VM Wealth Management Limited

Bond Analysis: Sagicor Financial Company Limited 5.30% 2028

VMWM Research| July 31, 2023

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- **Bond Recommendations:**

  Appetite for Low Risk: **OVERWEIGHT**

  Appetite for Moderate Risk: **OVERWEIGHT**

  Appetite for High Risk: **UNDERWEIGHT**

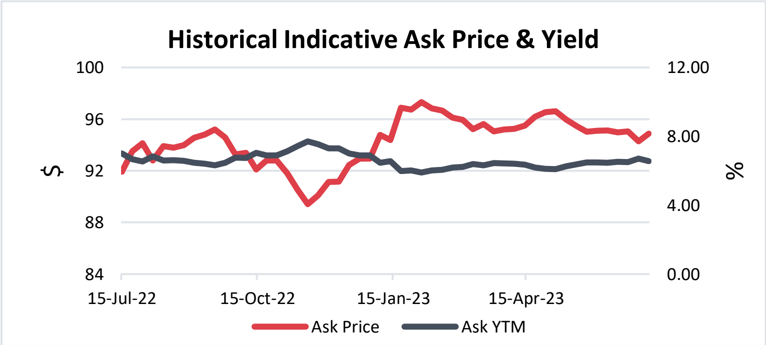
ABOUT THE COMPANY

Sagicor Financial Company Limited (SFCL) is a Bermuda-based financial holding company that is one of the Caribbean's largest providers of insurance and financial services. It provides insurance products mainly in the US, Jamaica, Barbados, and Trinidad & Tobago. In Jamaica the Company operates additional services such as commercial banking, pension schemes and investment management.

Primary insurance subsidies and the corresponding regions for SFCL include Sagicor Group Jamaica Ltd. (Jamaica), Sagicor Life Inc (Barbados/Trinidad) and Sagicor Life USA (US). Aside from these main subsidiaries, the company also has insurance operations in many of the Eastern and Dutch Caribbean islands and select Latin American countries.

SFCL announced in August 2022 that it has entered into an agreement to acquire 100% shares of Canadian life insurer, ivari. If the acquisition is completed, ivari would represent about half of the Sagicor group's assets and liabilities, which led S&P to change the outlook from stable to positive, while highlighting the likelihood of an upgrade if completed.

Sagicor Financial Corporation: Bond Term Summary	
Parent Company	Sagicor Financial Company LTD
Issuer	Sagicor Financial Company LTD
Industry	Financial (Life Insurance)
Currency	USD
Issued Amount	550,000 (M)
Issue Date	05/13/2021
Tenor	7.10 years
Indicative Ask Price	94.865
Indicative Ask Yield to Maturity	6.55%
Coupon	5.30%
Credit Rating (S&P)	BB+
Outlook (S&P)	Positive
Maturity Type	Callable
Maturity	05/13/2028
Day Count Basis	30/360
Use of proceeds	General Corporate Purposes, Refinance



Recommendation: Despite the ongoing global economic uncertainties, the insurance industry is projected to stay resilient in 2023 into 2024. We have confidence that SFCL will remain well-capitalized and experience steady year-over-year growth. The initiatives to digitize operations and expand into new geographical markets are expected to foster revenue growth and improve the capital base without imposing a substantial debt burden or compromising liquidity. Considering the bond's 5-year maturity, the current high interest rate market, satisfactory coverage ratios, and adequate liquidity levels, we recommend **OVERWEIGHT** for new and existing bondholders with a low to moderate appetite for risk, and **UNDERWEIGHT** for high-risk investors.

FINANCIAL PEFORMANCE

USD '000	FY 2020	FY 2021	FY 2022
Revenue	1,878,367	2,359,094	2,540,252
EBITDA	112,046	342,488	333,480
Interest Expense	44,885	45,054	39,626
Total Equity	1,658,210	1,666,213	1,502,852
Long Term Debt	471,622	683,388	632,535
Total Debt	471,622	683,388	632,535
Operating Cash Flow	(99,108)	124,882	(154,503)
Total Debt -to- Equity (%)	28.4%	41.0%	42.1%
Total Debt -to- EBITDA (x)	4.2x	2.0x	1.9x
EBITDA Margin (%)	6.0%	14.5%	13.1%
Interest Coverage Ratio (x)	2.5x	7.6x	8.4x
Debt Service Coverage Ratio (x)	0.22x	0.47x	0.50x

SFCL continued its post-pandemic recovery during financial year (FY) 2022, strongly aided by growth of the annuities business line in the US market, even as macroeconomic uncertainties persisted. The company recorded net revenue of US$2.54 billion, a 7.68% year-over-year (YOY) growth, primarily driven by increased premium revenue and interest income earned from financial assets. Despite the increase in revenue, EBITDA declined by 2.63% to US$333.48 million, as the growth in policy benefits and total expenses outpaced total revenue. Subsequently, the EBITDA margin experienced a negligeable deterioration from 14.50% in FY 2021 to 13.10% in FY 2022, indicating a marginal reduction in operating profitability.

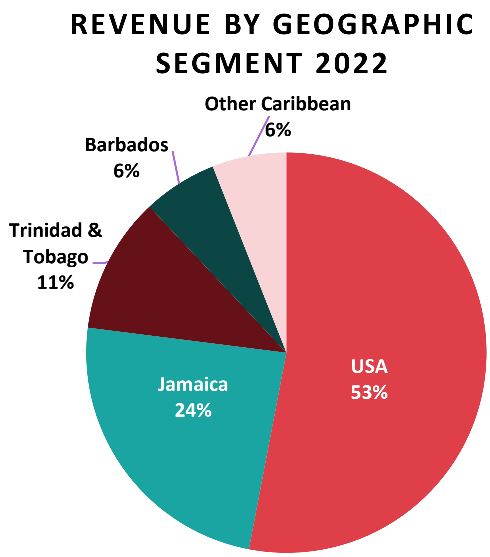
Following a peak in the company's debt level in FY 2021, total debt declined by 7.44% in FY 2022 to US$632.54 million, which resulted in the Interest Coverage Ratio improving from 7.6x to 8.4x. The improvement indicates the company's continued ability to meet interest payments, even though EBITDA declined. SFCL'S debt-to-equity increased from 41% in FY 2021 to 42.10% in FY 2022, as the company uses its debt to boost earnings. Additionally, the debt-to-EBITDA remained healthy in FY 2022, declining from 2x in FY 2021 to 1.9x and highlighting SFCL's ability to continue covering total debt. Of note, the debt service coverage ratio (DSCR) remains below the 1.25 standard but has improved year-over-year from 0.47x in FY 2021 to 0.50x in FY 2022.

SFCL continued to demonstrate strong capital adequacy during FY 2022, supported by an adequate consolidated Minimum Continuing Capital & Surplus Requirement (MCCSR) of 276% as at FY 2022, which improved from 269% over the previous period.

ECONOMIC OUTLOOK (US, JAMAICA & BARBADOS)

As the COVID-19 pandemic abates, the global economy remains on a recession watch but with much lower probabilities due to slowing inflation. Over half of SFCL's revenue in 2022 was generated from annuities, periodic premium and single premium life offered by Sagicor Life USA. Given the significance of the US market to SFCL's top and bottom lines, the performance of the US economy is paramount to the company's operations. According to the World Bank's Global Economic Perspective (June 2023), the US is projected to slow to 1.10% in 2023, before decelerating further to 0.80% in 2024. Rising interest rates are expected to stymie growth, but many analysts have reduced their probabilities of the US entering a recession in the next 12 months.

According to Fitch Ratings Agency, SFCL's investment portfolio has substantial concentrations in Jamaica and Barbados sovereigns. These investments are primarily used to meet regulatory requirements and for insurance liability matching purposes; as a result, the portfolio has a significant concentration of below investment-grade debt, which can pose a threat in the event of a catastrophic sovereign scenario.



Source: SFCL Annual Report 2022

The rating outlook for Jamaica's long-term foreign and local currency issuer default ratings (IDRs) was upgraded from stable to positive by Fitch Ratings in March 2023, and the IDRs have been confirmed at 'B+'. The upgrade was primarily driven by the economy's resilience during the COVID-19 pandemic and positive efforts to significantly reduce public debt. Amidst rising interest rates, public debt has started to decline Following the brief spike in 2020 to 109.70% of GDP. At the end of FY 2022/23 debt to GDP is projected to have fallen to 79.70%, which is below its pre-pandemic level. As the sovereign debt burden continues to fall, the overall economy is expected to continue its post-pandemic recovery, strongly aided by the tourism sector and an uptick in international reserves.

Fitch Ratings assigned Barbados a 'B' Long-Term Foreign-Currency (FC) Issuer Default Rating (IDR) with a stable rating outlook. Barbados' ratings reflect a careful consideration of various factors. On the positive side, the country enjoys a high GDP per capita and satisfactory governance. The external liquidity position has strengthened, and there is an improved debt repayment profile due to a comprehensive restructuring carried out between 2018 and 2019. However, the ratings also consider certain vulnerabilities. Barbados heavily relies on tourism, making it susceptible to external shocks. The country's public debt levels remain high, and local commercial banks are not inclined to take on much domestic debt. These factors present challenges to the country's economic stability, despite the ongoing recovery.

CREDIT RATINGS

Standard and Poor's (S&P): ('BB+'/Positive)

On August 26, 2022, S&P Global Ratings updated the outlook on its issuer credit rating for Bermuda-based nonoperating holding company, SFCL, from stable to positive. Following the announcement that an official deal to buy Canadian insurance solutions company, ivari, had been reached, the ratings of 'BB+' on SFCL and its $550 million senior unsecured notes due 2028 were affirmed. S&P believes that if the proposed acquisition goes through as planned, SFCL's group credit profile will strengthen. If ivari is brought into the group, SFCL's total operating risks would be reduced because the Canadian life insurance industry enjoys fewer country and industry risks than those in the Caribbean and the US.

Fitch Ratings Agency: ('BB-'/Ratings Watch Positive)

On November 22, 2022, Fitch Ratings has maintained SFCL's Rating Watch Positive (RWP), and SFCL's Long-Term Foreign-Currency Issuer Default Rating (IDR) and senior unsecured debt ratings remain unchanged at 'BB' and 'BB-', respectively. This rating decision was influenced by several factors, including the ongoing completion of the ivari Acquisition, which is expected to enhance SFCL's credit profile. The company also demonstrates adequate capitalization ratios, although there are some pressures on the capital structure. Additionally, SFCL shows above-average investment risk, but the exposure is manageable, and the financial performance remains strong. Fitch expects to conclude the SFCL Rating Watch once the ivari acquisition is successfully finalized.

S.W.O.T ANALYSIS

Strengths:	Weaknesses:
• Diversified financial Group operating across multiple geographic regions. • SFCL holds a dominant market share in the insurance and banking sectors in Jamaica, a leading market share in the insurance industry in Barbados, and the second-largest market share in the insurance industry in Trinidad & Tobago. • Robust financial fundamentals in the areas of capital adequacy, liquidity, earnings quality. • Strong operating results and positive trend in credit metrics.	• Investment portfolio has substantial exposure to non-investment grade bonds, mainly Jamaica and Barbados sovereigns. In the event of a default, SFCL risks losing a portion or the entirety of its initial investment, along with any accrued interest. • SFCL's small market share in the North American region reduces its competitive edge.
Opportunities:	**Threats:**
• The pending acquisition of ivari, is expected to improve the company's credit profile, due to lower operational and regulatory risks associated with the life insurance industry in Canada, where most of the premiums will be underwritten. • Growing presence in the US insurance market. • Improving macroeconomic conditions in the Caribbean is anticipated to improve the performance of financial assets and increase revenue. • The high interest rate environment is anticipated to allow SFCL to invest new policyholder funds at favorable investment spreads.	• Large exposure to the Jamaican and Barbadian markets, which remain vulnerable to external shocks. • Increased prices for products and services due to high inflation may result in higher claims expenses, which can reduce EBITDA margins.

COMPANY OUTLOOK

Pending Acquisition of ivari and Technological Developments will be Favourable to SFCL's Performance

The completion of the ongoing deal in 2023 is expected to further diversify SFCL's operations in the North American region, as Canada and the US are projected to account for a total of two thirds of SFCL's premiums. The integration of ivari into Sagicor is anticipated to enhance the group's capitalization. This is attributed to ivari being well capitalized, complying with Canada's prudent regulations. Its investment portfolio primarily comprises highly rated Canadian fixed-income securities, with plans to fully divest from some equity positions in the coming months, as per ivari's future investment strategy. Moreover, the transaction-related goodwill of ivari is expected to be minimal.

Additionally, SFCL has committed to enhancing its products and services offerings in the Caribbean via digitization. The company has already done major work with its eLife Direct to Consumer (D2C) platform. This initiative is expected to reduce overhead costs incurred by the group, while enhancing efficiency and boosting revenue, which will feed into increased EBITDA.

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CONCLUSION

Sagicor Financial Company Limited (SFCL) primarily offers insurance products in the US, Jamaica, Barbados, and Trinidad & Tobago. In Jamaica, SFCL also provides supplementary services like commercial banking, pension schemes, and investment management. As the pandemic subsides, SFCL has been experiencing revenue growth in its three business lines and has seen its revenue increase from US$2.36 billion in FY 2021 to US$2.54 billion in FY 2022, facilitated by strategic acquisitions. At the end of FY 2022 EBITDA declined marginally, but SFCL remains profitable and well-positioned to repay interests to bondholders and other creditors. Despite the ongoing acquisition and the maturing of a few notes in 2023 and 2024, SFCL maintains its liquidity position and aims to improve on its credit profile from the completion of the ivari deal. The expansion into Canada and improve macroeconmic conditions in the Caribbean are anticipated to positively impact SFCL's financial performance.

The following recommendations were applied to investors with the following risk appetite:

Appetite for Low Risk: **OVERWEIGHT**
Appetite for Moderate Risk: **OVERWEIGHT**
Appetite for High Risk: **UNDERWEIGHT**

SOURCES

Bloomberg, SFCL's Company's Website, S&P, Fitch Ratings, IMF, World Bank, SFCL's Financial Statements, Ministry of Finance & Public Services, Central Bank of Barbados

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.

- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.

- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.

- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.