Service downgraded Barbados' government and issuer ratings to Caa3 and maintained a stable outlook. This decision was attributed to "the continued increase in government debt and very limited prospects of fiscal reform," which led to, "rising domestic and external financing pressures that are very likely to impair the government's ability to service its debt.

Fast-forward fifteen months later, the newly-elected Prime Minister Mia Mottley revealed on Friday, June 1, 2018, that her government had discovered previously undisclosed financial liabilities which increased the country's debt-to-GDP from 137% of GDP to more than 175%, which is amongst the highest in the world. In addition, Mottley noted that with central bank reserves of just US\$220M, upcoming debt payments and hurricane season, the government was left with no choice but to seek the aid of the International Monetary Fund and restructure its debt. The government will suspend payments on debt owed to external commercial creditors while endeavouring to make scheduled domestic interest payments. Domestic creditors will be asked to roll principal maturities until a restructuring agreement is finalized.

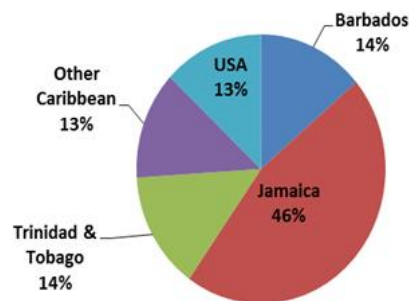
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### What does this mean for Sagicor Financial Corporation?

SFC was domiciled in Barbados before re-domiciling in Bermuda in July 2016, a move the company undertook to immunize the company from the burgeoning sovereign risks at the time. The company still retains a presence in the small island, which contributed \$169.14M (13.9%) of the \$1.22B in total revenues for the 2017 financial year, down from \$170.27M (15%) in the previous year. As at December 31, 2017, SFC held \$280.41M in Government of Barbados securities, which represented just 7% of the investment portfolio and 4.1% of total assets.

**SFC 2017 Revenues by Geographical Segment**



On June 6, 2018, Fitch Ratings affirmed its 'B' rating for the company with a stable outlook. Fitch noted that SFC's exposure to Barbados' sovereign debt as at Dec. 2017 was approximately 30% of equity, with approximately 85% of the exposure denominated in local currency debt. Over the past three years, Barbados has averaged a modest 17% of operating earnings for the group, with Jamaica and Trinidad & Tobago the main contributors.

**Sovereign Credit Risk as at Dec. 31, 2017**



Fitch added that its rating reflected: the challenging operating and economic environments of both Jamaica and Barbados; very high capital exposure to below-investment grade sovereign debt; high

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financial leverage; and macroeconomic challenges associated with low interest rates. The ratings were balanced by the company's: good operating company capitalization; good, stable profitability; and positive steps to reduce Bajan exposure and improve financial flexibility. A downgrade would be triggered by higher than expected losses directly or indirectly associated with an expected sovereign debt restructuring in Barbados, perceived deterioration by Fitch in the Jamaican economy and deterioration in key capitalization and leverage ratios.

### Financial Performance – Three months ended March 31, 2018

Sagikor recorded net income of \$38.86M for the period ended March 2018, 44% higher than the \$26.96M reported for the comparable period of 2017. This performance was driven by a 5% or \$14.05M increase in total revenues to \$296.56M and a 5% decline in total benefits to \$132.09M, partially offset by a 2% increase in total expenses to \$117.62M. Net premium revenue rose 12% to \$187.30M while \$70.17M was reported for interest income earned from financial assets during the period, when no such revenues were generated in the comparable period of 2017.

The fall in total benefits was driven by a 3% decline in net policy benefits and change in actuarial liabilities to \$119.72M and a 14% decline in interest expense to \$12.37M. Total expenses rose 2% to \$117.62M due to the booking of \$1.44M in credit impairment losses. Administrative expenses rose 1% to \$70.04M while commissions and related compensation fell 2% to \$24.82M.

### Solvency & Liquidity

SFC's assets amounted to \$6.9B as at March 31, 2018, relatively unchanged from the balance as at Dec. 31, 2017. Financial investments amounted to \$5.02M, up 1.4% from the start of the year. The next largest asset class, reinsurance assets, amounted to \$787.06M, down 1.3% from the start of the period. Cash resources amounted to \$314.36M, down 12.7% from the start of the year. Net cash outflows from operating activities of \$426K were reported for the period, which compares to net outflows of \$31.52M in the comparable period of 2017 due to the increase in pre-tax profits and an increase in the net change in operating liabilities from \$19.08M a year prior to \$56.95M.

Liabilities totalled \$5.93B, up 1.0% or \$59.06M year-over-year. Total policy liabilities were relatively unchanged at \$3.55B (up 0.2%). Notes & loans payable fell 1.6% or \$6.69M to \$407.11M. Deposit & security liabilities rose 3.5% to \$1.61B while accounts payable & accrued liabilities increased by 6.5% to \$263.09M. Shareholders' equity fell 0.6% or \$4.03M to \$622.89M, as a 28% increase in negative reserves to \$60.64M was partially offset by a \$9.19M increase in

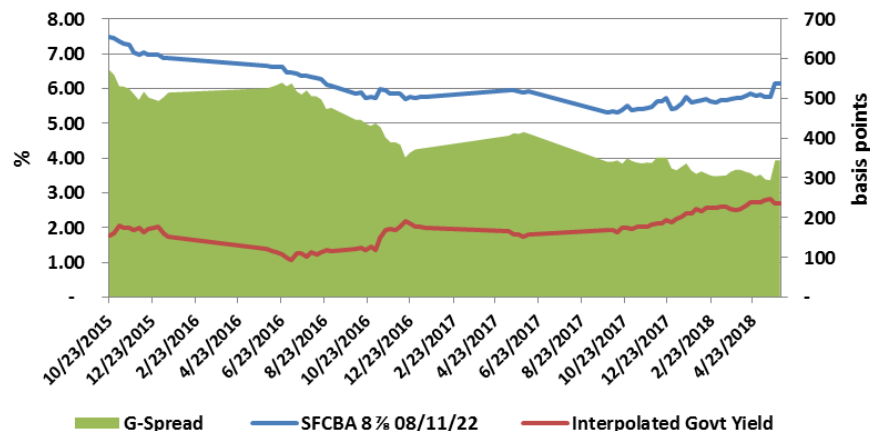
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retained earnings to \$379.97M. Total equity amounted to \$931.71M, down \$7.84M from the start of the year. SFC's leverage was relatively unchanged as the debt-to-equity ratio improved from 0.66x as at Dec. 31, 2017 to 0.65x as at Mar. 31, 2018.

### Analyst's Opinion

We share the sentiment of Fitch Ratings in the belief that in isolation, SFC's operations are diversified and its exposure to Barbados foreign currency debt so moderate that the company should be able to weather the storm of restructuring. The problem arises when one views the overall exposure to Jamaica and Barbados, two relatively high risk sovereigns. This risk is balanced by fair, stable profitability and sufficient capitalization and the steps the company has taken to reduce its exposure to Barbados, inclusive of re-domiciling in Bermuda.

**SFC 8.875% due 2022 Trading Performance**



The graph above displays the performance of the SFC 2022 note over the past three years. The note has appreciated 2.5% over the period as the yield declined by 18% to 6.19%. The G-spread narrowed 227 basis points to 345 basis points as the 2022 note's yield declined as the government yield rose from 1.77% to 2.69% during the same period. The current ask price on the SFC 2022 bond is around \$110.59 with a corresponding bid price of \$109.71, which indicates the market's confidence in the company as the price has not altered since the announcement of Barbados' situation.

Investors should be prepared for volatility in the bond's price if the terms of Barbados' restructuring are more onerous than initially anticipated. As such, this investment may not be

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suitable for low-risk appetite investors and some medium-risk appetite investors. We would recommend reducing exposure to an **UNDERWEIGHT** position for holders who are satisfied with erratic price movements as we expect the company to maintain its ability to service its debt obligations.

### Abridged Financials

USD '000	Year Ended Dec. 31					Three Months ended Mar 31		
	2013	2014	2015	2016	2017	2017	2018	% Change
<b>Revenues</b>	<b>1,039,483</b>	<b>1,045,167</b>	<b>1,104,219</b>	<b>1,134,147</b>	<b>1,220,869</b>	<b>282,508</b>	<b>296,560</b>	<b>5.0%</b>
Total benefits	592,790	542,217	552,943	560,359	660,761	138,352	132,092	-4.5%
<b>Total expenses</b>	<b>348,141</b>	<b>385,945</b>	<b>427,714</b>	<b>424,191</b>	<b>436,362</b>	<b>115,082</b>	<b>117,617</b>	<b>2.2%</b>
Income before tax	98,552	117,005	123,562	149,597	123,746	29,074	46,851	61.1%
<b>Net income available to shareholders</b>	<b>-36,370</b>	<b>27,370</b>	<b>34,679</b>	<b>61,671</b>	<b>72,233</b>	<b>26,955</b>	<b>38,862</b>	<b>44.2%</b>
<b>Total Assets</b>	<b>5,297,752</b>	<b>6,180,420</b>	<b>6,399,885</b>	<b>6,531,920</b>	<b>6,814,642</b>	<b>6,590,552</b>	<b>6,865,859</b>	<b>4.2%</b>
<b>Total Liabilities</b>	<b>4,572,566</b>	<b>5,406,878</b>	<b>5,660,721</b>	<b>5,730,275</b>	<b>5,875,089</b>	<b>5,772,888</b>	<b>5,934,150</b>	<b>2.8%</b>
<b>Shareholders' equity</b>	<b>512,097</b>	<b>531,698</b>	<b>506,046</b>	<b>539,210</b>	<b>626,922</b>	<b>547,028</b>	<b>622,890</b>	<b>13.9%</b>
<b>Key Ratios</b>								
pretax margin	9.5%	11.2%	11.2%	13.2%	10.1%	10.3%	10.7%	
net profit margin	-3.5%	2.6%	3.1%	5.4%	5.9%	5.9%	6.7%	
return on average equity	-6.62%	5.24%	6.68%	11.80%	12.39%			
return on average assets	-0.67%	0.48%	0.55%	0.95%	1.08%			
debt/equity (x)	0.57	0.56	0.94	0.73	0.66	0.66	0.65	

**Source: JMMB Investment & Research, Various Company Financial Statements, Fitch Ratings, Bloomberg**

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**APPENDIX****IMPORTANT DISCLOSURES**

**ABSTRACT**—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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**UNDERWEIGHT**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

**SELL**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

**HOLD/MARKETWEIGHT**—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

**OVERWEIGHT/BUY**—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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