View from Outside: What is the Logic Behind Consolidation? Does it Create Value?

Brian Shea, Head of Europe, Willis Capital Markets & Advisory

11th Symposium on Insurance Strategies

Consolidation in Insurance: What is it about?

6 November 2015, London
VIEW FROM OUTSIDE:
WHAT IS THE LOGIC BEHIND CONSOLIDATION?
DOES IT CREATE VALUE?

Geneva Association Symposium, 6 November 2015

Brian Shea, Head of Europe, Willis Capital Markets & Advisory
SUMMARY

1. What has been happening?

2. Drivers – Past, Present and Future

3. Does this activity create value?

4. Conclusions
2015 ALREADY A RECORD YEAR, EVEN EXCLUDING THE LARGE US HEALTH DEALS

Global insurance M&A activity (USD b)

Source: SNL Financial and WCMA Estimates.
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HISTORIC M&A DRIVERS – THE USUAL SUSPECTS

- Expand product portfolio
- Geographical expansion
- Add distribution channels
- Scale
  - Cost-cutting
  - Capital savings
  - Diversification
  - Better offering through bigger offering
- Value chain adjacency
  - e.g. insurer buying asset manager
  - e.g. bank buying insurer
- Outside money
  - Private equity
  - Run-off specialists
- Management egos
TODAY’S DRIVERS ARE SLIGHTLY DIFFERENT

Some of the historic drivers have particular relevance today; cyclical drivers too

- Greater impetus for scale
  - Solvency 2 raises fixed costs
  - Solvency 2 gives explicit credit for diversification
  - Tiering of reinsurance sector
  - Low interest rates drive greater need for cost efficiency

- Value chain adjacency
  - Has moved on to traditional capital / alternative capital

- Softening P&C market, growth harder to find

- A way to invest excess capital

- New money is attracted to the sector
  - e.g. a way to generate float
  - And/or a lower perceived cost of capital
WE PUT SCALE AS THE BIGGEST DRIVER

($ in billions)

Deal Rationale by $ Amount (Transactions >$1bn)

Source: SNL Financial and WCMA Estimates.
IN FUTURE, THE DISRUPTION OF VALUE CHAIN . . .

Historical value chain

Today’s value chain

The Future?

Source: WCMA Estimates.
IN FUTURE, THE DISRUPTION OF VALUE CHAIN ...
M&A is not the main panacea. More important is to:
- Not be held back by legacy data stores and IT systems
- Be open-minded about using external data sources

But M&A can:
- Provide technology and/or proprietary data
- Seed the organisation with a change agent

A few technology-drive acquisitions already
- MS&AD / Insure the Box; Generali / MyDrive
- Private equity has been more active in the space than insurers
- So have other ‘value chain adjacency’ players – eg TomTom, Vodafone, Verizon

If disruptive technology works, and claim costs fall, could also drive more traditional ‘scale’ M&A
- Shrinking premium income encourages acquisitive growth
- Shrinking capital requirement produces ample funding ability
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DEAL MULTIPLES HAVE BEEN GOING UP . . .

Source: WCMA Estimates
... BUT LOW COST OF FINANCING IS STILL GENERATING EPS ACCRETION ...
... AND EVEN THOUGH BV DILUTION IS INCREASING, SHARE PRICE REACTIONS HAVE BEEN FORGIVING

[Graph showing percentage change over time with specific points marked for 1/12, 1/13, 1/14, and 1/15.]

Source: SNL Financial and WCMA Estimates.
LONGER TERM, EVIDENCE DOESN’T SUPPORT THE VIEW THAT M&A DESTROYS VALUE

**Relative Stock Performance Post Announcement**

- **Days Post-Announcement**
  - 0
  - 30
  - 90
  - 180
  - 360
  - 720
  - 1080

- **Relative Stock Performance Post-Announcement**
  - 0.00
  - 0.50
  - 1.00
  - 1.50
  - 2.00
  - 2.50
  - 3.00
  - 3.50

**Note:** Average across insurance M&A since 1995 where deal size ≥ $1bn and deal size ≥ 20% of acquirer’s market cap.

Source: SNL Financial and WCMA Estimates.
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CONCLUSIONS

1. The current hump of M&A activity has not yet run its course

2. Disruption of the value chain will drive future M&A

3. Deal multiples have been increasing

4. The EPS impact is being softened by cheap financing, but higher multiples are driving up book value dilution

5. Still, the short-term perception of value creation has become more forgiving

6. And the traditional view that M&A destroys value is not supported by longer-term share performance

7. Investment bankers need to be industry experts
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5. Appendix
<table>
<thead>
<tr>
<th>Announce Date</th>
<th>Acquirer / Target</th>
<th>Deal Value</th>
<th>Acquirer Market Cap</th>
<th>Consideration % of Acquirer Market Cap</th>
<th>Purchase Price / Target TBV</th>
<th>Acquirer P / TBVPS Pre-Deal</th>
<th>Est. TBVPS Acc. / (Dil.)</th>
<th>Est. EPS Acc. / (Dil.)</th>
<th>Acquirer Stock Price D 1-Day</th>
<th>1-Week</th>
<th>1-Month</th>
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<tbody>
<tr>
<td>4/20/11</td>
<td>Hanover / Chaucer</td>
<td>$503</td>
<td>$1,981</td>
<td>25.4%</td>
<td>1.10x</td>
<td>0.81x</td>
<td>(1.9%)</td>
<td>11%</td>
<td>(5.4%)</td>
<td>(4.4%)</td>
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<td>11/21/11</td>
<td>Alleghany / Transatlantic</td>
<td>3,534</td>
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<td>0.82x</td>
<td>0.92x</td>
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<td>90%</td>
<td>(6.8%)</td>
<td>(11.8%)</td>
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<td>Validus / Flagstone</td>
<td>623</td>
<td>3,124</td>
<td>19.9%</td>
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<td>0.93x</td>
<td>4.2%</td>
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<td>Markel / Alterra</td>
<td>2,973</td>
<td>4,678</td>
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<td>1.04x</td>
<td>1.50x</td>
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<td>Dai-ichi / Protective</td>
<td>5,708</td>
<td>14,026</td>
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<td>0.83x</td>
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<td>11/24/14</td>
<td>RenRe / Platinum</td>
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<td>3,909</td>
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<td>1.13x</td>
<td>1.17x</td>
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<td>Aviva / Friends Life</td>
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<td>XL / Catlin</td>
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<td>Endurance / Montpelier Re</td>
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<td>1.05x</td>
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<td>6%</td>
<td>(4.9%)</td>
<td>(3.4%)</td>
<td>(5.3%)</td>
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<td>Tokio Marine / HCC</td>
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<td>30,134</td>
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<td>2.51x</td>
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<td>11%</td>
<td>0.5%</td>
<td>0.5%</td>
<td>2.1%</td>
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<td>6/30/15</td>
<td>ACE / Chubb</td>
<td>28,252</td>
<td>33,182</td>
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<td>1.38x</td>
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<td>9/8/15</td>
<td>MSI / Amlin</td>
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<td>26%</td>
<td>(2.9%)</td>
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