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Conference Call Transcript

MFC.TO - Manulife Financial Corp at UBS Global Financial Services Conference

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CORPORATE PARTICIPANTS

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Manulife Financial - SEVP and Chief Financial Officer

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Peter Rozenberg

UBS - Analyst

PRESENTATION

Peter Rozenberg - UBS - Analyst

Thank you. My name is Peter Rozenberg I am UBS' Financial Institutions Analyst in Toronto. It's my privilege to introduce Michael Bell, Senior Vice President and Chief Financial Officer of Manulife Financial. Michael is an actuary and prior to joining Manulife two years ago, he was Executive Vice President and CFO of CIGNA and President of CIGNA Group Insurance. Manulife is the second largest insurer in North America by market cap with significant operations in Canada, the US and through John Hancock in the US and Asia. Manulife is doing what they said that they would do, they've strengthened their balance sheet, they've improved their products, their business mix, they've reduced interest rate and equity sensitivity well ahead of schedule all to drive sustainable long-term growth and returns. And with that I will pass it over to Mike.

Michael Bell - Manulife Financial - SEVP and Chief Financial Officer

Thank you Peter, good morning everyone. As Peter said my name is Mike Bell and I'm the Chief Financial Officer of Manulife Financial Corporation, it's a real pleasure to be here in New York this morning, I'm happy to have the opportunity to discuss our company and specifically our strategic priorities at Manulife. I will start this morning with our legal disclaimer, it's sort of an eye test for you in the back, but I'm sure you've seen this before, since I will be making some forward-looking comments this morning and there are a number of risk factors that we've identified that could cause actual results to differ materially from our expectations. So I'd strongly urge you to review all of our disclosures and specifically our discussion on risk factors.

In my prepared remarks this morning I'm going to focus on several topics. I'll provide an overview of our company and specifically our strategic priorities. I'll discuss the way forward. I'll describe our focus on balancing risk and growth and I'll offer some overall conclusions about our company.

Now by way of summary, we at Manulife are a global company with a presence in three of the world's largest economies. We operate as John Hancock in the United States and as Manulife in Canada and in Asia. We've a very experienced management team and approximately a third of our earnings come each from Asia, Canada and the US. We trade on multiple stock exchanges including the New York Stock Exchange here in New York, the TSX in Canada and also the Hong Kong Stock Exchange.

We're well capitalized with capital ratios near historic highs, and we have strong financial strength ratings from the rating agencies which support our brands out in the markets. Now you can see here on slide five, there's a summary of the market caps for the world's largest life insurance companies. We are one of the world's largest public life insurance companies by market cap and in fact the second largest insurance company here in North America behind MetLife.

This next slide summarizes our global strategy; first and importantly we are leveraging our strong market position that we've built up over many many years and we're driving changes in our business mix to accelerate the growth of our higher ROE lower-risk businesses. We're also expanding our hedging programs to reduce our risk profile and to reduce our sensitivity to changes in equity markets and interest rates. We're also actively further investing in our brands, in our John Hancock brand in the United States and also our Manulife brand in Canada and in Asia.

In addition, we're constraining the growth of our lower ROE, higher risk businesses and for example increasing prices in those product lines. Very importantly we are effectively managing our capital, both to maintain a strong cushion to financial market volatility, the changes in interest

rates and equity markets and to be sure that we have the financial flexibility to play offense; to take advantage of acquisition opportunities and organic growth opportunities across the globe.

Now at our investor day this past November, we identified five strategic priorities and also our 2015 Financial Objectives. The first priority is earnings growth through diversification and specifically our objective is to increase our annual net income to \$4 billion by 2015. Our second objective is to maintain strong capital ratios and financial strength and as I said this provides the cushion to deal with interest rate and equity market fluctuations as well as the flexibility to take advantage of growth opportunities through acquisition and also through organic growth opportunities and importantly this capital strength supports our brands, it supports our strong John Hancock brand in the United States and also our Manulife Brands in Canada and in Asia.

Our third priority is to improve our ROE and we plan to improve our ROE to 13% by 2015 and to accomplish this with a combination of growing our higher return businesses and pricing new business to achieve a long term ROE in excess of 14%. Our fourth strategic objective is to manage risk, and we're specifically managing a risk by shifting our business mix and expanding our hedging programs to reduce interest rate sensitivities and equity market sensitivities and we have specific goals that we've committed to by year end 2014. And finally we're committed to continuing to deliver a quality value proposition for our clients around the world that also support our strong brands.

Ok next I'm going to focus on the way forward by going into some additional detail around each of our three geographies and our strategic priorities in those geographies. By way of overview you see on this slide that in terms of the world's ten largest economies, Manulife operates in the three largest; US, China and Japan and when you include Canada, we operate in four of the top ten largest economies in the globe. This footprint provides us with a strong level of diversification and importantly the flexibility to select our best opportunities to profitably grow.

Now looking at our top three geographies in some additional detail you'll see that each has significantly different characteristics. In Asia as you know there is the highest expected GDP growth rates as well as insurance market growth rates. In Canada and the US these are diverse large markets but with slower expected growth rates going forward. Now in Asia where the growth rates are higher, insurance penetration is currently low and projected insurance growth rates in particular are quite high.

Growth rates in the emerging Asian economies is in the neighbourhood of 9-10% and we currently have operations in each of these key economies specifically China, Indonesia, Malaysia, Philippines, Thailand and Vietnam. I'd also note that while China and the US are more mature and slower growth markets, they still offer tremendous opportunities for growth given the overall size of these markets.

So what does all this mean? It means that we have opportunities for growth in all three of our geographies and importantly the flexibility to select our best opportunities for profitable growth across the globe. The sixth slide displays our earnings contribution from each of our three main operating divisions. And you can see that we benefit from this international diversification. The contribution to our bottom line from our three main divisions is relatively balanced with each Asia, US and Canada contributing roughly equal proportions of our after-tax earnings.

Now let's go into some additional detail in each of the three geographies, let's start with Asia. This slide depicts an overview of Manulife's operations in Asia. We're currently operating in 11 countries and have had a long history in Asia with a presence in Hong Kong for over 100 years. While we have plans for growth in all three of our divisions, in Asia in particular we have the opportunity for continued double-digit growth in the future. And our success in Asia we expect to continue to come from leveraging our Pan-Asian presence. We're targeting the faster growing economies like China and the ASEAN countries but also high value economies such as Japan, Hong Kong, Taiwan and Singapore.

In all of our Asian territories we seek to build our brand, to expand our distribution capabilities, to continue to lead with our insurance products but continue to add wealth management as a cross sell on top of that. Now Asia is certainly a collection of different markets and therefore each of them require different tactics, to give you some examples of that we're growing in China, and aim to become the number one foreign insurer by being the first with a truly national footprint. We're expanding in ASEAN by adding bancassurance distribution to our tradition force of insurance agents, and we're now successfully adding wealth management product offerings to our traditional focus on insurance.

In Hong Kong, we're focused on leveraging our strong brand to cross-sell and leverage our extensive customer base I would note that one in every five people in Hong Kong today is a Manulife customer and we have an opportunity to sell additional products to that existing base. In Japan, we're adding additional wealth products to our insurance portfolio and expanding our distribution with additional bancassurance opportunities to supplement the traditional agency force that we've had in Japan and across Asia we expect to continue to ride the economic wave.

So in Asia, we're driving strong top line and bottom line results, so for example in 2010, insurance sales reached a record \$1.1 billion, a 43% increase over 2009, and this was driven by significant increases in distribution capabilities and continued product innovation. Wealth management also experienced strong sales growth, these sales more than doubled year-over-year in the first quarter of this year. And importantly

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over the last 12 years our net income in Asia has grown at a compound growth rate of 18% per year, an impressive result, and we are bullish about the future in Asia overall and specifically for Manulife.

Now this slide highlights some additional successes we've had with our growth plan in Asia. Again with the focus on insurance we see that our insurance sales have grown with a compound annual rate of 36% over the last three years. As I mentioned a minute ago, insurance sales reached over \$1 billion in 2010 and represented 42% of Manulife's global insurance sales, over double the comparable amount in 2007 and this is a key milestone for our company and we're very proud of this accomplishment.

Now switching over to Canada. In Canada, we're currently successful as a diversified financial services provider, with the focus on growth in our higher return businesses. Now in Canada we have leading market positions in many businesses so for example we have approximately 20% market share in the life insurance business and 20-25% market share in the group benefits business in Canada. These businesses are mature and have provided strong earnings. We have a number of businesses in Canada which can continue to generate double-digit top line and bottom line growth and these businesses include the Manulife Bank, our mutual fund businesses, our Define Contribution Pension business, our Affinity Business and our small-case group businesses.

And the key to our strategy in Canada is our leading distribution capabilities in addition to our strong diversified platform.

Another key element for us in Canada is strong cross-selling and leveraging our in force block of businesses. Today just like Hong Kong, we served today one in every five Canadians and we're successfully leveraging these existing customer relationships to increase our cross-sharing and to increase our share of wallet. We're driving strong growth in our wealth management businesses, as we had record mutual fund sales in Canada in 2010 triple 2009 levels. This continued in the first quarter of 2011 which saw a 68% increase relative to the prior year.

In addition, we achieved record annual sales in the individual insurance and travel insurance in Canada, and our Manulife bank also continued its track record of profitable growth. Now our Manulife bank in Canada is a specific success story, it's shown in more detail on this next slide. It illustrates our overall business strategy in Canada. You can see on this slide, the tremendous growth that we've driven over the last five years, a 32% compound annual growth rate for statutory earnings and a 23% compound annual growth rate for debt lending assets.

At the core of this success story is Manulife One, our flagship product at the bank. Now instead of having a mortgage, a checking account, a savings account, lines of credit and all these different inefficient pieces where bank make a lot of money on the float by paying depositors a relatively low rate and then lending money to many of those same depositors at a high rate, Manulife One integrates everything into a single account where borrowers can leverage the value of compound interest and become debt-free years sooner and potentially save thousands of dollars of interest.

Manulife One specifically is tailor-made for the independent advisor and this distribution channel represents a competitive advantage for us across Canada. Now besides the fact that Manulife One helps clients become debt-free years sooner, it also helps these independent advisors insulate their clients from the big banks. Which is a considerable benefit to the business models of these independent advisors. So this is our fastest growing product line in Canada and we expect continued growth with this product and the overall Manulife Bank for the years to come.

In the United States we're transforming our business to focus on higher return, lower risk products and services. We're achieving this by leveraging the strong John Hancock brand as well as our market position and leading distribution capabilities. Our targeted areas include our mutual funds and our retirement plan the 401K services that we have as part of our wealth management business. In insurance, we have leading shelf space with distributors and an industry leading position in variable universal life and we're also successfully repositioning our universal life line up to improve the pricing, to provide a better balance between returns for our shareholders and values for our clients.

In the wealth management business, John Hancock mutual funds delivered record sales in 2010, up 48% from 2009. And in the first quarter 2011, the sales growth year-over-year was 42% relative to first quarter 2010. John Hancock retirement plan services also delivered record sales in 2010 and we ranked number one in the small group 401K segment. In insurance, we're successfully leveraging our strong distribution capabilities to reposition our John Hancock insurance business to reduce the focus on long duration guarantees. And these actions support our five year ROE objectives as well as our risk reduction initiatives.

Now to highlight the success we are having with our repositioning efforts this slide compares the US wealth management products that are targeted for growth to those that are not targeted for growth, and you can see that we grew our mutual fund sales by 42% in the first quarter of 2011 versus the prior year. Fixed deferred annuity sales of \$103 million were up 43% despite the low interest rates and as part of our repositioning we're happy to give up some market share in certain businesses but importantly we intend to price these products to deliver margins that make sense for the capital that's required as well as for the risk profile of these products.

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So as an example in first quarter 2011, Variable Annuity Sales were down 25% and Book Value Deferred Annuity sales were down 82% both versus the prior year. These are conscious efforts on our part as we believe the repositioning efforts of the US are working well and helping support driving the company to our 2015 objectives in terms of earnings growth and diversification, higher ROE and a lower risk profile.

Next on the agenda I want to take a few minutes to talk about our risk management and the importance to our overall strategic priorities. You can see on this slide that we have successfully reduced our equity market sensitivity over the last several quarters. Here at the end of first quarter 2011 we've now achieved our stated year-end 2012 target for equity market sensitivities and we're well on our way to our year-end 2014 target for this equity market sensitivity goal. So importantly this lower equity market sensitivity when combined with our strong capital position provides us with a substantial cushion against future equity market risk and turbulence.

This next slide illustrates a similar pattern as it relates to interest rates. You can see that we've made significant progress in reducing our interest rate sensitivities. Since the third quarter of 2010, which you can see in the middle of this slide, we've decreased our sensitivity to \$1.5 billion, this has actually surpasses our year-end 2012 target and brings us close to our year-end 2014 target of \$1.1 billion. So as shown on this next slide we also continue to change our business mix, in order to improve our long-term ROE outlook as well as our overall risk profile. So the products that we've targeted for growth have increased at double digit rates, while the premiums and deposits for products not targeted for growth have been constrained relative to the prior year.

So by way of summary, we're successfully executing on the strategic priorities that we've communicated consistently over the last 24 months. We're driving significant growth in our targeted, higher return, lower risk businesses. We're building on our accelerated growth in Asia. We're capitalizing on our strong, growing and diversified financial services firm in Canada. The repositioning work that we've undertaken in the US continues to progress well and importantly our strong capital levels, when combined with the lower equity market and interest rate sensitivities provide a substantial cushion. So overall we're really pleased with the progress that we're making and we expect additional good things into the future.

So by way of closing, this slide summarizes a number of elements in terms of financial performance and ratios. Look at the analysis on this slide and you compare this with comps out in the market, we believe there's significant upside potential for shareholder value. Thank you very much and I believe we have a few minutes for questions here before we move to the break-out.

QUESTION AND ANSWER

Unidentified Audience Member

(inaudible question - microphone inaccessible)

Peter Rozenberg - UBS - Analyst

Can you just take us through that as, given your background, my understanding of it is in the West we don't see that very often book and embedded value are close, but I think it's the low interest rates in places like Japan and the rest of Asia and the medium term normalization assumptions that exist that create that divergence between book and embedded value.

Michael Bell - Manulife Financial - SEVP and Chief Financial Officer

Sure, so the question relates to our current price to book and also price to embedded value and from our perspective this does represent a buying opportunity for exactly the reason the gentleman laid out, we know that our stock has been punished from the financial market turbulence over the last couple of years, the fact that under Canadian GAAP accounting it's much more of a mark-to-market regime than the US GAAP accounting here in the US. So, as an example, our book value has been depressed in Canada under Canadian GAAP because we've had to reflect the low interest rates worldwide, correctly as you point out relative to the interest rates in Japan in particular. Our view is that if you include the fact that our book value has taken this hit, because of the lower interest rates, our price-to-book value of a 1.3 ratio is in fact very attractive relative to other global competitors, particularly when you include the value of our Asian franchise, which is now delivering approximately a third of our global earnings, if you apply a multiple in Asia that reflects the likely growth rates over there we think that 1.3 is very attractive in

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terms of the price to embedded value of 0.77, again including the impact of today's lower interest rates that are impacting that embedded value we believe the 0.77 is in fact an attractive ratio as well.

Now obviously we need to execute on our priorities I don't want to trivialize the importance of the five strategic priorities that we've laid out, but as Peter said in our opening we've been very consistent in our communications over the last 24 months and we have successfully made progress on the five strategic priorities that we've been talking about consistently throughout that period, so for those reasons we believe that our stock price is more of a trailing indicator relative to our progress and specifically with the good results that we're having in Asia and the good progress on these priorities and you couple that with Canadian GAAP market-to-market accounting we think there's real upside potential.

Unidentified Audience Member

Two questions, on slide 11 you showed the 38% of the first quarter net income from Asia can you split that between emerging Asia and developed Asia? As you referred earlier in the slide, one is growing definitely faster than the other and then the second question earlier on in the discussion, you spoke about how you wanted to keep your powder dry in terms of capital for M&A, can you give us a sense of the size and what regions would be interested to do M&A in the future?

Michael Bell - Manulife Financial - SEVP and Chief Financial Officer

Sure, first of all in terms of our overall Asian growth rates we're really proud of our growth rates in Asia in virtually all of the countries there we're growing very successfully in Hong Kong, significant expansion in our agency force there, continued growth in the bancassurance model, so overall we're taking share in Hong Kong mainly through those distribution capabilities, so even though Hong Kong obviously is a relatively mature market, we're very positive on our growth rates.

Similarly, in Japan we've successfully shifted the focus of our Japan sales efforts away from variable annuities from a few years ago to now a much more diversified portfolio of insurance and wealth management products that don't have the same kind of risk profile that the VA sales had and we feel very positive about our growth rates in Japan. In terms of the emerging markets, Indonesia has been a home-run for us; again we have been significantly growing our agency force there at double-digit rates now for a couple of years and the overall insurance sales have followed that.

We've also been adding bancassurance relationships to supplement that growth, so Indonesia has been a real home-run and our growth in China has also been a real success story. We're now in 44-45 of the cities across the country and really at this point are rapidly becoming a true national player and for our partnerships with Sinochem on the insurance side and then through the Manulife TEDA venture, on the mutual fund side we've had good growth from both insurance and wealth management, we've picked good partners to date for sure, so we're very proud of the results, the sales results, and the growth results we've had in China.

In terms of your question around M+A, obviously I don't want to go into a lot of detail on a specific targets that we're looking at, but I think it's fair to say that the combination of capital ratios increasing across the globe as well as the impact of the financial turbulence over the last couple of years, we're starting to see a steady increase in M+A targets that are out there.

We have a strong M+A team that look at deals and at any point in time we almost always have several potential deals in the hopper that we're looking at. You ask about size and you ask about geography, in terms of size we've seen these come in a wide variety of sizes, some as small as a few hundred million, some that range in the billions and it's obviously impossible to speculate which at the end of the day we will find more attractive, it's not lost on me as CFO, given that our stock price has still not recovered to the strong historic levels in my view back to the answer to the first question from the audience this morning, not to the levels that we think some of our global comps would suggest we should be at. It's harder to get one of those big deals to pencil because we would have to use our stock and it would be dilutive to long term shareholders if we don't find a real home-run opportunity given our current valuation.

So we don't feel compelled to rush out to do a big deal, we certainly have evaluated big deals and evaluated them on their own merits, they're harder to get done though with our current stock price, and I think it's fair to say if our stock price recovered to what we think is a reasonable comp there'd be a higher probability.

But we don't feel compelled to rush out and get a deal done but we do see a growing number of good opportunities and certainly at this point that have the kind of capital strength to be able to get one of those done. From a geography standpoint, a couple of answers there; Number one, obviously to date we've seen increasing opportunities in Asia, and certainly in the two years now that I've been in this job there've been more

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opportunities in Asia in terms of numbers of potentially attractive deals than in anywhere else. I actually expect that if the capital rules continue to tighten here in the US, I would expect to see more of a supply in terms of potential US deals than what we've seen to date.

Particularly in the wealth management area opportunities out there for example to jump-start either our mutual fund platform or 401K platform, that would obviously be something that we would look very closely at, so at the end of the day what I really want you to hear in terms of M+A is that yes we are looking at a wide variety of opportunities, we don't feel strategically compelled to have to go out and do something, we are going to be a disciplined buyer, certainly in the last 15 years Manulife has had a very strong history of being a very disciplined buyer, but with the increased number of supply of opportunities, we think this is a very good time to have strong capital ratios.

Unidentified Audience Member

At your annual meeting, your management indicated that one of the main concerns they had was regulation and accounting as one of the key risks can you talk about that?

Michael Bell - Manulife Financial - SEVP and Chief Financial Officer

Sure, Peter's absolutely right at our Annual General Meeting Donald Guloien our CEO went through in a fair amount of detail what we see as the changing landscape in terms of global capital requirements as well as accounting standard changes and I think it's fair to say a couple of different things; Number one that this is a really big deal and in fact in my view it has been under appreciated by the market in terms of being a big deal if for example Solvency II kinds of capital regulations made their way to the US, that would actually dictate significant changes in various insurer portfolios, so number one headline is this is a big deal and really has been under appreciated by the investment markets to-date. Second, there's a lot of uncertainty here and there's still an opportunity really to influence the decisions that are made.

We certainly spend a lot of time with our regulator in Canada as well as with various Federal Government departments and ministries in Canada to make sure that they are kept abreast of what the capital requirements look like in Canada, relative to the capital requirements in other jurisdictions because at the end of the day this isn't just about getting the capital standards right from some kind of theoretical standpoint to have adequate capital, but importantly to have a level playing field across the globe so that there aren't jurisdictions that either have a competitive advantage or competitively disadvantaged in the global markets.

The other topic that Peter just mentioned that Donald talked a fair bit about at the AGM last week is accounting standards. IFRS Phase II is likely to move something closer to some kind of mark-to-market accounting methodology; certainly a dramatic departure from what US GAAP has been in the past.

Again that has various pro's and con's associated with it, again I think it's fair to say that that's likely to be moving closer to Canadian GAAP and closer to the mark-to-market kind of methodology that we have been living with in Canada over the last several years so I think that we're actually reasonably well-positioned to understand the volatility that comes with a mark-to-market regime but once again this is a bigger deal than the general investing product in the US has picked up on.

So it really has big stakes and where it is most important is with long duration guaranteed products, so products like the variable annuities, products like the no-lapse guarantee universal life, these are really ground zero for the most significant volatility that we might see under the potential new accounting standards as well as capital standards so more to come there but if I can leave you with one message it's that this has not gotten the mind space that it deserves as a potential to truly change the global insurance landscape and really incumbent upon all companies whether it be Manulife or whether it be companies headquartered here in the US or in Europe to take this much more seriously than has been done to date.

So again I appreciate everyone coming out this morning, I hope to see some of you in the Q&A session in the break-out. Thank you very much.

Peter Rozenberg - UBS - Analyst

Thank you.

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