Analyst Commentary

May 7, 2008

Recommendation
Buy

Risk
Low

Target Price
$56.00

Price
$47.30

52-Week Range
$43.23 – 56.50

% Below High
-16.3%

% Above Low
9.4%

Shares O/S
562 million

Market Cap
$26.4 billion

Average Daily Volume
20 day: 1,662,000

Year-End
December 31

C$	EBITDA	Multi.
2007a	$3.98	11.9x
2008e	$4.15	11.4x
2009e	$4.60	10.3x
Book Value	$28.31	1.7x

	Amount	Yield
Dividend	$1.44	3.0%

Analysts
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SUN LIFE FINANCIAL

(SLF-TSX - $47.30)

Data Source: www.BigCharts.com

Q1/08 LOWER THAN EXPECTED

CONCLUSION: BUY – 12-MONTH TARGET LOWERED TO $56.00

Operating EPS were reported at $0.93, down 4% Y/Y and below our forecast and consensus by $0.07. In the quarter, currency was a negative $0.07 and credit-related write-downs of $0.12 per share, including higher reserves of about $0.07 per share driven by volatile equity markets. On a constant currency basis, EPS would have increased by 4% Y/Y. ROE decreased to 13.4% in the quarter from 14.3% last quarter, but was up from 12.0% in the same quarter last year.

We are scaling back our 2008 estimate to $4.15 from $4.35, due to lower projected growth in AUM and lower returns on investments. The 2008 estimate factors in the expected $0.05 accretion in 2008 from the Genworth U.S. Group Benefits business and slower earnings gains in Asia and MFS. The positive news is that a return to more historical credit spreads could see some recapture into earnings from the reserves added this quarter. Our 2009 EPS estimate has been lowered to $4.60 from $4.70, which is slightly above management's objective of 10% average EPS growth. The dividend payout ratio approximates 35% of our 2008 EPS estimate. Investors should expect a dividend increase of about 9% over the next 12 months to the $1.56 level, which will be significantly below the 20% growth experienced last year.

Valuation

We value SLF on a component basis and have split our valuation between the life insurance business and the asset management business. We have placed a 12-month target valuation on the life insurance business of $40.70 and a valuation on the wealth management group of $15.30 for a total valuation of $56.00, down from $58.00 previously. This valuation would indicate that we expect SLF to support a P/E multiple of 12.3 times our 2009 EPS estimate or about 5% below the average of Great-West Lifeco (GWO) and Manulife (MFC). The total expected return over the next 12 months is 21.6%.

In summary, our valuation for SLF is based on the two principal components:

(1) **Sun Life Assurance,** the core insurance business, which we believe will support a P/E of 12.1x 2009 net earnings or $40.70 and,

(2) **Sun Life Financial,** the asset management business valued at $15.30 per SLF share as follows:

- **MFS,** the U.S. asset manager (approx. 96% owned), which we believe should support a P/E of 18x our 2009 forecast earnings of contribution to SLF of $0.55 per share or $9.90 per SLF share.
- **McLean Budden**, institutional investment management company (56% owned). We estimate that McLean Budden should support a multiple of 22x estimated 2009 earnings of $39 million, which would represent an equity value of approximately $0.85 per SLF share.
- **C.I. Financial,** mutual fund management company (36.5% owned). We value C.I. Financial based on our 12-month target price which was recently lowered to $25.00 from $26.50 and which now translates into $4.55 per SLF share.

Negatives in Quarter

Currency Impact - Constant currency EPS were $1.00 in Q1/08 versus reported operating EPS of $0.93, which would imply an increase Y/Y of 4% versus the negative 3% reported. The currency impact in Q1/08 alone was negative $43 million, which is the highest yet for a quarter. Based on the current C$:US$ exchange rate (about par) we would expect the negative impact on EPS to continue in Q2/08 but moderate in the second half and have a slight positive.

Credit-Related Write-Downs – One-time credit-related write-downs and reserve strengthening amounted to about $0.12 per share. Widening of credit spreads required management to increase reserves by $0.07 per share. Some of this reserve strengthening could be reversed if credit spreads narrow.

MFS – AUM Declines 4% Y/Y – 2008 & 2009 Estimates Lowered Marginally

MFS reported lower Q1/08 earnings of $59 million, down 18% sequentially and Y/Y. Earnings in US$ were down a more modest 3%, driven by a 4% Y/Y decline in AUM to US$184 billion. The AUM decline was driven by volatile equity markets (down US$12.4 billion) and net redemptions of US$2.7 billion. Pre-tax margins increased to 35% from 34% in the same period last year. Margins are expected to stabilize at closer to the 36% level over the next 12 months, as MFS recently made investments in its global distribution and added to its investment teams.

Net redemptions on retail mutual funds in Q1/08 were somewhat disappointing, as they increased to US$1.9 billion from US$0.6 billion in the same period last year and well above the last eight quarters net redemption run rate of US$1.4 billion. Retail redemptions were US$6.8 billion, due to the volatility in the U.S. market. Gross retail sales continued good at US$4.9 billion. Managed Funds (largely institutional) experienced a net redemption of US$0.9 billion.

We have lowered our estimated 2008 MFS contribution to SLF to $0.50 per SLF share from $0.53 per SLF share, due to a lower AUM expected for fiscal 2008. We forecast a 10% increase in 2009 to $0.55 per SLF share.

Other Quarterly Highlights

- **SLF overall consolidated net income** in Q1/08 was reported at $533 million, down 4% Y/Y. As noted, earnings on a constant currency basis would have been closer to $576 million, for a gain of 3% Y/Y. Volatile equity markets, wider credit spreads (lower investment valuations) and higher reserves were also significant negative factors in the quarter and lowered earnings by an estimated $0.12 per share.

- **SLF Canada reported net income in Q1/08 of $247 million, down 1% Y/Y.** The quarter had flat sales in Individual Insurance Y/Y. Individual Wealth reported sales down 4% Y/Y as segregated fund sales increased 6% Y/Y benefiting from the new SunWise Elite Plus product, while sales of mutual funds declined 18% Y/Y. Net income from Individual Insurance increased by 2% Y/Y while Group Wealth and Group Benefits dropped by 4% Y/Y. Lower equity markets had the largest impact.
- **SLF U.S. reported better earnings**. The U.S. operations of SLF reported Q1/08 net income of $113 million, up 15% Y/Y. On a constant currency basis, net income advanced 35% Y/Y. The improvement was partly the result of higher strain last year and the addition of Genworth Financial's U.S. Employee Benefits Group (EBG) which experienced an increase in business in-force to US$2.0 billion from US$1.2 billion last year.
- **SLF Asia reported weaker earnings** of $13 million, down 35% from $38 million last year. Sales in Asia continued strong, increasing to $259 million, up from $135 million on a Y/Y basis. The lower earnings resulted from higher than expected spending to expand distribution.
- **SLF repurchased about 2.4 million common shares** in Q1/08 for $110 million. Our 2008 and 2009 EPS estimates are based on a share repurchase program of 10.5 million shares.

Asset Backed Bond Exposure Remains Relatively Small

Management updated its exposure in asset backed bonds, with the total exposure at C$6.3 billion (of which 99.5% were investment grade), down from $6.6 billion as at the end of last quarter. The bulk of its investments are in Commercial Mortgage Backed Securities (CMBS) and Residential Mortgage Backed Securities (RMBS) which are virtually 99.9% investment grade and fixed rate. It was also indicated that the exposure to Collateralized Debt Obligations (CDO) lending is relatively small at $355 million.

Recent U.S. Group Benefits Acquisition

On May 31, 2007, SLF completed its acquisition of Genworth Financial's U.S. Employee Benefits Group (EBG). EBG's operations offer primarily group life, disability, stop-loss and dental insurance. The acquisition of EBG should prove strategically positive with low integration risks. It will add to SLF's existing U.S. group business and position it as the #5 provider of Group Life & Disability insurance in the U.S., plus make it the #2 provider of medical stop-loss insurance. This acquisition added much-needed scale and distribution for SLF in the U.S. market. Management continues to expect the acquisition to be accretive in 2008 by $0.05 per share.