Definity Financial Corporation

First Quarter 2024 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Definity Financial Corporation First Quarter 2024 Financial Results Conference Call.

At this time all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the Operator.

This call is being recorded on Friday, May 10, 2024.

I would now like to turn the conference over to Dennis Westfall, Head of Investor Relations. Please go ahead.

Dennis Westfall – *Head of Investor Relations, Definity Financial Corporation*

Thanks to all andgood morning, everyone. Thank you for joining us on the call today.

A link to our live webcast and background information for the call is posted on our website; definity.com under the Investors tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on the conference call.

Joining me on the call today are Rowan Saunders, President and CEO; Philip Mather, EVP and CFO; Paul McDonald, EVP of Personal Insurance and Digital Channels; and Fabian Richenberger, EVP of

Commercial Insurance and Insurance Operations. We'll start with formal remarks from Rowan and Phil, followed by a Q&A session, where Paul and Fabian will also be available to answer your questions.

With that, I will ask Rowan to please begin his remarks.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Thanks, Dennis. Good morning, everyone.

We reported first quarter results last night that get the year off to a strong start and continue to deliver on our financial targets. In the quarter, solid underwriting income, robust net investment income, and ongoing contributions from our insurance broker platform resulted in operating net income of $75.2 million, or $0.65 a share. Our combined ratio of 93.9 percent reflected improved underlying results and continued expense efficiencies, partly offset by an increase in catastrophe losses.

The benefit of higher earned rates flowing through the business combined with milder winter driving conditions to generate improved core accident year loss ratios in our Personal Auto and Commercial Lines. Following proactive rate actions in 2023 to protect the profitability of our auto business, we're in a stronger competitive position to grow the underwriting income generated by this book of business in what is now a firm market. The rapidly firming conditions in auto, continued favorable conditions in commercial insurance, and our strong broker proposition combined to generate significant growth momentum in the quarter, as premiums increased 12.8 percent.

Operating results again benefited from growth in net investment income, driven primarily by higher interest income that was enhanced by active management of the portfolio in the current interest

rate environment. Combined with ongoing contributions from our expanded broker distribution platform, our financial performance led to an Operating ROE of 9.4 percent.

According to the industry outlook on Slide 6, we believe the operating environment is one that remains conducive to sustaining favorable market conditions overall. We expect conditions in auto lines to remain firm, as insurers aim to keep pace with the combined impact of elevated theft and lingering cost pressures. We also expect firm market conditions in personal property will persist, particularly following a second consecutive year of industry CAT losses north of $3 billion, and the dynamics of recent reinsurance renewals.

In commercial insurance, we expect the market to remain firm as carriers focus on ensuring long-term profitability and sustainable availability of capacity. Overall, we expect the industry's return on equity to be close to its long run average in 2024.

Slide 7 shows our key financial targets for 2024. I've already touched on our ability to deliver on our growth and our combined ratio targets. We view this combination of mid 90s COR with above industry growth as an effective way to create shareholder value. As I mentioned last quarter, the strength in underwriting profitability combined with expansions in investment and distribution income, are expected to increase operating ROE to 10 percent or more in the second half of 2024 and beyond.

Slide 8 illustrates the progress we made last year to diversify and strengthen the earnings profile of the business with repeatable distribution income that complements our underwriting operations. McDougall and McFarlan Rowlands have well established operations in Ontario, while our late 2023 edition of Drayden provided immediate scale in Alberta.

Looking ahead, we expect continued M&A activity and the organic growth potential of the business to result in $1.5 billion of managed premiums in the next three to five years. We continued our recent momentum with a couple of additional deals in the quarter and maintain our expectations for 2024 operating income from this part of the business.

With that, I'll turn the call over to our CFO, Philip Mather.

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Thanks, Rowan.

I'll begin on Slide 10 with Personal Auto. Premiums were up 15.6 percent in the first quarter of 2024, driven by a double digit increase in written rates, and return to unit count growth in our broker business reflective of our significantly improved competitive position in a firm market environment. Higher premiums assumed from industry pools also contributed 2.8 points to the overall growth.

We expect our broker business to benefit from continued strong retention, increased portfolio transfer activity, and the inherent scalability of our Vyne platform. The combined impact of which should support a strong pace of growth in the coming months. We will continue pursuing additional rates and segmentation actions to maintain our target profitability.

Focusing on our direct business Sonnet, we are maintaining our disciplined approach, and we remain on track to reach our run rate breakeven target by year end. Our approach includes focusing on areas of the business where we see opportunity for profitable growth. In the current environment, this excludes Alberta, where we maintain our pause on all Sonnet marketing activities.

Personal Auto reported a solid combined ratio of 97.1 percent in the quarter, 3.8 points better than a year ago. Our overall claims ratio improved 1.6 points as the benefits of earned rates and mild winter weather was somewhat muted by the negative impact of industry pools. Theft continues to be a major challenge for both us and the industry as a whole, although signs are pointing to a stabilization in recent months. We maintain our underwriting and claims initiatives aimed at addressing theft and auto recovery. Overall, earned rate levels remain above current loss cost trend, reinforcing our expectations for personal auto to generate a mid to upper 90s combined ratio in 2024.

Turning to personal property on Slide 11, growth of 5 percent picked up slightly from the pace in Q4 or remained below prior periods, which had benefited from unusually high levels of portfolio transfers. Our continued actions to address risk concentration in CAT exposed regions further slowed growth in the quarter. We expect this line to grow at a mid to upper single digit pace for the full year given the firm pricing conditions prevalent in the industry. Focusing on the bottom line, we reported a combined ratio of 91 percent in Q1, essentially unchanged from the same quarter a year ago. Higher favorable prior year claims development and an improved expense ratio, largely offset by an increase in catastrophe losses, driven by a deep freeze in British Columbia. We continue to target a mid-90s combined ratio for the personal property line of business on an annual basis.

Slide 12 outlines the highlights in the quarter for our commercial business, as double-digit growth in commercial lines continued with gross written premiums up 15.8 percent versus the prior year. Strong growth momentum was driven by by targeted growth across strategic segments with strong retention and rate achievements in a firm market environment, and further expansion of our small business and

specialty capabilities. We expect commercial insurance to maintain growth at a double digit to low teen pace in 2024.

Commercial lines benefited from continued focus on underwriting execution with a combined ratio of 92.1 percent in Q1 of '24, compared to 90.9 percent in Q1 of 2023. The increase in the combined ratio was driven primarily by non-weather-related catastrophe losses, which can vary from quarter-to-quarter, as well as lower favorable prior year claims development. These were partially offset by improvements in the core accident year claims ratio and the expense ratio. With solid performance to start the year, we continue to expect our commercial insurance business to sustainably deliver an annual combined ratio in the low 90s.

Bringing this all together on Slide 13. Consolidated premiums increased 12.8 percent. The disciplined nature of our growth through our underwriting expertise, pricing strategies and product expansion, along with the continued focus on expense management resulted in the first quarter combined ratio of 93.9 percent, 1.4 points better than the solid Q1 of last year. Our expense ratio of 31.3 percent was 1.4 points improved from the prior year, benefiting from the investments we've made to improve productivity along with our disciplined expense management. We view much of the improvements as sustainable and expect 2024's expense ratio to come in at the lower end of the 31 percent to 32 percent range.

Focusing on distribution income, when adjusting for an unusually strong CPC benefit in the first quarter of 2023, underlying income essentially doubled year-over-year, reflecting the inorganic expansion of the platform last year. I'd also point out that distribution income is expected to experience a similar

seasonality to our overall written premiums, which tend to be lower in the first quarter each year. As we mentioned on our last call, all impacts from our national broker platform also includes the benefits of consolidated expenses in the form of a commission offset. In aggregate, we maintain our full year target of $75 million before finance costs, taxes, and minority interests, and expected to have a roughly 70/30 split between distribution income and commission offsets.

Slide 14 shows our investment portfolio in greater detail. Our net investment income again increased meaningfully in the quarter up more than $7 million from Q1 of 23 due to higher interest income from increased book yields captured through active management of the fixed income portfolio. Growth is expected to slow from double digits to mid-single digits in ‘24 as book yields and market yields converge. We therefore maintain our expectations for full year, net investment income exceeding $190 million.

As you can see on Slide 15, our financial position remains robust with over $1.3 billion of financial capacity now that we've continued to the CBCA. Strong operating income and investment gains supported growth in our capital in the first quarter and combined to generate sequential growth in book value per share of 2.5 percent.

Slide 15 shows recent capital management actions and longer-term priorities. When it comes to deploying our capital, the primary focus remains in support of our robust organic growth strategy. We also intend to continue growing our dividend over time. With an objective to build our Company into a top five player in the industry, we’re actively pursuing inorganic growth, including both insurance carriers and distributors. Following our initial build of the platform via our partnership with McDougall, recent broker acquisitions have been more programmatic in nature, which we expect to continue.

With that, I will turn the call back over to Rowan for some final remarks.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Thanks, Phil.

As Phil described, while our financial performance and operating results continue to meet or exceed our financial targets, we believe there are controllable organic levers that we can pull to further enhance our operating ROE. We've discussed two of them already, namely the removal of Sonnet's current drag on performance once it has reached breakeven, and the continued march lower in our expense ratio. The third lever is our claims transformation to Guidewire ClaimCenter.

I've spoken previously about becoming the first P&C insurer in Canada to transition our core insurance platform to Guidewire Cloud. By modernizing and digitizing our core infrastructure in this way, we've become better positioned to effectively scale our business and improve our service quality. Just last month, we began managing new automobile claims using ClaimCenter. This modern platform helps us speed up claims resolution, improves communication and transparency, and gives our customers real time updates on the status of their claims. This marks an important milestone in our continued claims transformation, seizing opportunities to modernize and digitize our claims processes to create better broker and customer experiences.

Performance improvements are expected to come from our increased ability to optimize our indemnity and expense management practices. Further benefits will be targeted once we've completed the claims transformation, with property claims currently targeted to transition late next year.

With that, I'll turn the call back over to Dennis to begin the Q&A.

Dennis Westfall – *Head of Investor Relations, Definity Financial Corporation*

Thanks, Rowan. We are now ready to take questions.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star followed by the one on your touchtone phone. You will hear three tone prompt acknowledging your request and your questions will be pulled in the order they are received.

Should you wish to decline from the polling process, please press star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

Your first question comes from Mario Mendonca with TD securities. Your line is now open

Mario Mendonca – *Analyst, TD Securities*

Good morning. Let me start first with a question on commercial. Commercial has been a big part of this Company's story since demutualization, big part of the growth and I think the profitability. But over the last couple of quarters, you've made reference to non-weather-related CATs. I'm assuming that means

fires or stuff of that nature. Could you speak to what's driving that? If you're concerned that this is a trend, you'll need to address with pricing or some other underwriting mechanism?

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Thanks, Mario, for the question. I'm going to let Fabi take that. I'll just reiterate the points you've made. We've put a lot of effort into building and shaping the portfolio with growth in commercial. As you've noted, it's really been a big part of the story. It has grown significantly over the last couple of years, and as we build out multiple segments, not just small business, middle market, and specialty with building teams and capabilities. I would say at the macro level, we're delighted with this business. We see strong future potential as well. There is no concerns from our perspective in terms of how this business overall is projecting and performing at this stage. We continue to be very, very pleased.

With that. Let me pass it Fabi to give you a bit more specific insights to the nature of your question.

Fabian Richenberger – *EVP, Commercial Insurance & Insurance Operations, Definity Financial Corporation*

Yes. Mario, very much in line with what Rowan just outlined. The big picture is that we have no concerns whatsoever with our large loss events in such you've seen over the last couple of quarters in our commercial business. As you know, large losses will always vary a bit quarter-by-quarter. You'll have a quarter where you have two or three large losses, and then you have a quarter where you don't have any large losses. Overall, we have a very sound underwriting, very sound pricing approach.

We have a very diligent risk management and governance practice around our large accounts, and that business has been profitable over the last four years. Even if you look at the performance over the

last two quarters, you're still making an adequate margin in that business because we are collecting an adequate amount of premium. We do expect that we have about 10 large losses in any given year. Again, the big picture is that we're not concerned about it, and we do feel that we have a very good opportunity to keep that business profitable going forward as well.

Mario Mendonca – *Analyst, TD Securities*

Not to put too fine of a point on it, but are you talking about fires here when you say non-CAT losses, non-weather-related CAT losses?

Fabian Richenberger – *EVP, Commercial Insurance & Insurance Operations, Definity Financial Corporation*

That is, it, yes. In our commercial portfolio of $1.2 billion in annual premiums, about 60 percent is in the P&C space, 40 percent is in the auto space. If you look at our losses into Q1, we had two large fire losses and one was larger other loss. But again, in both lines, they are much in line with our price assumptions. We are making the margin [….] to that place and what it's important to note as well is that obviously we have specific reinsurance protection in that business as well. It's not really a severity concern that we have in that business, because our reinsurance will kick in above our retention of $5 million. The team that we have hired four-five years ago that is running the businesses, they literally have 20 years' experience, and they are also adding secondary reinsurance for some of the risks that we have. Again, absolutely no concerns about the large loss emergence that you've seen in the segment.

Mario Mendonca – *Analyst, TD Securities*

Thanks. Rowan, your comments about improving the ROE, through those three approaches, the claims, Sonnet and the expense ratio. I've held the view that the Companies ROE is stuck in that 9.5 percent to 10 percent range until you can do a large acquisition. But it sounds like through those three approaches, you're a little more optimistic than I would be on what that ROE can get to. Maybe let me ask the question this way, absent the transaction, what can those three approaches do for the ROE?

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Yes, Mario. As you said, there's a combination of factors that we think that will improve over the next couple of years. For sure the ones that are a bit more opportunistic are the ones where we can deploy the capital through M&A. Of course, we'll keep working on that. The other ones we refer to as more controllable and that we've shared that the path for Sonnet to breakeven by the end of this year is what we've been targeting, and we're encouraged about that journey, and then it'll start being more contributive. If you just do the math on Sonnet, there's a couple of points that we've had a drag for a while. That'll be helpful.

If you looked at last year and continuing to this year, you now start to see us gaining some traction on that expense ratio. What's encouraging there is when you look into that expense ratio, it's essentially a combination of underwriting expenses, operating expenses, and then commissions. The year-on-year improvement this year is really all in the operating expenses. That's about the tools that we put in place. The productivity tools are working. There's good expense discipline. We're now starting to certainly get a bit of operational leverage in the business with revenues, able to outpace the growth of expense growth. What we feel there is there's a couple of points over a couple of years. What we're trying to do is glide

into a lower expense ratio. We felt that there is a couple of points of opportunity over the next couple of years as we do that, continue to fund what we do, the innovation and the growth story.

The other area, which we just commented on the call on here is certainly the claims transformation. If you just step back over the last couple of years, what we really did in terms of transforming Economical into Definity was really around the front part of the business before the claims operations. This really supported the ambition and the growth story. We're now well in flight in the claims transformation and given automobile is a big part of our business, it's logical that we were in first. That has just launched literally in April.

We think that over the coming quarters, there will be both indemnity benefits as well as expense ratio benefits, and then we'll get to property next year. That transformation of the operating model for the property parts of the business is again, just started.

I don't think it's fair to stack them all up because some of that will be reinvested. But it definitely feels to us like there's some opportunity to get a few points of Operating ROE expansion, and that's before we do something inorganic, which then allows us to deploy the excess capital and introduce some leverage into the balance sheet. That's the way. We're thinking about that.

Mario Mendonca – *Analyst, TD Securities*

If I could just pull this together, you refer to a couple of points in all cases Sonnet, expense and claims that would be, just doing the math, 600 basis point improvement in the ROE. That's clearly not what you're suggesting when you said stacking up.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Yes.

Mario Mendonca – *Analyst, TD Securities*

What are you suggesting? Is Definity a 12 percent ROE Company without a deal? Is that reasonable over the two-to-three-year period?

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Yes, Mario that's reasonable. If we think about our internal plans, that's the way we think about it, because there will be some of that reinvestment, as you said you can't stack them all up. One of the things that's coming ahead is, we're going to be sending out notification of an Investor Day in September and that will be a good double click for us to get into quite a bit of detail on the actions, the path, and the credibility of improving that Operating ROE through those three organic, or let's call them controllable levers.

Mario Mendonca – *Analyst, TD Securities*

Thank you.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Welcome.

Operator

Your next question comes from Tom MacKinnon with BMO Capital Markets. Your line is now open.

Tom MacKinnon – *Analyst, BMO Capital Markets*

Okay. Great. Thanks. Good morning, and thanks for taking my question. Probably just more numbers questions. Really if we look on Slide 13, there's a line called Other that seems to be up quite a bit year-over-year, and probably quarter-over-quarter as well. What's driving that? How should we be thinking about that Other line going forward? There's a follow up. Thanks.

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Hey, thanks. It's Phil calling. Within there, you've got a little bit of seasonality—not seasonality, but one timers that happen. Within the $13.9 million, there's a recurring component, which includes the public company expenses, includes the interest expense within the business. I'd say overall, we'd normally expect that number to be in the $11 million to $12 million range. What's causing some of the variance year-on-year, partly, is the interest expense is up. As we've drawn down on the credit facility as part of the broker acquisitions. Obviously, that has increased that level by about a million-and-a-half, that we see as more of a structural increase.

But there's also just a little bit of lumpiness coming on through a couple of the associate positions that can move quarter-on-quarter. Historically, it's been more or less a wash. This quarter, it's a small drag on a swing basis. There's also about a million dollars in there that we clearly see as a one time. Big picture, we see that more in the $11 million to $12 million range, and the increases on prior year is more about the interest expense as we've drawn on the facility.

Tom MacKinnon – *Analyst, BMO Capital Markets*

Okay, that's great. I don't know, if you've talked, if we just move to the next slide there, 14. We seem to have plateaued in terms of both interest income and dividend income. With such a growing portfolio and probably a gap between new money rate and your book rate, I would have expected that dollar amount to increase. Any thoughts around why it hasn't increased quarter-over-quarter?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Yes. Thanks, Tom again. There's a couple of component parts in there. Overall, when you look at year-over-year, obviously, we're still running up a sizable increase compared to this point last year. That's the interest income driving that as the yields earn in. Quarter-on-quarter, there's a couple of components though. In the fourth quarter each year, we get a one-time dividend payout that comes from foreign equity pooled fund.

There's about a million dollars of dividend income there that pops in the fourth quarter. The underlying dividend trend is pretty consistent. You'll see it's been pretty consistent over the last several quarters, as we haven't really added to the overall equity exposure. But it causes a bit of a trend quarter-on-quarter.

The other factor I'd call out is just the cash flow drain in the first quarter of the year. Q1 is always a cash flow consumptive quarter, more so this year than in others because we have the traditional payouts for incentives, the traditional payouts for CPCs. We also had our largest payout on taxes, and we had the

deployment of capital into the broker portfolio. A little more exaggerated there and that's what's really depressed the interest income as we've utilized some of the funds from the portfolio.

Later on in the year you get more cash generative. We would expect that to tick back up as we're able to then deploy positive cash flows into the portfolio. Overall, though, we're still very comfortable with our overall projection. We still see north of $190 million for the full year.

Tom MacKinnon – *Analyst, BMO Capital Markets*

Okay, thanks for that.

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

No problem.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press star followed by the one. Your next question comes from Geoff Kwan with RBC Capital Markets. Your line is now open.

Geoffrey Kwan – *Analyst, RBC Capital Markets*

Hi, good morning. Just wanted to follow-up on the earlier question by Mario, on the ROE. If you think over the next couple of years you can get to a 12 percent ROE without a deal, when you optimize the capital structure, is that maybe adding a couple of points to the ROE or how do you think about what the optimized capital structure ROE looks like?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Yes, thanks, Geoff. Yes, the way we've expressed it is, on a controllable basis, we think we can push up towards the top end of the double digits but below teens, is the way we think about it. Optimizing the balance sheet, we definitely think that adds a couple of points. We also think it helps us sustainably land within the teens range. If we can get that additional scale, if we can optimize the balance sheet and just pull away some of the equity drag that is obviously earning 4 percent or so in the investment portfolio as opposed to double digit return on the investment. Not only does that push us into the low to mid-teen range, it also keeps us there, from our perspective and helps us balance some of that volatility. That's the opportunity and that's a structural one. Obviously, once you get the scale advantages, you can build from there. But that's a good way to put them together.

Geoffrey Kwan – *Analyst, RBC Capital Markets*

Okay. The other question I had was, I suppose, I was on the call a bit late, I don't if you about it, on the auto side impacted the industry pools on premium growth. Has that contribution or that impact increased over the past year, just wondering, given where rates are and if players have been a bit more picky on underwriting? Just trying to understand what the impact has been both on the topline and also too, has it added more or less volatility looking at the combined ratio?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Yes, thanks, Geoff. The answer your question, bluntly, is yes. What we've seen in the last, probably three or four quarters, certainly the last couple, is that the industry usage of the pool has gone up. When

we look at the pools, you only see half the story in the gross written premium. Within there, you get what we assume back from the pools, so that is the risk-sharing pools, and also the Facility Association. In recent quarters, you've definitely seen the industry activity pick up. That has resulted in a high degree of growth coming from the pools and a quarter-on-quarter and you'll see this quarter it was 2.8 percent of the overall auto growth. Historically, it wouldn't have been as high as that. Now, that's the one side of the picture.

The other side is we're ceding more into the pools as well. As we're seeing high-theft vehicles, and we think that's a big driver of it, we're increasing our cessions, not quite at the same pace. But if you think through to the bottom-line on that on a net underwriting bases, it's more muted than you see on the gross written premium itself. Total impact on the quarter was just under a point of drag on the 97 percent, personal auto rates. Historically, the pools have been a bit of a wash for us. When you look through to the combined ratio, it's washed. We're keeping an eye on it because it is being used at higher rates. In this theft environment, it's not surprising that peers are also utilizing the pools at a higher clip.

Bigger picture, I would say the usage has gone up from the industry. Our cessions have also gone up. The overall impact on the quarter at a point that's not unusual, you'll see pauses like that. But it is something we're going to keep an eye on.

Geoffrey Kwan – *Analyst, RBC Capital Markets*

Okay, sorry, if I can clarify. When you're talking about a year, you're talking about both the risk-sharing pools as well as the FA—

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

That's correct.

Geoffrey Kwan – *Analyst, RBC Capital Markets*

—in terms of seeing their contribution and your comment about the auto theft is, I get it anecdotally you're seeing players in the industry putting more of the identified vehicles that are typically having the theft, putting those into the risk-sharing pools, or is that what your point was?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Yes, that's totally the point.

Geoffrey Kwan – *Analyst, RBC Capital Markets*

Okay, all right. Thank you.

Operator

Your next question comes from Jaeme Gloyn with National Bank Financial. Your line is now open.

Jaeme Gloyn – *Analyst, National Bank Financial*

Yes, thanks. I just want to make sure that I firmly understand the contingent profit commission profile here. My understanding or for my take from your commentary, this is purely a Q1 phenomenon. It's not something we should expect to reoccur throughout the rest of 2024 where CPC accruals, in '23 were higher than where we are today. Is that correct, or should we see some drag from that in upcoming quarters as well?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Yes, the way I'd look at it is if you look at the prior year comparison, we had about $9.5 million of distribution income. Our $4.5 million of that was a true up from 2022 CPCs. If you go back to that period of time, 2021 and 2022 are very good years for the industry and were strong years from a CPC perspective for the brokers. There was more upside that came through against the original expectations when we closed off the books at the end of that year. Also, we'd only just acquired McDougall at that point in time and we were working with them to understand their accrual practices.

When you look at the year-on-year comparison, the 10, really, we'd say is more comparable to a five if you isolate for the item. When we looked at this year's accruals, we were very close. We didn't really see that same true up, if you like, that came through. First comments I'd make is that's why we think the underlying growth pattern is very representative of the expansion of the business.

The outlook for CPCs, we have factored that in our guidance of the $75 million before the minority interests, finance, and taxes. We were not expecting the same level of scale coming through from CPCs for brokers, nor have we been paying them. It's a bit of what you saw in the second half of last year, really driven by the CAT events. We see that as probably being a little more of a headwind for the brokers overall. But we had already factored that into our estimate for the full year. That was fully reflected in our expectations.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Hey, just to add to that, the big picture is that as Phil said, we're comfortable with our guidance on distribution income for the full year. We definitely think that $75 million is on track. We just explained the first quarter. And we continue to be delighted with the performance of McDougall and the acquisitions we've done. We closed a reasonably sized acquisition in Alberta in the first quarter of this year. That will help earn in as it goes on and a couple other small ones. The pipeline looks good and the business, from an organic perspective, continues to operate very strongly. The strategy is unfolding exactly as we anticipated. We like it. We think is going to continue to diversify the earnings. Despite a bit of noise, which really was more of a 2023 item than a 2024 item, as fully explained, we're good with our guidance.

Jaeme Gloyn – *Analyst, National Bank Financial*

Yes. Understood. Thanks for the extra color. Still on the broker channel just curious to get an update as to how some of these more recent acquisitions and even like as the McDougall and McFarlan, how is the integration of those businesses going? Are you seeing an uptick in penetration of Definity premiums through these brokers in Ontario and Alberta? Then maybe wrap it up with a commentary around the environment for further broker M&A? At this point, I see one of your peers is very active and so just curious on your take on that front.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Yes, the macro view here is that we think that consolidation in the broker sector is continuing. As you know, there are several players that are involved in consolidating and making acquisitions. There's a certain profile that fits very well with McDougall and that likes our model. We don't win all deals. The pipeline, I would say, is pretty healthy as Fabi commented. At the end of the year, last year, there's

something unique about the model we have. They like the fact that they continue to run operational independent models. They like the fact that they can keep maintaining equity and wealth creation opportunities in the model. As far as the integration is concerned, it's different, of course, for us, because we don't integrate these businesses. We own them and we support them.

There are some logical synergies that happen. For any broker model, clearly, there's some back-office opportunities and common technology platforms. But a lot of it actually comes with expertise and new product and new sales capabilities that they can bring to, particularly, some of the smaller brokers that are rolled up. Of course, that keeps the margins pretty high. We like this. It has been positive for us. We think it is going to continue to grow.

I think the guidance we said, if you remember, when we implied McDougall was $0.5 billion business, and just over a year we doubled that to a billion-dollar business. We're very comfortable that between the normal organic growth of these brokers and some programmatic bolt on activities, we will end up with $1.5 billion or so in the next few years. It's likely going to continue to help support our earnings and of course, diversify earnings.

Jaeme Gloyn – *Analyst, National Bank Financial*

Okay. Last one, just on one of the components of the ROE expansion, you mentioned at the top of the questions is the Sonnet breakeven towards the end of this year. Maybe just a quick update as to where we are on that path towards that breakeven now. It looks like there's a little bit more advertising, at least in in Toronto area. Are you starting to generate a lot more flow or more volume activity in Ontario? Is that setting up on the path to hit the right level of premiums?

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Let me just start with that. I'm going to ask Paul to give us some color there. The reality is we have indicated that we felt we had plans in place to get Sonnet to breakeven by the end of this year on the run rate basis and the macro story is very consistent. That still looks to be on track for us. Paul, why don't you just add some more color to progress on Sonnet?

Paul MacDonald – *Executive Vice-President, Personal Insurance & Digital Channels, Definity Financial Corporation*

Yes, absolutely. Thanks, Rowan. Yes, that's correct. We are actually seeing an increased interest in the market. We're seeing an increased focus on quote volume and bind volume. We are supporting that with increased marketing attention to the segments that are profitable for us. Although, when you look at the aggregate level, our unit count is relatively flat, underneath that actually is a contraction in Alberta, as we mentioned previously, and mid to high single digit growth outside of Alberta. We're quite pleased with that.

One other highlight, I would say as previously mentioned, how much more profitable and sustainable our affinity businesses is. I'm delighted to share that that is going very well for us. Whereas last year it represented about 20 percent of our GWP in the Sonnet portfolio, it's now up to almost 28 percent. On the unit basis, it used to be about 25 percent of our units last year and it's now up to 33 percent over unit. We continue to market to that segment in particular and that segment is very interested in the digital self-serve capabilities that we have to offer, and so it will continue to drive that entire portfolio to that path of profitability by the end of this year.

Jaeme Gloyn – *Analyst, National Bank Financial*

Good, that's great. Thanks very much.

Operator

Your next question comes from Paul Holden with CIBC. Your line is now open.

Paul Holden – *Analyst, CIBC*

Thanks. Good morning, all. I apologize, I'm a little bit late. Hopefully, you haven't already answered these questions. But a few for you. First off, an update on personal auto and where earned rates sit versus written and then, of course, where claims inflation is as well, please?

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Go ahead, Paul.

Paul MacDonald – *Executive Vice-President, Personal Insurance & Digital Channels, Definity Financial Corporation*

Yes, thanks for that question. On a written basis in Q1, we're about 13 percent and on an earned basis, we're just over 10 percent. That was a strong contribution to that 15.6 percent growth that we experienced in the quarter. In terms of actual severity and inflationary statistics, what we are seeing is a continued stabilization over the year-over-year inflationary or severity increases. We're in about the mid-single digits in essentially all of the lines both on the physical damage side and on the casualty side, which

is reassuring, because it has given us an opportunity for our rates to begin to catch up. As we mentioned, in Q4, we crossed over where rate achievement was in excess of the trend.

One highlight I will add to that is theft. We've talked about theft extensively before, and theft continues to be very elevated relative to pre-pandemic levels. However, theft was very elevated last year. On a year-over-year basis, actually, the impact is very flat. If you unpack that, what we're seeing is a slight increase in severity on individual theft. That's really representative of the fact that there are more new vehicles now becoming available in the marketplace. Shoppers are buying more vehicles and therefore more vehicles with higher content are being stolen.

But on a positive note, we are seeing a significant, almost a double digit decrease in frequency in theft year-over-year. Our frequency and our rate are covering the severity components and that's why it leads to a flat year-over-year result. We're watching this space carefully to make sure that we continue on in a positive manner. If we continue to see frequency reductions as is, that bodes well for the future. Of course, we're working actively with IBC and various governments to ensure that we take every action possible to reduce the impact of theft on our portfolios.

Paul Holden – *Analyst, CIBC*

Okay, that's great. Couple of follow up questions on that. In terms of the difference between the written rate and earned rate, should I assume the earned rate migrates towards that 13 percent? I think so but tell me if I'm wrong. Then second question is that 13 percent, it's abnormally high number, how long can that continue for? Can we see that written rate continue, at least for the remainder of '24?

Paul MacDonald – *Executive Vice-President, Personal Insurance & Digital Channels, Definity Financial Corporation*

Yes. To answer your first question, yes, it's reasonable to expect that our earned rate will tick up by a couple of points for the remainder of the year as that high written rate activity from last year and into beginning of this year earns through the portfolio. Again, that's positive for the profitability of this line. To answer your second question, we believe it is a firm market. The entire market is taking double digit rate. It was necessary after a prolonged period of very flat, and in some cases negative rates, obviously, with the inflationary severity trend we've seen in the marketplace, that the entire market had to take that rate. Our expectation is we will remain at that level for the duration of this year.

Paul Holden – *Analyst, CIBC*

Great. One last question for me. Here, I had some data points suggesting a slowing or less firm rate market in commercial. Are you seeing any evidence of that, assuming it doesn't show up in your premium growth, which remains very strong. But wondering if you're seeing any early indication of, not soft markets, but I don't know, less firm, less hard?

Fabian Richenberger – *EVP, Commercial Insurance & Insurance Operations, Definity Financial Corporation*

Fabian here. Maybe to give you a little of color on your question. We've seen a couple of segments in the commercial space that have become a little bit more competitive, but I would say overall, the commercial marketplace is remaining firm and being attractive to drive growth. Maybe there are three additional insights I wanted to share with you in relation to the question that you just asked.

As you've seen, from our disclosure, our premium grew by 15.8 percent in Q1, and about half of the growth has been generated through rate and inflation adjustments, and that gives us a great deal of confidence that we are continuing to cover our loss trends in our portfolio. With that in mind, we are very confident that we can continue to run the commercial portfolio in that low 90s combined ratio range.

The second point I would like to make is that outside of the rate growth that we've had, as you know, from prior disclosures, we are focusing on driving growth in our small business. In our specialty segments, we have a very strong value proposition in those segments. We have great support from our broker partners and most importantly, we have very strong underwriting capabilities. We are very comfortable with the margin position that we have in those segments. The new business that we have been adding to our portfolio, we do expect to be profitable as well. Despite increased competitive compensation that you're referring to, our retention rates are holding quite nicely in that mid-80s, to high 80s range. Overall, no concerns with the growth and the profitability that we have in our commercial segment overall.

Maybe the last point to add is that if you look at our portfolio, what is important to understand is that the vast majority of our portfolio is in premium bands, so 100,000 or less. Given the fact that the pricing elasticity in those bands, is not lower, we have a very good opportunity to retain our profitable business, effective rates, and retention numbers.

Overall, very pleased with the growth momentum that we have in commercial, and very pleased with the underlying profitability that we have. As you know, we are always putting a premium on protecting our profitability. Maybe the growth rate might come down by a couple of points, as you're

making the right tradeoff decisions in growth and margin protection. But with the strength that we have in our teams, very strong underwriting culture, and a very strong actuarial capability that we have built in the last five years, we're very confident that we can sustain combined ratio in the low 90s and keep the growth in that low double-digit range as well.

Paul Holden – *Analyst, CIBC*

Okay, sorry, I have to ask a follow up because the price elasticity point you brought up was really interesting. You're suggesting where you're competing in the market because it's smaller to mid-size accounts, less price elasticity versus large commercial, where that might be the opposite higher price elasticity. Do I understand that correct?

Fabian Richenberger – *EVP, Commercial Insurance & Insurance Operations, Definity Financial Corporation*

Maybe not so. That is a typical sign of less firm market. If you're a company that has 250 to 500 thousand in team expenses with new capacity coming into marketplace, means these accounts are being chased more. The other point that is important to recognize is that lower premium bands, we have very strong value proposition that are mitigating the impact of price. In that small business space, is developed that digital capability that allows our brokers to quote and bind business in an automated fashion and our renewables segments are on an automated basis as well. That additional benefit of service and the ease of doing business is mitigating the importance of price by the fact that we're looking at it that this quarter in the last few quarters. We're quite comfortable that we can sustain attractive rates and renewal rate in the smaller in the commercial marketplace.

Paul Holden – *Analyst, CIBC*

Got it. Okay, I'll stop there with the questions. Thanks for your time.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press star followed by the one. Your next question comes from Doug Young with the Desjardins Capital Markets. Your line is now open.

Doug Young – *Analyst, Desjardins Capital Markets*

Good morning. Phil, you mentioned the Facility Association and I just wanted to dig into this in terms of what you're seeing within that book, specifically in Alberta, but in general. Is there anything to worry about in terms of what you're seeing in terms of the growth of the Facility Association? Is pricing adequate within the Facility Association? Is it below where the industry is pricing? Just hoping to get a little bit of color.

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Yes, I'd lump FA in with the risk sharing pools. It's more of a pickup that we're seeing in the risk-sharing pools themselves than the pure FA. That's the increased usage from the industry. We're not seeing really a big change from the Facility Association itself. It's more about the usage of the pool. We just talked about them collectively, when we think of it in that fashion. Facility Association we're still seeing as pretty

normal behavior and stability and activity coming back from. It's the pools where we've seen the increased activity. Paul, I don't know if you want to add any flavor?

Paul MacDonald – *Executive Vice-President, Personal Insurance & Digital Channels, Definity Financial Corporation*

Just a bit more colour on there. As Phil mentioned, the industry is utilizing the pools more particularly around the theft area. But of course, the industry itself is taking significant rate to cover theft. We would expect that trend to mediate a bit throughout the year. The pools naturally grow from that perspective, and then there's an assessment back to that. We'll watch the space carefully to see how this develops.

Doug Young – *Analyst, Desjardins Capital Markets*

We're not seeing a return to the bad days of the Facility Association, is essentially the messaging that I'm getting there?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

We're not seeing that. We're just seeing an increased usage of the pools but we're also responding with the increased usage ourselves. It's more muted when they actually take it through to the net impact.

Doug Young – *Analyst, Desjardins Capital Markets*

Yes. That's fair. Just back on the M&A side and broader or bigger question. I understand the strategy around the roll up in the broker side, and looking at manufacturing and insurance in Canada, have

you started to—if you can't find anything of size in Canada, have you started looking outside beyond the Canadian region in terms of opportunities to deploy capital, or is it strictly remain just Canadian focus?

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Yes, our priority and definitely the focus is on Canada. When you think about the thesis that we do think consolidation is going to continue to pick up in Canada after a bit of a pause. When you think about the platform we've built in Canada, which really is being built for a bigger business than we are. The natural synergies we would get the support from the broker distribution, and the fact that we've got a very seasoned and experienced team that knows how to operate in Canada. That is, clearly, any in market acquisition is definitely top of our list and top of our priority.

At this stage, we don't feel that it's necessary to depart from that in terms of priority. That doesn't mean we'd never say no to it ever. Of course, we'd have to think very carefully about that. It'd have to be in a certain line of business, etc. But what I would share to you, meanwhile, where we're active and where we're putting our attention in is definitely in market carrier focus.

Doug Young – *Analyst, Desjardins Capital Markets*

Appreciate the colour. Thank you.

Operator

Your next question comes from Stephen Boland with Raymond James. Your line is now open.

Stephen Boland – *Analyst, Raymond James*

Sorry, I apologize if this was asked. Just in terms of optimizing your balance sheet looking to do some term debt, is there a possibility that you come to the market before there's actually a need, or is it going to be coincident with some acquisition?

Philip Mather – *Executive Vice-President and Chief Financial Officer, Definity Financial Corporation*

Hi, thanks. It's more likely that we do it coincident with M&A activity. The only caveat to that one is you see we have drawn somewhat on the debt facility that we have in place. To the extent on the broker distribution side that runs up to a sizable enough action to support an issuance from our sales, we might look at that. It's more likely in the scenario of a more concerted deployment of capital through M&A.

Stephen Boland – *Analyst, Raymond James*

Okay, and the second question, again, I apologize if it was asked, is the Alberta government recently or the regulator commission to reports consensus is that they're not very effective or not telling a true story. I'm just wondering if you have any comments on the reports.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

Go ahead, Paul.

Paul MacDonald – *Executive Vice-President, Personal Insurance & Digital Channels, Definity Financial Corporation*

Thank you. We share the industry's general concern with the reports, in particular the report that tried to calculate the impact of the cost consumers in comparing various different jurisdictions and

different methods. We've shared those concerns through the industry and directly with the government. We continue to work proactively with government with regards to their reforms. We are encouraged to hear that they are looking to put reforms to the system. We're certainly watching that space and determining the extent to which and the timing of those reforms will impact the portfolio. But yes, there are concerning reports in terms of the methodology.

Rowan Saunders – *President & Chief Executive Officer, Definity Financial Corporation*

The only thing I would just add to that is, that as we've shared in the past, obviously, the environment in Alberta is less attractive to us than other provinces. When we think about our portfolio in Alberta, it's only 12 percent of our total auto portfolio. We've got 5 percent of that in Sonnet and 7 percent in the broker business. The broker business is in a different position from our Sonnet business, brokers are much more mature business. Whilst there is some compression on the margin as this takes time to unfold, we do think eventually the government will end up with some form of a reasonable outcome and reforms in place. But in the meantime, we continue to contract our Sonnet business and we've been in discussions with the government.

Our business in Sonnet now is down to about $66 million. Whilst this has been a drag, the drag is getting smaller for us. Paul and his team have turned the marketing off there. Really that position we keep risk managing that area, and all the other growth has really been redirected to other more attractive divisions, regions. We will continue to engage and watch how that unfolds.

Stephen Boland – *Analyst, Raymond James*

Okay, thanks very much.

Operator

No further questions at this time, I will now turn the call over to Dennis for closing remarks.

Dennis Westfall – *Head of Investor Relations, Definity Financial Corporation*

Thank you, everyone for participating today. The webcast will be archived on our website for one year. A telephone replay will be available at two o'clock today until May 17. A transcript will be made available on our website. Please note that our second quarter results for 2024 will be released on August 1. Please also note that we will be hosting our inaugural Investor Day on Thursday, September 19. Additional details will be posted on our website closer to the event. That concludes our conference call for today. Thanks, and have a great one.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.