Citi Research

Deep Dive | **Equities**

8 October 2014 | 44 pages

Global

Global Insurance

Putting its Money Where its Mouth is: FCF Supports Positive View

- **Global Insurers generating under-appreciated free cash flows** — Our latest analysis suggests 'holding company' FCF yields in the global insurers of ~7% in 2015e, compared to an estimated global equity market average of ~5%. While historically there may have been good reasons for the market to put a lower multiple on insurance cash flows (e.g. opacity, volatility, balance sheet concerns), we think some of these negative drivers are starting to disappear.

- **FCF supports our constructive view, especially on global life and Europe** — Our forecasts for free cash generation from global insurers support a generally positive view on the sector, especially on the life insurance names, where profit drivers are more opaque, and European insurers. We are least positive on the US P&C and global reinsurance names:

  - ***Stronger cash flow yields emerging in Europe.*** Partly due to the stronger performance of US insurers, the European insurers currently offer the highest regional FCF yields (~8%). We believe greater capital clarity on Solvency 2 will support stronger than expected dividend growth in European insurance, where average dividend yields are already close to ~5% (2015e).

  - ***Capital return remains a supportive theme.*** US insurers have been prominent capital return stories, returning >100% of FCF through dividends and buybacks – and we expect this to continue in coming years. Increasingly, we expect capital return will become a theme in Europe too, with more life & composite insurers considering buybacks / special dividends in the next few years.

  - ***Quality of life earnings improving.*** Initiatives to improve focus on cash generation in the life sector (e.g. shifting business mix to less capital intensive products) are bearing fruit, in our view. We estimate the ratio of FCF to reported earnings is ~70% on average for global life names.

  - ***P&C and reinsurance pricing concerns dwarf buyback potential.*** Global P&C names have been active in returning capital to shareholders, reflecting excess capital in the industry. However, an environment of negative pricing in global reinsurance and US P&C sectors could offset the valuation benefits of this.

- **Buy AIG, Allianz, CNO Financial and Progressive** — We highlight these stocks as those benefitting the most from improving cash or capital return themes in the global insurance sector. AIG and Allianz are also both on the Citi Focus List. We believe AIG is a compelling capital return story, supported by its deferred tax assets and monetization of non-core assets. We expect Allianz to radically improve its dividend and capital return policy in the next 5-years. CNO offers one of the strongest FCF yields in the US life sector, with potential to buyback ~20% of its market cap. Progressive appears to be reaching an inflexion point earnings growth and offers the prospect of a special dividend.

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Contents

Figure 1. Summary of European and US Free Cash Flow – 2015e

European Insurers	Admiral	Ageas	Aegon	Allianz	Amlin	Aviva	AXA	Catlin	Delta Lloyd	Direct Line	Esure	Hiscox	Lancashire	L&G	Generali	Hannover Re	Munich Re	Prudential	RSA	SCOR	Standard Life	Swiss Re	Zurich
	£bn	€bn	€bn	€bn	£bn	£bn	€bn	$bn	€bn	£bn	£bn	£bn	$bn	£bn	€bn	€bn	€bn	£bn	£bn	€bn	£bn	US$ bn	US$bn
Life new business capex	0.0	-0.3	-1.5	-1.8	0.0	-0.3	-2.2	0.0	-0.2	0.0	0.0	0.0	0.0	-0.2	-1.6	0.0	-0.8	-0.7	0.0	-0.2	-0.3	0.0	-0.9
Life in-force cash flow	0.0	0.6	3.0	3.6	0.0	1.5	4.8	0.0	0.6	0.0	0.0	0.0	0.0	0.9	3.0	0.2	1.9	2.7	0.0	0.4	0.8	0.9	1.5
Life FCF	0.0	0.3	1.5	1.8	0.0	1.3	2.5	0.0	0.3	0.0	0.0	0.0	0.0	0.7	1.4	0.2	1.1	2.0	0.0	0.2	0.6	0.9	0.5
P&C FCF	0.3	0.2	0.0	3.1	0.2	0.5	2.7	0.2	0.1	0.3	0.1	0.1	0.2	0.0	1.1	0.6	1.8	0.0	0.6	0.3	0.0	1.1	2.4
Other FCF	0.0	0.0	0.0	1.7	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.0	0.3	0.4	0.0	0.0	0.1	0.0	0.9
Operational FCF	0.3	0.4	1.5	6.5	0.2	1.8	5.8	0.2	0.4	0.3	0.1	0.1	0.2	1.0	2.8	0.8	3.1	2.4	0.6	0.5	0.7	2.0	3.9
% remittance to HoldCo	95%	74%	91%	116%	95%	79%	78%	95%	85%	95%	95%	95%	95%	95%	75%	97%	84%	64%	90%	97%	76%	95%	88%
Dividends to HoldCo	0.2	0.3	1.3	7.6	0.1	1.4	4.5	0.2	0.4	0.3	0.1	0.1	0.2	0.9	2.1	0.8	2.6	1.5	0.5	0.5	0.6	1.9	3.4
HoldCo costs	0.0	0.0	-0.2	-1.2	0.0	-0.6	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	-0.1	0.0	-0.3	-0.2	-0.1	-0.1	0.1	0.0
Holding company FCF	0.2	0.3	1.1	6.4	0.1	0.8	3.3	0.2	0.4	0.3	0.1	0.1	0.2	0.9	1.4	0.7	2.6	1.2	0.3	0.3	0.5	2.0	3.4
HoldCo FCF per share	0.87	1.34	0.54	14.06	0.29	0.28	1.37	0.47	1.78	0.23	0.15	0.37	1.06	0.16	0.90	6.18	15.59	0.48	0.34	1.84	0.21	5.26	22.80
HoldCo FCF yield	7%	5%	8%	11%	7%	5%	7%	9%	9%	8%	7%	6%	16%	7%	6%	10%	10%	3%	7%	8%	5%	7%	8%
Dividend cover from HoldCo FCF	1.0	0.9	2.2	2.1	1.1	1.7	1.5	0.9	2.1	1.3	0.9	1.7	1.0	1.5	2.0	2.0	2.1	1.2	2.4	1.4	1.2	1.2	1.3
HoldCo FCF / Earnings	83%	42%	66%	95%	68%	51%	58%	54%	66%	81%	61%	71%	93%	91%	57%	91%	96%	44%	95%	65%	82%	73%	78%

US Insurers	ACE	AIG	Arthur J Gallagher	Allstate	Aon	Axis	Chubb	Marsh & McLennan	Progressive	Renaissance Re	Travelers	Aflac	Ameriprise	CNO Financial	The Hartford	Lincoln	Metlife	Principal Financial	Prudential Inc	RGA	Torchmark	Unum	Voya
	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn
Dividends from life insurance subs	0.1	3.4	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.1	0.8	0.3	0.5	0.8	4.6	0.6	2.2	0.4	0.5	0.7	0.8
Dividends from P&C subs	0.7	1.9	0.4	1.7	1.5	0.4	1.5	1.3	1.2	0.5	3.4	0.0	0.0	0.0	0.8	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Earnings from non-insurance entities	0.0	2.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.2	0.1	0.1	0.2	0.4	0.7	0.1	0.0	0.1	0.2
Dividends to HoldCo	0.8	8.0	0.4	2.1	1.5	0.4	1.5	1.3	1.2	0.5	3.4	2.1	1.6	0.4	1.4	0.9	4.9	1.0	3.0	0.4	0.5	0.8	1.0
Holding company interest expense	-0.2	-1.2	0.0	-0.2	-0.2	-0.1	-0.4	-0.1	-0.1	0.0	-0.2	-0.1	-0.1	0.0	-0.4	-0.2	-0.7	-0.1	-0.4	-0.1	0.0	-0.1	-0.2
Other holding company expenses	0.0	-1.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	-0.1	-0.2	-0.1	0.0	0.0	-0.9	0.0	-0.1	0.1	0.0	-0.1	-0.2
Holding company FCF	0.6	5.8	0.4	1.9	1.3	0.4	1.1	1.2	1.0	0.5	3.1	1.8	1.3	0.3	1.0	0.8	3.3	0.9	2.5	0.4	0.5	0.6	0.6
HoldCo FCF per share	1.9	4.2	2.3	4.6	4.7	3.8	4.5	2.1	1.7	12.2	9.3	4.2	7.1	1.6	2.5	2.9	2.9	3.1	5.4	5.7	3.7	2.5	2.6
HoldCo FCF yield	2%	8%	5%	7%	5%	8%	5%	4%	7%	12%	10%	7%	6%	9%	7%	5%	5%	6%	6%	7%	7%	7%	7%
Dividend cover from HoldCo FCF	0.7	7.4	2.0	3.9	6.8	3.3	2.3	1.8	5.6	9.7	4.0	2.7	3.1	6.5	3.6	4.5	2.2	2.5	2.5	4.4	7.2	4.0	19.2
HoldCo FCF / Operating Earnings	20%	84%	78%	78%	77%	79%	59%	68%	93%	109%	106%	64%	76%	112%	66%	48%	48%	68%	53%	66%	82%	65%	80%

Source: Citi Research estimates

Cash Flow and Our Global Insurance View

While the global insurance sector continues to be viewed as relatively opaque, we believe the market may still be overlooking its capacity to generate and return cash to shareholders. We conclude that: i) Global Insurance FCF yields continue to significantly exceed the market – and stand out as particularly strong in European insurance; ii) we expect capital return and dividend growth to be an increasingly important driver in the global sector and iii) cashflow data supports our overall constructive view of the sector, but with a preference for global life names and relative caution on US P&C / reinsurers. Our preferred global stocks to play the FCF theme are: AIG, Allianz, CNO Financial and Progressive.

Free cash flow is becoming an important tool to understanding the global insurance sector and supplement traditional valuation models – especially as a means to compare insurers across inconsistent accounting and regulatory frameworks. We also continue to see evidence that management teams in both the US and Europe are more focused on demonstrating cash generation.

We continue to urge global insurers to provide better disclosure on cash

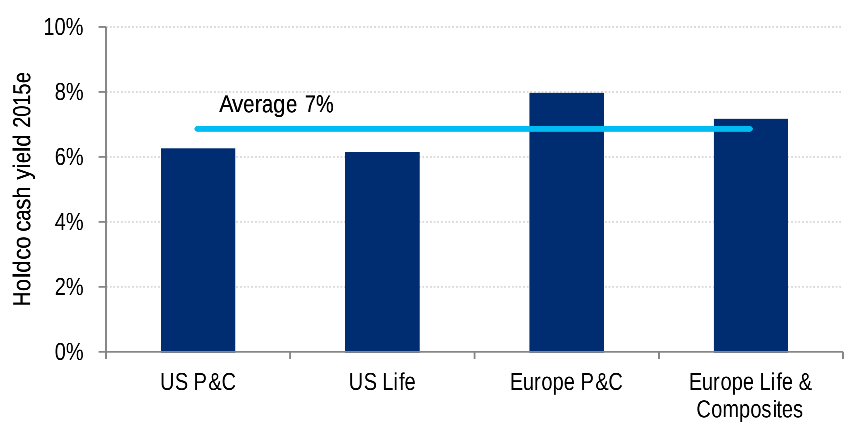
We continue to urge global insurers to provide better disclosure on this topic and still see a wide disclosure gap, with the Asian insurance sector lagging the US and Europe. We also believe global life and composite insurers would benefit from better disclosure on embedded value cash emergence, the drivers of cash (e.g. new business capex versus cash from in-force policies), and remittance ratios. We believe such disclosure would help to mitigate the global insurance sector's still high cost of equity.

We first examined cash flow on a global basis last year in July 2013 (Global Insurance: Show Us the Money - A Global Analysis of Free Cash Flow) and followed up with a more detailed piece on US insurers earlier this year (Cash Rules Everything Around Me - Examining Free Cash Flow Generation for US Insurers) – and we update this analysis in this report. Our analysis covers the European and US insurers – we have excluded Asian insurers due to a lack of comparable data at the current time – but we hope to expand our analysis in the near future.

FCF Supports a Constructive View on Global Insurers

We believe our free cash analysis supports a generally constructive view on the global insurance sector – but more so for life insurers where there is often less clarity over cash flow. We use the concept of a 'holding company FCF', i.e. cash remitted to group holding companies, less central and holding costs, as the most comparable measure of cash flow.

Figure 2. Global insurance holding company free cash flow yields (2015e)



Source: Citi Research estimates

Our analysis particularly supports a positive view on global life insurers

There is potentially a comparatively less positive case for some of the P&C and reinsurance stocks, where there is a less radical difference between cash flow and earnings, and where there may be other headwinds, e.g. pricing. In our analysis, we focus on 'holding company free cash flow', i.e. cash remitted to company HoldCos, less central costs. Broadly, we believe the key global insurance *sector* conclusions from our updated free cash flow analysis are as follows:

We estimate global insurance holdco FCF yields of 7% vs. 5% for the market

- **Global insurance FCF yields look stronger than the market** with an estimated 2015e holding company FCF yield of ~7% for the sector, a significant premium to the estimated 5% FCF yield to equity for the global equity market. While there may be some good reasons for the market to put a lower valuation multiple on insurance cash flows (e.g. volatility of earnings, opacity), we also think some of the negative drivers that have elevated the sector's cost of equity in recent years are starting to disappear. In particular, balance sheets look strong, and capital returns have improved. Holding company free cash flow, which only includes cash remitted from operational subsidiaries to the group HoldCo, probably underestimates the true underlying free cash flow of the global insurance sector due to regulatory and commercial restrictions on upstreaming capital. Adjusting for this, we estimate the sector's free cash flow yield could rise to ~8%.

- **Stronger cash flow yields emerging in Europe.** Due partly to the stronger performance of US insurers, it appears that a gap is opening up between European free cash yields and those in the US insurance sector. The US insurance sector has benefitted, in our view, from a capital return theme as improved balance sheets and a focus on cash generation (especially for some of the major US life insurance companies) has supported widespread buybacks. We believe greater capital clarity in Europe as Solvency 2 becomes better defined by next year, could provide a supportive catalyst for the European insurance sector – especially for European life & composite companies.

We anticipate stronger dividend growth and an increasing capital return theme in Europe after the finalization of S2

- **Capital return remains a supportive theme.** US insurers have been prominent in returning capital to shareholders in recent years, returning >100% of their holding company FCF generation (especially the P&C insurers), supported by strong balance sheets and underlying cash generation. Our cash flow forecasts support our view that this will continue, and we expect it to remain a supportive theme, particularly for the US life companies. Some European insurers (mainly P&C names) have also been returning capital, but we believe this could become more widespread as insurers benefit from better balance sheet clarity once Solvency 2 is finalized in the next 1-2 years. We anticipate stronger dividend growth from the European insurers in the next few years and increasing use of buybacks / special dividends in the European life & composite space – supported by strong free cash generation. Overall, we anticipate the global insurance sector providing a 6-7% capital return yield (i.e. combination of regular dividends, special dividends and buybacks) in 2015e.

Capital return from US P&C and reinsurers reflects negative pricing

- **Capital return theme may not offset headwind of US P&C and reinsurance pricing.** As we have already stated, there has always been less debate on cash generation in the P&C sub-sector. Therefore, our free cash analysis is probably better priced in for the P&C names. Their cash generative models and strong balance sheets have allowed US and European P&C insurers to be active capital return stories. However, we believe many P&C insurers maybe using capital return as a means to grow EPS in an environment of negative P&C pricing, which is being hurt by excess capital in the industry (and the influx of alternative capital). This is a particular headwind for the US P&C insurers and global reinsurers. While buybacks may be a good way to deal with a challenging business environment, we are not clear that these will always benefit valuation.

- **Quality of reported earnings for life companies appears better than commonly perceived.** A comparison of holding company cash flow to reported earnings suggests that the conversion of earnings into tangible cash continues to be better than the market may give the global life insurers credit for, with holding company free cash flow accounting for ~70% of reported earnings. As we point out in this note, this is primarily driven by capex needed to fund growth (which is not fully reflected in earnings) as well as regulatory restrictions on dividends or decisions not to repatriate foreign cash flow. Our analysis suggests relatively high correlation between P/E multiples and the conversion of earnings into FCF for the life names.

Key Stock Ideas

On the back of our analysis, we highlight 4 preferred stocks globally that we believe could outperform over the longer-term based on their FCF yields, capital return potential and quality of earnings. These are: Allianz, AIG, CNO Financial and Progressive.

Allianz – Buy (Citi Focus List Europe)

Allianz offers one of the highest global insurance FCF yields

As well as generating one of the highest holding company FCF yields globally (>10%), with a high remittance of cash to its HoldCo, we believe Allianz could be one of the first of the European composites to consider accelerating capital return to shareholders. Allianz benefits from sector-leading capital (with an economic solvency ratio in excess of 200%), relatively low debt leverage and in our view increasing degrees of capital freedom in the next 1-2 years as greater clarity over Solvency 2 starts to emerge.

We expect the company to improve its dividend payout ratio from the current target of 40% towards 50% over time (targeting >10% DPS CAGR) and as well as considering additional capital return measures, subject to commercial or regulatory constraints. Based on these factors, we see the company growing towards the 5%+ dividend yield level, with additional capital return potential.

While PIMCO is a potential source of downside risk, given recent net outflows from this business and its gearing to potentially rising long-term bond yields in the US, we believe the risks in this business are now better priced in to the stock.

AIG – Buy (Citi Focus List US)

Please see our AIG initiation published for more details. American International Group, Inc. (AIG).

We forecast AIG to return significant capital to shareholders over the next few years, driven by monetizing non-core assets and strong cash flow (which benefits from the company's sizable deferred tax assets). Specifically, we expect AIG to be able to free up capital from its Direct Investment Book and Global Capital Markets portfolios (estimated present value of $5bn) and equity stake in AerCap (current value of $4.5bn) over the next few years. In addition, we estimate that AIG has about $3bn of excess capital in its life business (568% RBC ratio vs. 475% target) and could free $3bn from its P&C operations over time. Finally, the company has deferred tax assets of $18B (we estimate a PV of $10bn), so it generates more capital than implied by reported earnings (which are shown on a fully-taxed basis).

Our analysis projects AIG to generate holding company free cash flow of $4-5bn in 2014 (~70% of operating earnings) and $5-6bn annually in 2015 and 2016 as benefits from the DIB/GCM runoff and DTAs increase. There is potential upside to these estimates if management can accelerate the runoff of the DIB/GCM or begins to monetize the AER stake (not included in our numbers). We expect most of this to be available for share repurchases, and our model assumes buybacks of $3.8bn, $4.5bn, and $4.0bn in 2014, 2015, and 2016, respectively. The key risk, in our view, is uncertainty surrounding non-bank SIFI capital rules, but so far AIG has been able to use the proceeds from asset sales to repurchase shares (as it did with ILFC).

While we believe AIG's capital return story is compelling, it is also well understood by the market, and our estimates for share repurchases are not meaningfully different from consensus. In our view, capital return should limit downside risk for AIG, but the key driver of future multiple expansion is improved profitability in the P&C business. We believe that AIG's current reported combined ratio could be overstated by 7 points due to adverse development on older accident years and conservatism on recent years. The company appears to have significantly improved underwriting in recent years, but this is being masked by still deficient reserves on older blocks (notably 2006-11 accident years, which we estimate to be $2.4B deficient). We suggest that AIG should use some of its excess capital to take a modest reserve charge (~$1.7B), which would eliminate the drag from adverse development and allow improved underwriting results to emerge more quickly. However, even if AIG does not take a charge, we expect gradual improvement in underwriting margins to drive P/BV multiple expansion over time.

CNO Financial – Buy

CNO generates the highest FCF yield of its US life peers and we expect it to return >100% of earnings to shareholders

CNO trades at an 8% FCF yield, highest in the US life group. The company pays minimal taxes (due to its sizable NOL), and its underlying business also generates strong cash flow given a focus on basic protection products. As a result, we expect CNO to generate among the highest FCF conversion ratios in the sector and return >100% of earnings through buybacks and dividends for the next few years.

We believe investors under-appreciate the sustainability of CNO's cash flow story. While management estimates that FCF will decline ~$50mn in 2016 as the company begins to pay some taxes, we project FCF conversion to remain in the 90% range for the next several years (as CNO will continue to benefit from its non-life NOL). This should allow management to sustain meaningful share repurchases and continue increasing the dividend.

In addition to strong cash flow, we also believe CNO has an opportunity to free additional capital by doing a leveraged recap of its balance sheet. The company is currently under-levered vs. peers (17% debt: capital) and could likely improve the terms of its outstanding debt given its improving credit profile. Based on our estimates, a recap could free $125-150mn for buybacks and be 60 bps accretive to CNO's 2015 ROE. Our model assumes a recap in 4Q15, but we believe it is likely management chooses to act sooner. In total, we project $710mn of share repurchases over the next 6 quarters, which represents ~20% of CNO's market cap.

Progressive – Buy

We think Progressive will pay another special dividend in 2014 in December

Progressive's subsidiaries have the ability to dividend almost $1.2 billion to the parent company in 2014, while earning are up over 10% year to date. We think this greatly enhances the company's ability to pay a special dividend later in the year.

Although Progressive does repurchase shares, dividends are the preferred method of capital deployment for the company. This is driven mainly by the stock's valuation, at over 2x book value. We think Progressive will end the year with about $650 million in cash above and beyond the $1 billion or so that the company likes to keep available. We think this will allow for the company to pay another $1 per share, or about 4%, which when combined with the company's annual ordinary dividend, would push the yield to over 6%.

Figure 3. Progressive Can Pay A $1 Per Share Special Dividend

Ending cash balance, 2013	**$1,800**
Shareholder dividends	($890)
Share repurchase	($223)
Subsidiary dividends	$1,170
Interest expense	($77)
Other sources and uses	($100)
Ending cash balance, 2014	**$1,680**
Cash retained at parent	$1,000
Remaining cash available for special dividend	**$680**

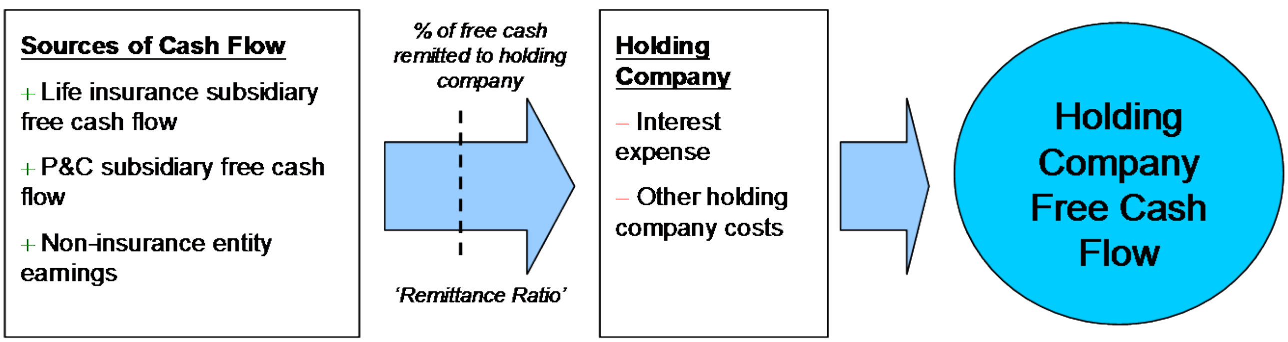
Source: Citi Research and Company Data

Global Conclusions from FCF Analysis

Since we first addressed this topic globally in mid-2013, we believe industry focus on cash generation has improved – particularly in global life insurance sectors with relatively opaque earnings. We see this as a supportive trend as absolute levels of free cash generation look strong in a market-wide context and should support increasing levels of capital return. This has been a key theme for US insurers, especially US Life companies, although for US P&C we believe capital return is unlikely to offset pricing headwinds. For European insurers, capital return could ultimately become a more prevalent theme once there is greater clarity on the implications of Solvency 2. We remain constructive on the global insurance sector overall, although with a bias towards life over P&C.

Why Cash Flow Matters for Insurers

Figure 4. Our definition of 'holding company free cash flow'



Source: Citi Research

Holding company FCF improves the comparability of global insurers across regulatory / accounting frameworks

Our global equity research has increasingly incorporated free cash flow analysis and we have written two major reports on this theme in the past two years: (Global Insurance: Show Us the Money - A Global Analysis of Free Cash Flow, Cash Rules Everything Around Me - Examining Free Cash Flow Generation for US Insurers). Given differences in the quality of disclosure on free cash we prefer to use the concept of a 'holding company free cash flow' (Figure 4), which measures the actual internal dividends paid to a company's HoldCo, less the costs at the HoldCo (e.g. interest, central costs). We believe free cash flow will continue to become an increasingly important metric for analysts and investors for the following reasons:

- **Accounting inconsistency.** GAAP and IFRS reporting methodologies remain inconsistent across different regions, and also in their treatment of assets and liabilities. This is particularly an issue for life companies, where often highly different product designs and regulations, as well as different accounting approaches to measuring liabilities, make it difficult to compare financial statements cross-border (and often even between different companies in the same market!). Free cash flow, on the other hand, measures how companies are using their operating models to generate actual cash, and is a far more comparable metric.

- **Less opaque than GAAP.** Insurance accounting frameworks contain a number of conventions that often make the sector opaque and may not relate to local regulatory or statutory accounting rules that actually govern how a company manages its capital and cash. Again, this is a particular issue in the life insurance sector which often relies on major intangible items to support profit measurement (e.g. embedded value, deferred acquisition costs). A focus on cash, and the ability to use cash throughout the group, can help to clear this opacity.

- **Relating the insurance sector to the market.** It has been generally very difficult to compare insurance company profitability and fundamental performance across the investment market as a whole, given its very sector-specific accounting approach and terminology. However, free cash flow allows us to do that – and we believe the insurance sector's cash flow metrics look surprisingly supportive in this context.

We urge global insurers to give us more disclosure on cash

Given these factors, we are seeing more investors globally using cash flow to supplement traditional valuation metrics in their approach to insurers. We continue to urge the global insurers to consider improving their disclosure on free cash generation, particularly for life insurers where there can be major discrepancies between reported earnings and underlying free cash flow. For example:

- Companies should increasingly explain the key drivers of underlying free cash generation (e.g. the cash emerging from the 'embedded value' of life contracts) and to what extent this cash generation is restricted from being remitted to the group due to regulatory restrictions.
- It would be useful to get a better grasp of how much 'capex' companies spend to grow and fund new business.
- The sector could benefit from a deeper understanding of potential cash emergence from 'legacy' life insurance books that no longer contribute meaningfully to new business and which the market may currently apply low valuation multiples to.

Key Drivers of Insurance Free Cash Flow

Life insurance requires significant upfront capex and breakeven may after several years

Free cash flow generation differs greatly between life and P&C insurers. Life insurance often requires significant upfront capital investment of acquisition costs and buffer capital, with returns emerging over relatively long duration policy terms. Breakeven may occur several years after a contract is written (although there appears to be increased management focus on improving breakeven periods globally).

For 'shorter-tail' P&C policies, breakeven can happen relatively quickly, and policies are generally immediately cash generative. Having said that, in longer-tail lines there is greater uncertainty over actual versus projected claims experience (e.g. due to volatile events such as catastrophe losses). Cash flow for both life and P&C insurers is also dependent on investment returns and can be affected by volatile markets and the shape / level of yield curves.

FCF is affected by regulatory 'traps' to upstreaming dividends to HoldCos

Note that our use of a 'holding company cash flow' means that cash flow is also subject to any regulatory restrictions on the payment of dividends from regulated insurance operating subsidiaries to the rest of the group or the HoldCo. These restrictions may be very specific (as is the case in the US), or simply due to general regulatory pressure exerted on insurance companies to hold high levels of buffer capital in excess of regulatory minimum levels. For example, we believe regulatory pressure to build up local buffer capital ahead of Solvency 2 rules has been an important driver of capital management in Europe – and at some companies has resulted in a less proactive capital return and dividend policy than may be justified by free cash flow.

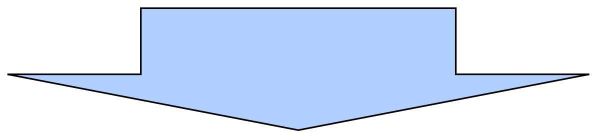
Figure 5. Drivers of insurance cash flow

Life Insurance

- \+ Earnings from in-force block
- \+ Release of capital from in-force block
- \- Acquisition costs (commissions, underwriting expenses)
- \- New business required capital

P&C Insurance

- \+ Reported earnings
- +/- Capital needed for growth



Insurance Free Cash Flow

Source: Citi Research

In US regulated insurance companies and subsidiaries, dividend payments from operating subsidiaries are subject to the following restrictions set in each relevant State (the basic insurance regulatory structure is organized by State in the US); however, in most States, the maximum dividend payable is limited to the greater of:

- Prior year *statutory* net income (as opposed to reported GAAP net income);
- 10% of statutory surplus, i.e. capital surplus based on filed statutory accounts.

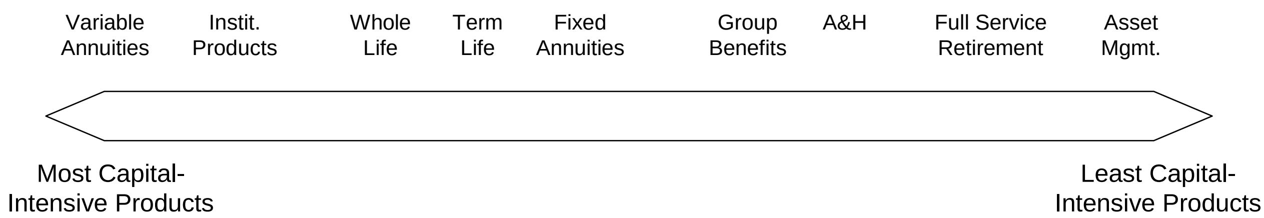
In the US, special dividends above the “ordinary” level require regulatory approval. Statutory earnings differ from GAAP net income in a few key ways, most notably that stat accounting does not permit the deferral of acquisition costs and typically uses more conservative reserve assumptions. As a result, growing companies typically report statutory earnings that are lower than GAAP earnings, which is one reason cash flows from insurance subsidiaries are typically less than operating earnings.

Business Mix and its Impact on Life Companies

Business mix plays a significant role in cash generation ability

Business mix plays a significant role in determining how much cash flow insurers generate. In general, companies that write significant amounts of long-duration, capital-intensive business tend to generate lower cash flow than insurers whose mix is more skewed toward shorter-tail or fee-based products. This is because longer-duration products typically have higher initial selling expenses and require more reserves, reducing cash flow in the early years. By contrast, products such as asset management require very little capital and produce cash flow that is close to earnings. In addition, most insurers’ asset management subsidiaries are owned directly by the holding company, so there is no regulatory process to approve dividends. Most sales of new insurance contracts, especially those with longer durations, are cash flow negative in the first year given high acquisition costs (especially commissions).

Figure 6. Spectrum of Life Insurance Products in the US life market by capital intensity



Source: Citi Research

This 'new business strain' is not deferrable under statutory accounting and local solvency rules (as it is under IFRS and US GAAP), and can vary significantly by type of contract. Unfortunately only the European Insurers (and a handful of Asian insurers disclosing embedded value metrics in sufficient detail) disclose the new business capex.

Solvency 2 in Europe has driven life insurers to less capital intensive products – with similar trends in the US

As we discuss a little later in this report, data from European life insurers show a clear trend toward lower strain products (e.g. fee-based unit-linked contracts, or hybrid savings contracts with lower guarantees). As well as trying to improve product mix ahead of the introduction of Solvency 2 in Europe, this also suggests that company managements are paying greater attention to cash generation and trying to improve payback periods in their new business mix. Unfortunately, this data is not available for US life insurers; however we attempt to show the relative new business capital intensity for different types of products in Figure 6. In the US life market too, there appears to be a greater focus from company management on minimizing new business strain where possible – for example through the vast reduction in capacity in the variable annuity market in recent years.

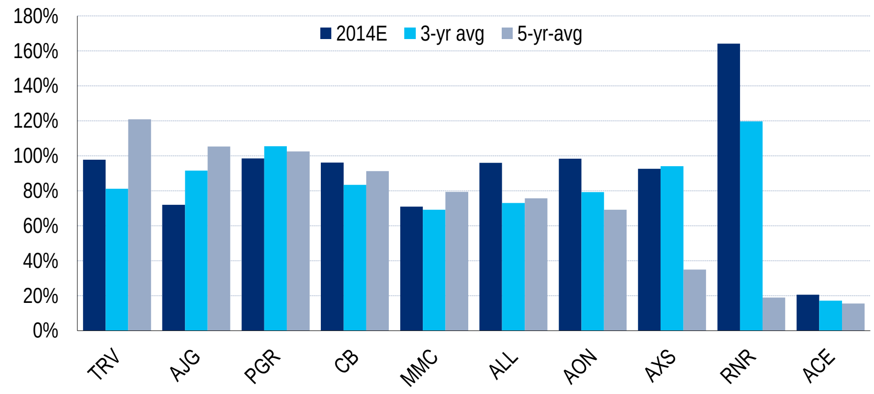
Cash flow drivers in P&C

Reported earnings for P&C companies are closer to cash than typical IFRS or GAAP statements for life insurers. This is because there are less intangible factors influencing earnings. Although there are still differences between statutory and reported accounting in the P&C sub-sector, for many of the companies in this report (e.g. the Europeans) we have assumed that cash generation is close to reported earnings, after deducting an amount for the capex required to fund growth (e.g. the rating agency or regulatory capital requirements for top-line growth).

Longer-tail P&C business can generate volatile cash flows due to large losses or reserve development

For US P&C companies, we can look at published statutory statements to analyse cash generation and allow for a portion of statutory surplus to be left behind to fund growth. Like the US life insurers, there are similar restrictions on the amount of statutory cash flow that can be paid as a dividend to the HoldCo (e.g. greater of statutory net income or 10% of statutory surplus). For the US brokers, we view free cash flow (cash flow from operations less capital expenditures) as a close proxy for unrestricted cash. Brokers are not as highly regulated as the underwriters, so whatever free cash flow they generate can be used to buy back stock, pay dividends, make acquisitions, or fund growth. Given the potential for catastrophe losses or significant reserve development, P&C cash flow tends to be significantly more volatile than life cash flow on an annual basis. Figure x demonstrates this for the US P&C sector by comparing projected free cash flow conversion (as a percentage of operating earnings) for 2014 with the average levels over the past three and five years.

Figure 7. P&C Cash Flow Tends to be Volatile on an Annual Basis
Free cash flow / operating earnings



Source: Company reports and Citi Research estimates
Note: Free cash flow for ACE only includes dividends taken from insurance subsidiaries

Restrictions on Upstreaming Dividends

International groups may face particular restrictions on moving cash between regions

Apart from local regulatory requirements, there are often other 'dividend traps' that may mean that not all of an insurance company's free cash generation can be upstreamed to its HoldCo. For European insurers we can measure this using a metric we call the 'remittance ratio', i.e. the ratio of dividends upstreamed from operating subsidiaries to the actual underlying free cash generated in these subs. Key drivers of a <100% remittance include:

- **Restrictions on releasing capital from international subsidiaries.** Since the financial crisis, we have seen a growing trend of large international insurance groups finding it more difficult to transfer capital 'cross-border', even if they enjoy decent capital buffers in their international subsidiaries. This may be due to a trend of 'subsidiarisation', where regulatory pressures to hold capital locally have increased – a phenomenon in Europe due to the approach of Solvency 2, which may bring in tougher regional capital requirements for insurers.

- **Accounting differences.** Major accounting differences in international subsidiaries (e.g. Japanese GAAP vs. US GAAP) may mean that there is a large gap between group reported earnings and the underlying statutory cash generation in a local subsidiary. This may lead to a low ratio of holding company cash flow to reported earnings for some companies with large international operations.

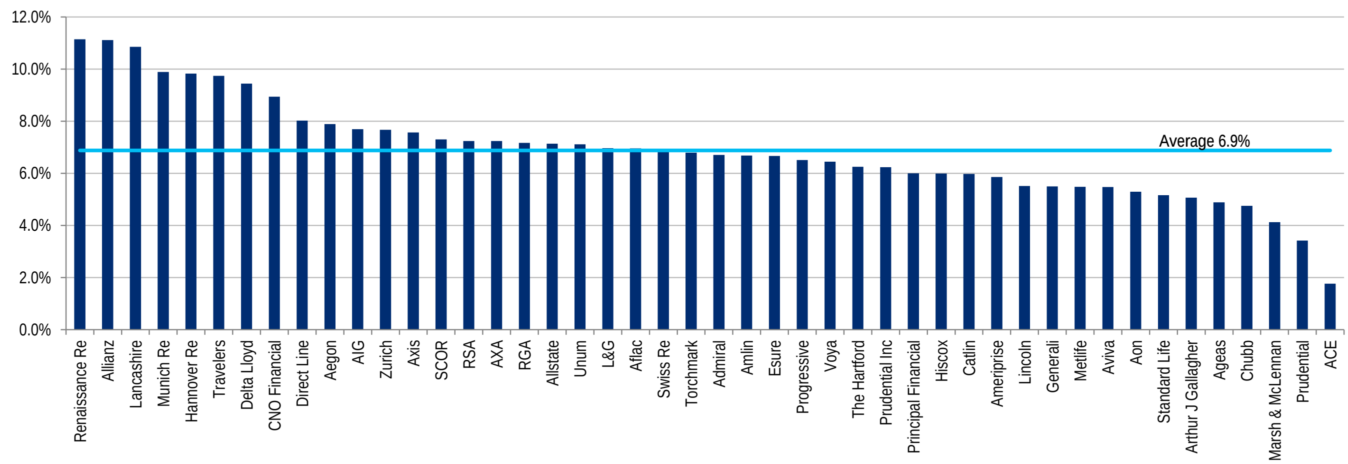
- **Other drivers of low internal dividends.** These could include tax (e.g. more tax efficient to keep surplus capital and earned profits in an international subsidiary rather than re-domicile this cash), or the desire to fund strong growth by maintaining stronger than average capital buffers. The latter is probably an important driver for subsidiaries in high growth and 'emerging' markets, with insurers preferring to keep surplus generation locally to fund additional growth and maintain strong local capital ratios to attract third party distribution.

Key Global Conclusions

Insurance FCF Yields Attractive Relative to the Market

Using the methodology described above, we show our estimates of the holding company free cash flow yield for US and European insurers in Figure 8. Our analysis excludes the Asian insurers at the current time due to a lack of widely available comparable data – although we hope to address this in the near future.

Figure 8. Our forecast of Global Insurance holding company free cash flow (2015e)



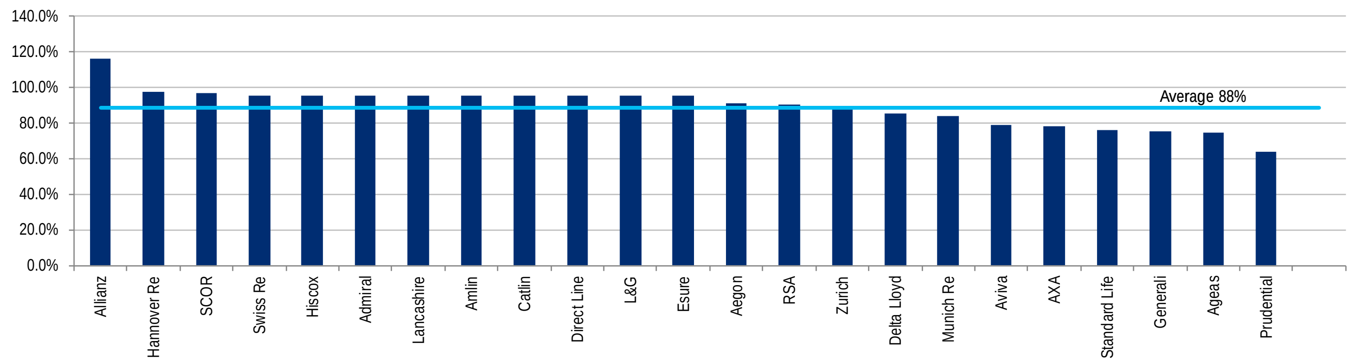
Source: Citi Research estimates

Overall, we believe this data is fundamentally supportive for global insurers:

- **Attractive global insurance cash generation relative to the *market*.** There is clearly a wide spread of free cash flow generation in the global insurance sector, ranging from ~2% to >10%. This may not always reflect relative cash generation ability but may also be affected by restrictions on upstreaming capital from operating subsidiaries to the HoldCo, e.g. due to regulatory dividend traps or a desire to retain capital locally to fund growth. However, the *overall* cash generation picture looks attractive relative to the market, with average holding company cash yield in the global insurance sector of ~7%, which we believe compares well with a global equity market FCF yield of ~5%. Importantly, the cash flow yield in the insurance sector is similar to levels estimated in our previous global insurance note on this topic in July 2013. This suggests that sector's cash flow has grown and has kept pace with share prices.

- **Greater management focus on cash flow metrics.** There has been increased management focus on cash flow in the sector, particularly for the life insurers who have struggled with less cash generative and more opaque business models than the P&C insurers. For example, European life insurers have been shifting new business mix away from capital intensive product lines in recent years ahead of Solvency 2, and they are also taking other measures to reduce new business capex costs. Many US and European life insurers also have significant 'legacy' policy books (e.g. traditional guaranteed life or annuity contracts in run-off) which are providing an increasing source of cash generation.

Figure 9. Remittance ratios of operational cash generation for European Insurers – 2015e

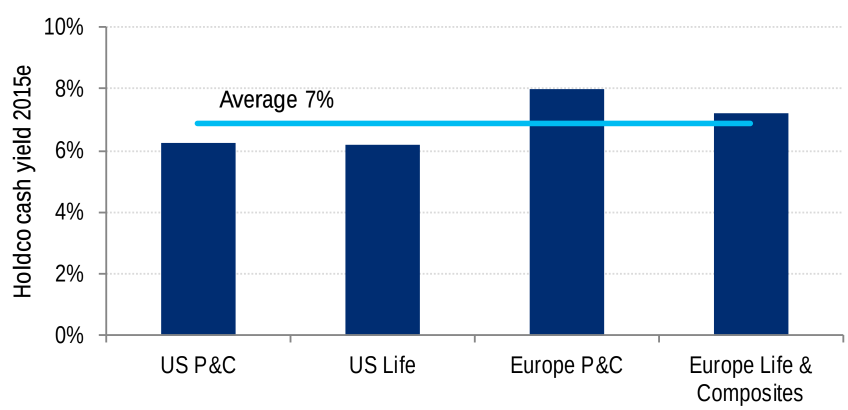


Source: Citi Research estimates

- **Holding company cash flow probably underestimates full FCF potential.** As we have discussed, we believe many insurers are restricted in some way from upstreaming *all* of their free cash generation to their holding companies, for regulatory or commercial reasons. Our data on remittance ratios for European insurers suggests that the average remittance of operational cash generation from insurance subsidiaries to the group HoldCo is ~90% (Figure 9). On this basis, we believe holding company free cash flow estimates in European and US insurance companies probably underestimate their underlying operational FCF cash generation, which may be closer to ~8% on a FCF yield basis.

- **Free Cash Flow analysis is fairly supportive for European insurers.** It appears from Figure 10 that the European insurers are generating relatively higher free cash yields compared to US peers. This may simply reflect greater market skepticism over the cash generation potential of the Europeans, e.g. due to factors such as a more uncertain macro outlook in Europe and regulatory uncertainty from Solvency 2. It may also reflect lower restrictions on upstreaming capital from operating subsidiaries in Europe compared to the fairly clear 'codified' restrictions on paying dividends from insurance subs in the US. Within Europe, the life and composite insurers probably face greater barriers on intragroup cash transfers than pure P&C or reinsurance companies, since they face a more radical change to their capital management under Solvency 2.

Figure 10. Holding company cash flow yield by global sub-sector (averages – 2015e)



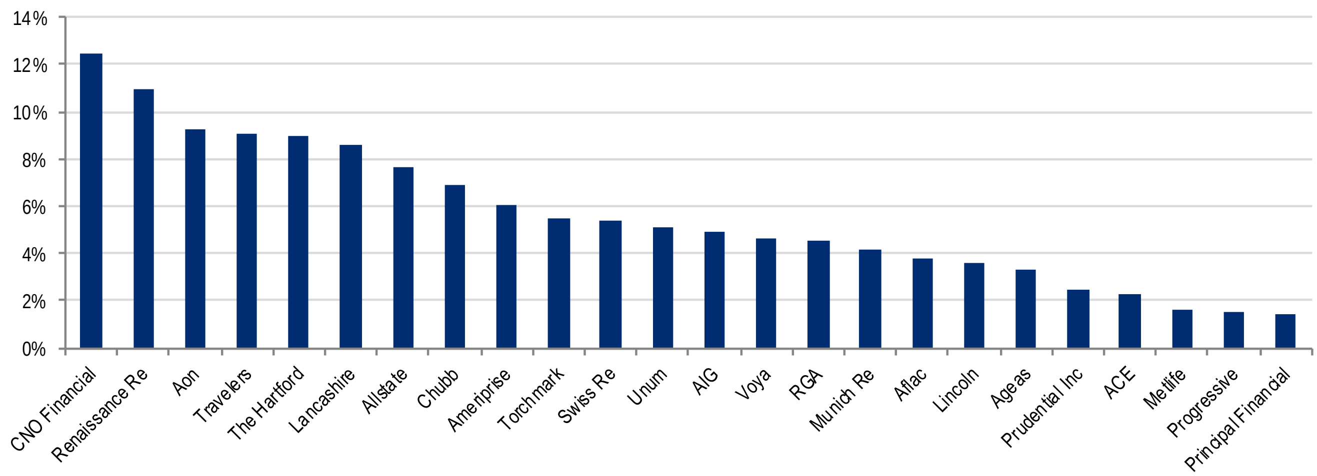
Source: Citi Research estimates

Robust Capital Return Potential – Increasingly in Europe

Buybacks and special dividends have been an important driver in the US, but could become a theme in Europe

The global insurance sector's cash generation supports robust capital return potential, either through regular dividends or additional capital management such as buybacks or special dividends. This has already been an important driver in the US insurance sector, where both life and P&C insurers are continuing to offer additional capital return through share repurchases (Figure 11). In Europe, buybacks and special dividends have been an important driver for some mainly P&C focused names, including Lancashire, Munich Re and Swiss Re – although Ageas in the life & composite sector has also conducted buybacks. Figure 11 shows the total capital return of global insurance stocks expressed as a proportion of market capitalization. This is the sum of regular dividends, buybacks and special dividends.

Figure 11. Buybacks or special dividends as a proportion of market capitalization (2014e)



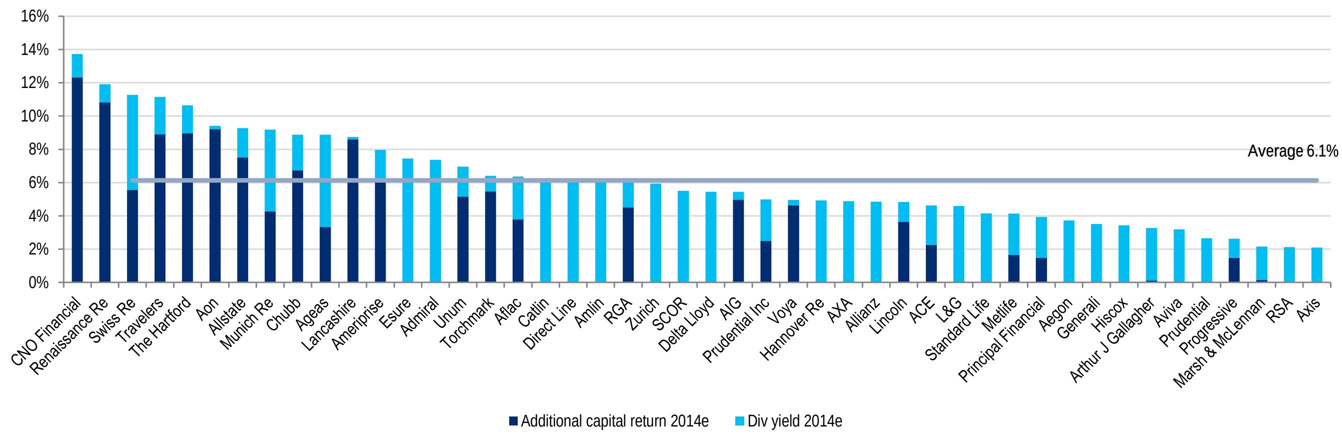
Source: Citi Research estimates

As Figure 11 suggests, we expect strong levels of capital return from the global insurance sector through dividends or buybacks, equivalent to ~6% of market capitalization on average (or 80-90% of holding company cash flow). However, we would also highlight the following points:

- **US insurers are currently offering stronger capital returns than the Europeans.** The vast majority of companies to the left-hand side of Figure 11, offering the strongest capital returns in the global insurance sector, are US insurers. This is particularly driven by the P&C companies and reinsurers. Although the US insurers offer slightly lower holding company free cash flow yields than the Europeans, they are able to return a far higher proportion of this cash flow back to shareholders.

- **P&C insurers are reacting to excess capital in the industry.** The ratio of capital return to FCF is greatest for the US P&C insurers – as shown in Figure 14 – but is also ~100% for the European P&C sector. We believe this reflects the strong levels of surplus capital in the global commercial P&C insurance and reinsurance business, and willingness by these sub-sectors to return capital to shareholders rather than to put it to work at unattractive returns in their core businesses.

Figure 12. Total capital return (% of market capitalization) – 2014e



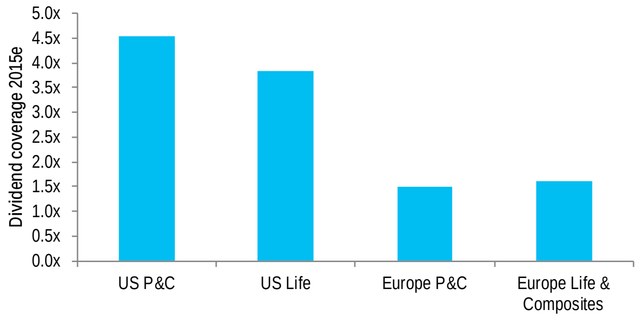
Source: Citi Research estimates

- **Europeans offer stronger regular dividends.** The US insurers tend to offer lower regular dividend yields than the European insurers, but with higher overall capital returns driven by sizable share buybacks. This is a feature of the US market that we believe may remain the norm, although strong holding company free cash flow generation should give the US companies greater confidence in supporting regular dividend growth. The European insurers offer relatively strong regular dividend yields, but have been reluctant to use additional capital return measures (with the exception of a few insurers, mainly in the P&C sub-sector, as already noted).

- **The greatest capital return upside potential lies with the European life & composite companies.** As suggested in Figure 14, US insurers already distribute >100% of their holding company free cash generation to shareholders – primarily driven by US P&C companies. European P&C insurers are also (on average) returning ~100% of their capital generation to shareholders, although this is skewed towards a few insurers such as Lancashire, Munich Re and Swiss Re. The greatest *underpayment* of capital generation is in the European life & composite space, where insurers are returning ~75% of holding company cash generation to shareholders in the form of regular dividends, specials or buybacks. As we note in our later chapter on the European insurers, we believe this presents an opportunity for strong growth in dividends and / or companies considering additional capital measures in the Europe life & composite space – predicated on the outcome of Solvency 2. The European life & composite insurers are rightly cautious ahead of the finalization of this new capital regime and potentially have the most to lose from a conservative outcome. At the same time, we believe this sub-sector has been managing its balance sheet in a reasonably conservative way the past few years. We believe this leaves substantial scope for a combination of strong dividend growth from the European insurers and potentially even special dividends and buybacks from the life companies once there is greater clarity over Solvency 2.

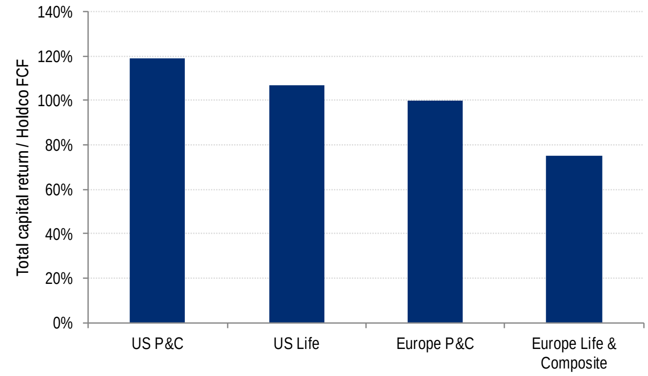
- **The overall common dividend growth potential of the global insurers continues to look robust** with ~2x dividend cover (regular dividends) on average. We would expect relatively strong dividend growth from the global insurers in the medium-to-long term in both the US and European insurance sectors (Figure 13).

Figure 13. Regular dividend cover by global insurance sector



Source: Citi Research estimates

Figure 14. Total capital return as % of FCF by global insurance sector



Source: Citi Research estimates

‘Quality’ of Earnings

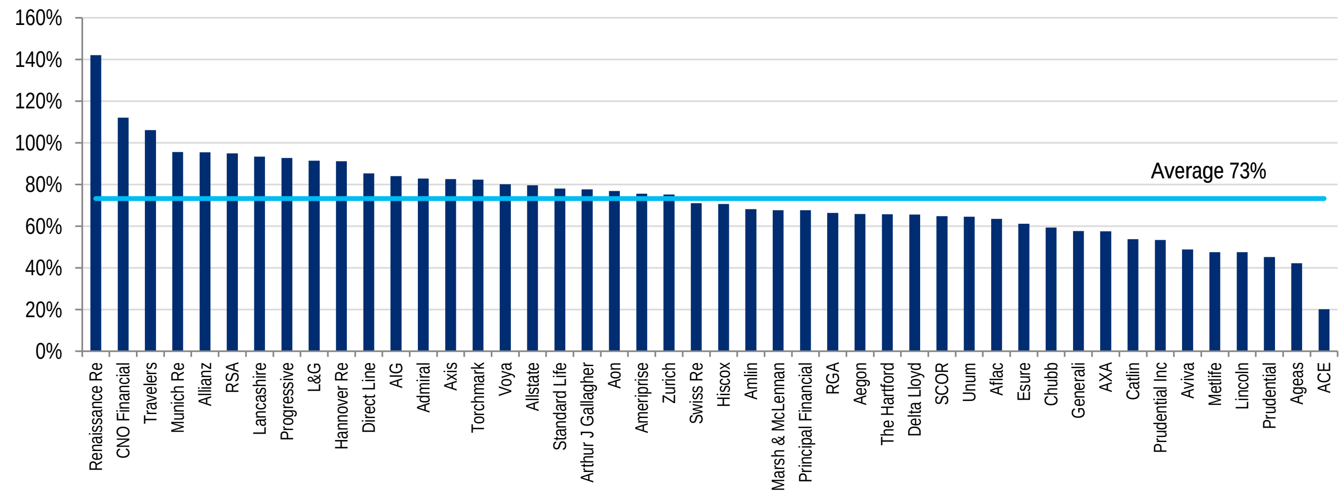
One of the persisting criticisms of the global insurance sector is its often opaque accounting and the difficulty of comparing reported numbers between companies from different global accounting regimes. This is particularly the case with the life insurers. Although the valuation methodology of balance sheet assets seems to be reasonably consistent globally, the approach to valuing liabilities can be extremely different such that companies selling similar products in different countries can often show large variances in both their balance sheets and reported earnings. Delta Lloyd is an extreme example of this in the European insurance market, with its complex mark-to-market accounting methodology. We believe these global accounting differences highlight the importance of analyzing cash generation as a means to ‘normalise’ and compare the financial performance of the companies in the global insurance sector.

The market will continue to put a premium on insurance stocks perceived to be cash generative

Given these factors, we believe the market will continue to place a premium on stocks that are perceived to be cash generative, and where earnings are relatively correlated with cash flow. We believe the data on the conversion of earnings into holding company cash flow (Figure 15) is quite supportive for many global insurance stocks in this respect. This shows an average ratio of holding company cash flow to reported earnings of close to ~75%; however, many stocks in the sector show substantially higher ratios than this. This ratio is imperfect in many ways since it is affected by business mix, the volatility of loss experience in P&C, capex to fund growth and other company specific factors:

- **Business mix is a key driver of the cash flow to earnings comparison for life insurers.** Life insurers with fee-based products, or significant exposure to asset management businesses, benefit from low capital intensity and earnings that are fairly closely correlated to cash. Examples include L&G, Standard Life and Allianz in Europe, or Ameriprise in the US. Additionally composite insurers benefit from cash generative P&C businesses. Insurers with substantial exposure to relatively less capital intensive protection & health business also have similar cash generation properties of P&C companies (e.g. CNO, Torchmark). Importantly, companies facing dividend traps due to a diversified International exposure (e.g. MetLife in the US, suffering from a lack of dividends from its Japanese business) also screen relatively less well in this analysis.

Figure 15. Ratio of holding company free cash flow to reported earnings (2015e)



Source: Citi Research estimates

- **Strong growth rates will cause cash flow to deviate from earnings.** Since acquisition costs are deferred in most global insurance accounting regimes, and the required regulatory or risk-based capital is not measured in reported earnings, companies with high growth rates will also show a large deviation between earnings and holding company cash flow. The classic example here is Prudential UK, which reinvests capex to support growth in its Asian business and prefers to hold capital locally in its key Asian markets rather than repatriate the largest proportion to the group HoldCo.

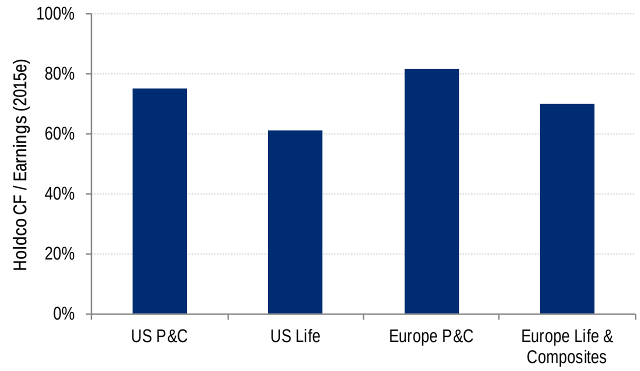
- **Cash flow conversion for P&C insurers less relevant in any one year.** As we have already pointed out, P&C cash flow can be highly skewed by the occurrence (or absence) of large loss events. In our view, the more relevant metric is average free cash conversion over a multi-year period.

Nevertheless, we believe this analysis is supportive of the sector, especially the life companies globally given the degree of investor skepticism over their earnings quality. We believe cash flow has been relatively consistent for life companies in the past few years, particularly as cash generation has risen in importance on the management agenda for these companies. The fact that life companies can convert a reasonably high proportion of their earnings into tangible cash generation, given the volatility of markets in the past few years and declining bond yields, suggests to us that this sector has been more resilient to the macroeconomic environment than the market may give it credit for.

‘Legacy’ life business forms quite a stable source of cash flow for many global life companies

It is important not to ignore the benefits of long-tail life businesses, in our opinion, particularly from ‘legacy’ traditional life books that do not form a large part of the global life sector’s new business ambitions. These include traditional ‘participating’ life books in Europe, or fixed annuity / traditional universal life in the US. Companies have not invested significant capital in writing new business in these books in the past few years, and we expect these to become increasingly rich sources of ‘back-book’ free cash flow generation in the next 5-10 years as they mature. We believe global life and composite companies have an interest in explaining how the ‘embedded value’ of these books is likely to convert into cash in the next few years. This is something the European insurers do well, through their market-consistent embedded value disclosure, but is lacking in the US life sector (and for most of the Asian insurance sector too).

Figure 16. Holding company cash flow to earnings for global insurance sub-sectors



Source: Citi Research estimates

Key Conclusions for US Life Insurers

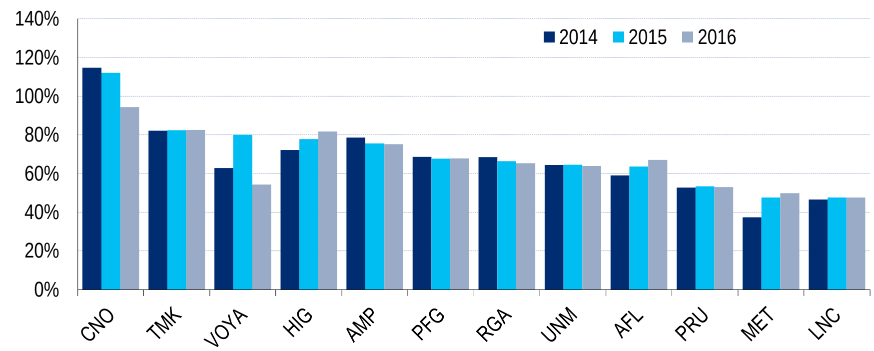
Cash Flow Conversion to Remain Key Metric

U.S. life insurers on average generate FCF equal to ~65% of operating earnings

We expect investors to continue focusing primarily on FCF as a percentage of operating earnings since this makes it easy to compare capital generation across companies. This is also the metric that most companies guide to when forecasting cash flow. As more companies shift away from capital-intensive lines (variable annuities, guaranteed UL) and focus on shorter-tail or fee-based products, FCF conversion should trend slightly higher. However, we forecast FCF conversion to remain in the 60-65% range for the overall industry.

The companies where we project the most improvement in future years are HIG (increased dividends from Talcott Resolution) and MET (higher Japan dividends, benefits from merging statutory entities). AFL should also benefit from increased capital repatriation from Japan. On the other hand, we expect FCF conversion to decline for CNO (as it begins to pay some income tax).

Figure 17. Projected FCF Conversion Rates for 2014e-2016e
Sorted by 2015 estimates



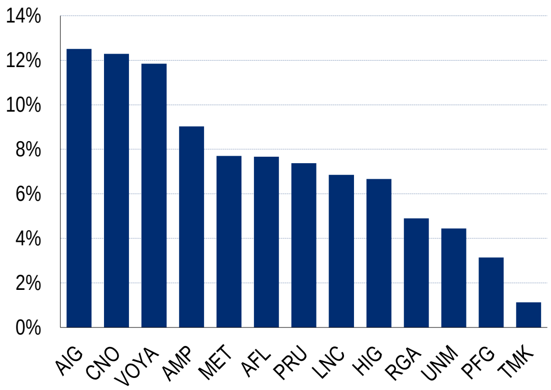
Source: Company reports and Citi Research estimates

Healthy Cash Flow Supports Capital Return Theme

We define excess capital as money that could be used without the insurer being subject to a ratings downgrade

We expect share repurchases and dividend increases to remain key themes for the life insurance sector given strong balance sheets and healthy cash flows. In our view, most of our coverage companies have deployable "excess" capital, which we define as unencumbered cash which can be spent without jeopardizing a company's rating. In coming up with our estimates, we look at risk-based capital (RBC) ratios relative to minimum thresholds, holding company liquidity above 2x fixed cost coverage, and any restrictions on moving capital to the holding company (such as negative earned surplus in an insurance subsidiary). In many cases, our estimates are more conservative than the excess capital numbers provided by management. We expect most insurers to continue holding more capital than they have historically as a buffer against adverse market movements, effectively raising the minimum RBC threshold.

Figure 18. Excess Capital a Meaningful % of Market Cap
Estimated excess capital divided by market cap (as of 10/2/14)



Source: SNL Financial, FactSet, company reports, and Citi Research estimates

Figure 19. Most Life Insurers Have Deployable Excess Capital
$ in millions; RBC ratios as of 6/30/14 where available

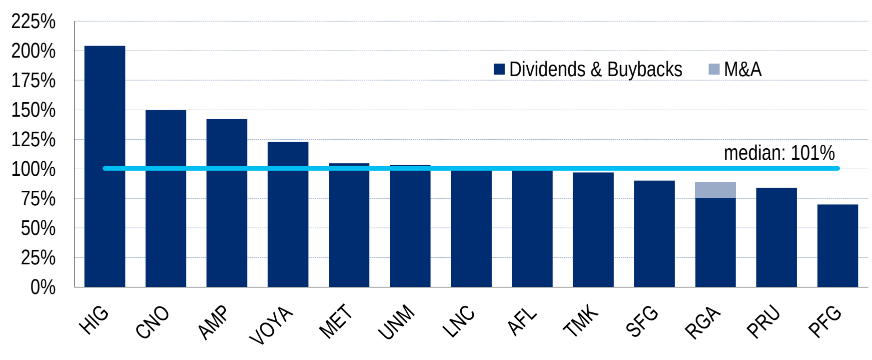
	Current RBC Ratio	RBC Ratio Threshold	Excess Capital	Hold Co. Liquidity	Target Liquidity	Excess Liquidity	Total Excess Capital
AFL	800%	500%	1,500	1,300	800	500	2,000
AIG	568%	475%	3,708	14,100	8,400	5,700	9,408
AMP	530%	425%	621	2,300	900	1,400	2,021
CNO	437%	400%	176	469	200	269	445
HIG	430%	350%	1,090	1,400	1,400	-	1,090
LNC	503%	450%	842	573	500	73	915
MET	450%	425%	1,539	5,500	2,500	3,000	4,539
PFG	438%	400%	416	350	300	50	466
PRU	457%	425%	1,008	3,200	1,300	1,900	2,908
RGA	285%	275%	65	500	300	200	265
TMK	342%	325%	71	60	55	5	76
UNM	403%	375%	265	616	500	116	381
VOYA	501%	450%	697	879	450	429	1,126

Sources: SNL Financial, company reports, and Citi Research estimates

On average, excess capital equals 7.3% of market cap, suggesting companies have significant capacity for share repurchases, dividends, and M&A.

Given our estimated excess capital, we expect most insurers to return all of the free cash flow they generate to shareholders. For 2014, our models assume buybacks, dividends, and announced M&A of slightly over 100% of FCF. This is consistent with the actual behavior we saw in 2013, and we are encouraged that company management teams' are acting as though they have excess capital.

Figure 20. Life Insurers Returning Most Free Cash Flow to Shareholders
2014E capital return / 2014E FCF



Source: Company reports and Citi Research estimates

Risks to Free Cash Flow Story

In our view, the key risks to sustaining (or improving) the current level of free cash flow generation are required capital contributions to insurance subsidiaries or reduced statutory earnings due to a market decline or investment losses. We consider the most likely triggers for a statutory reserve charge to be sustained low interest rates, poor long-term care experience, or adverse variable annuity policyholder behavior. However, we believe this is unlikely near-term. A pick-up in sales growth would also increase capital consumption and depress near-term stat earnings, although we expect the impact to be relatively modest.

Cash Flow Will Continue to Play a Role in Valuation

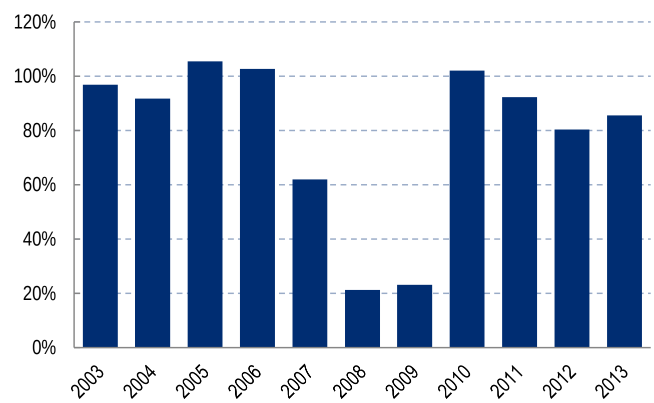
Our analysis shows relatively strong correlation between cash flow and valuation for life insurers. In our view, there are several reasons that we expect investors to continue using cash flow data to supplement traditional valuation metrics when analyzing life insurers:

- **Key driver of capital return –** As discussed previously, insurers are returning close to 100% of holding company free cash flow to investors, so this is a key metric for projecting future dividends and share repurchases.

Please see our report Where Have All the Earnings Gone? Deconstructing the Recent Lack of Book Value Growth for MET and PRU for more discussion of the gap between operating and net income

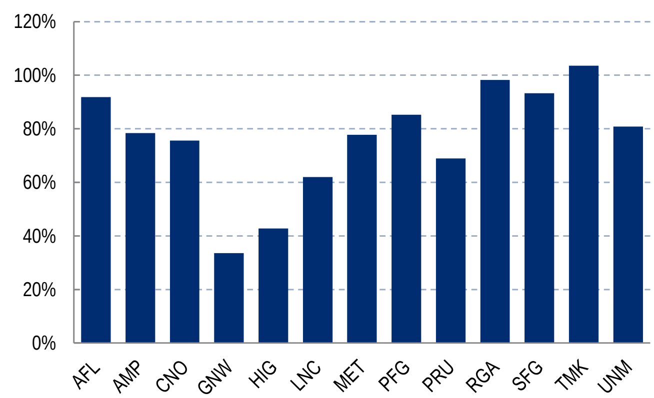
- **Operating earnings and GAAP book value becoming less relevant –** Life insurers have seen increased volatility in net income, which we attribute largely to the proliferation of hedging for market and currency risks. Most hedge assets are required to be marked-to-market through net income, but liability changes are not. This creates a mismatch, so at any given time, book value is not a true representation of economic value. Similarly, there has been a wide gap between operating EPS and net EPS for many life insurers. While much of this noise has been driven by asymmetric accounting and non-economic items, it has raised questions about the quality of earnings. Cash flow provides another way to look at economic value creation and is less affected by accounting noise. While we are not suggesting FCF yield or a DCF approach will supplant P/BV or P/E as the primary approach for valuing insurers, we think cash flow generation will continue to play a role in how investors think about fair multiples.

Figure 21. Life Insurers' Gap Between Net and Operating EPS
Net EPS / operating EPS, shows industry average



Source: Company reports and Citi Research estimates

Figure 22. Results Vary Considerably from Company to Company
Average net EPS / operating EPS for 2003-2013



Source: Company reports and Citi Research estimates

Key Individual Stock Takeaways

- **Aflac (AFL):** AFL forecasts 2015 capital repatriation from Japan of ¥110-150B (~$1.0-1.4B). In our view, if its solvency margin continues to increase over the next few quarters (currently ~800% vs. a target of 500-600%), the repatriation target is likely to increase. Based on management's cash flow disclosure, we forecast FCF of ~$1.9B next year (pre-dividend) if repatriation comes in at the high end of the target range. FCF would increase further if the company executes additional reinsurance transactions, which we believe is likely.

- **Ameriprise (AMP):** We project AMP to generate free cash flow of 80-90% of net income over time, which should enable the company to continue deploying significant capital for buybacks and dividends. Over 60% of earnings now come from the company's asset and wealth management businesses, which generate fee income and require limited capital. Even within its insurance businesses, about 40% of earnings come from fee income, and some of the capital strain is mitigated through the use of reinsurance. If annuity and life sales accelerate, the capital strain could reduce cash flow to the low end of our target range. Given AMP's cash flow dynamics and current excess capital position, we expect the company to continue returning the vast majority of its earnings to shareholders. Our model forecasts the company to deploy over 100% of net income for buybacks and dividends for at least the next three years, driving above-average EPS growth and further ROE expansion.

- **CNO Financial (CNO):** CNO generates considerable free cash flow as a result of its business mix and the fact that it currently pays minimal cash taxes. Given the company's focus on protection oriented life and supplemental health products, its insurance subsidiaries provide relatively predictable statutory earnings and dividends. We believe investors under-appreciate the sustainability of CNO's cash flow story. While management estimates FCF will decline ~$50M in 2016 as the company begins to pay some taxes, we project FCF conversion to remain in the 90% range for the next several years. CNO will continue to benefit from its non-life NOL through 2025, and debt amortization payments could cease if the company completes a balance sheet recap. Our model, which assumes a recap in 4Q15, projects buybacks of ~20% of the market cap through 2015.

- **Hartford Financial (HIG):** HIG's cash flow and capital return should continue to accelerate given redeployment of the proceeds from its Japan business, increased dividend potential from the U.S. blocks within Talcott, and strong capital generation in its core businesses. In addition, we see the target level of liquidity at the holding company coming down over time as HIG repays debt and its equity market exposure declines. HIG plans to repurchase $2.8B of shares and retire $1.2B of debt in 2014-2015. While we do not anticipate any material updates to the capital plan until mid-2015, we see potential for upside if Talcott runs off faster than expected or the P&C business has low cat losses.

- **MetLife (MET):** MET is guiding to FCF conversion of ~35% in 2014, with that ratio improving to 45-55% in 2015/16. This would bring MET from having the lowest cash flow generation in our coverage universe to being roughly in-line with LNC and PRU. In our view, improving cash flow, and being able to return the excess capital being generated to shareholders, will be key levers to improve overall returns. The key near-term drivers of improved cash flow conversion are expected to be 1) increased dividends from Japan, 2) higher dividends from U.S. subsidiaries, driven in part by capital efficiency benefits from the 4-way merger of statutory entities, and 3) lower sales of capital-intensive products. Longer-term, we believe FCF conversion in the 50-60% range is achievable as MET's mix continues to shift toward international and basic protection products.

- **Prudential (PRU):** PRU has consistently generated FCF of ~50% of earnings, a ratio we expect to continue near-term but which could trend up slightly over time. In its international business, capital generation is typically ~60% of earnings, although this is not all repatriated to the U.S. holding company. In the U.S., PRU benefits from having less capital intensive asset management and annuity businesses, although it also has significant exposure to variable annuities and individual life. Over time, as sales shift to less capital-intensive annuities and away from SGUL, cash conversion could improve modestly.

Key Conclusions for US P&C Sector

Figure 23. US P&C free cash flow metrics – 2015e - $mn

	ACE	AIG	AJG	ALL	AON	AXS	CB	MMC	PGR	RNR	TRV	Median
Dividends from life insurance subs	74	3,409	-	429	-	-	-	-	-	-	-	
Dividends from P&C subs	744	1,930	414	1,718	1,514	438	1,481	1,288	1,167	475	3,384	
Earnings from non-insurance entities	-	2,759	-	-	-	-	-	-	-	-	-	
Gross free cash flow to hold co.	817	8,098	414	2,147	1,514	438	1,481	1,288	1,167	475	3,384	
Holding company interest expense	(187)	(1,218)	(47)	(226)	(164)	(58)	(411)	(113)	(80)	(17)	(239)	
Other holding company expenses	-	(968)	-	-	-	-	-	-	(100)	-	-	
Total enterprise free cash flow	630	5,912	367	1,921	1,350	380	1,070	1,174	987	458	3,144	
Operating earnings	3,118	6,961	470	2,452	1,754	483	1,802	1,732	1,060	419	2,964	
FCF as % of operating earnings	20.2%	84.9%	78.1%	78.3%	77.0%	78.7%	59.4%	67.8%	93.1%	109.3%	106.1%	78.3%
Remittance ratio	26.2%	116.3%	88.2%	87.6%	86.3%	90.8%	82.2%	74.3%	110.0%	113.4%	114.1%	
Capital Return Summary												
Common dividends	877	790	184	495	200	115	460	638	175	47	786	
Share repurchases	441	4,500	-	2,000	1,820	368	695	700	220	260	2,300	
Total capital return	1,317	5,290	184	2,495	2,020	483	1,155	1,338	395	307	3,086	
Capital return as % of FCF	209.0%	89.5%	50.0%	129.9%	149.6%	127.1%	107.9%	113.9%	40.0%	67.1%	98.1%	107.9%
Capital return as % of op. earnings	42.2%	76.0%	39.1%	101.7%	115.2%	100.0%	64.1%	77.2%	37.2%	73.3%	104.1%	76.0%

Source: Citi Research estimates

Share Repurchases to Accelerate as Pricing Cycle Slows

Most US P&C insurers are overcapitalized, in our view

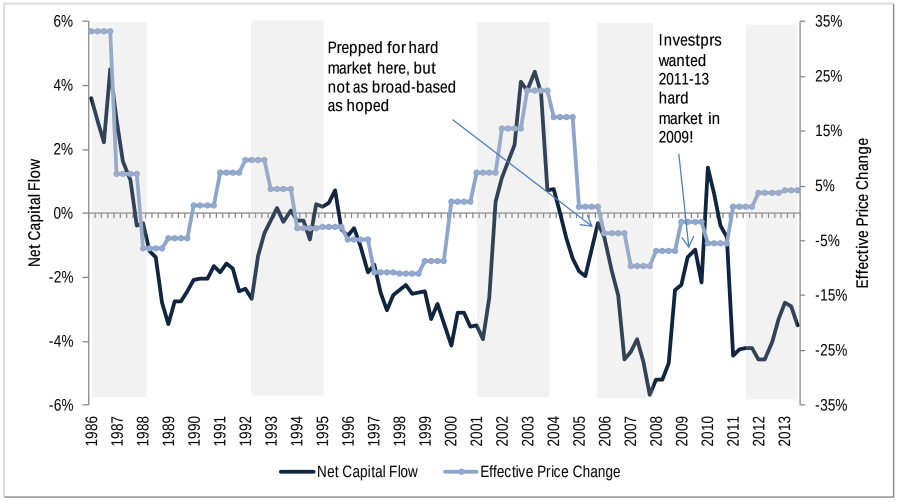
In our view, most US P&C insurers are over-capitalized, so all cash flow should be available to shareholders. We expect the P&C underwriters to increase share repurchase as a way to grow earnings during the softening pricing cycle. Historically, during the second half of a hard market share repurchases tend to increase. Pricing is still increasing in most lines, albeit at a slowing rate. With limited growth opportunities available for the industry, we think companies will turn to share repurchase as a way to increase EPS. A number of companies have already committed to this theme of accelerating share repurchase, including ACE, Allstate and Marsh & McLennan.

Increasing Buybacks Good for Earnings Growth…

While share repurchase is a good way to grow EPS when the business environment is becoming more difficult, our analysis shows that there isn't any benefit to valuation from share repurchase in P&C. We view stock buybacks are cyclical: they tend to decrease as pricing accelerates (with capital raises in extreme cases), and increase as pricing decelerates and declines.

It is apparent from the figure below that recent buybacks have increased versus history. Average capital return was 3% of surplus per annum during 2006-13, and 4% during 2011-13.

Figure 24. US Industry Net Capital Flows vs. Effective Price Changes, 1986-2013



Source: ISO, SNL Financial, Citi Research
Note: Shaded regions are hard markets. Net Capital Flows are New Funds less Shareholder Dividends as a percentage of Policyholder Surplus. Effective Price Change is an estimate of Price Change less Loss Trend.

…but Our Analysis Shows that it Won't Help Valuation

There is little evidence that buybacks have directly supported valuations

Some clients have argued that higher buybacks could support higher valuations. Yet as the chart suggests, valuations have not noticeably increased, whether considered on an absolute or relative basis, despite higher levels of capital return. If we take simple averages, post-crisis (2010-13) average valuations remain below pre-crisis (1980-2007), whether measured absolutely (1.04x book post vs. 1.27x pre) or relatively (0.47x relative book post vs. 0.55x pre). There are many factors that influence valuation, of course, but it's hard to say from the available data that increased buybacks have aided valuation.

All this suggests is that buybacks are expected by the market, and may not represent new bullish information. The companies in our coverage have much higher average capital returns than the industry, which is not surprising given the presence of mutual and private companies. Our coverage's average capital return during 2008-13 was 7.3% of equity, versus 2.7% of surplus for the industry. While our current assumptions for 2014 (-7.8%) are similar to 2013 actual (-8.1%), we tend to model only announced programs, and thus we would expect upside to buybacks versus our current models (which would come out of book value growth). Yet none of this seems to have changed the basic cyclical behavior of insurance stocks, which is the basis of our current cautious view on the group.

For more on share repurchase cyclicality, see our note: It's Not Complicated: Buybacks Are Cyclical - Increasing Stock Buybacks are Expected, Not Necessarily Bullish published on Feb 27th.

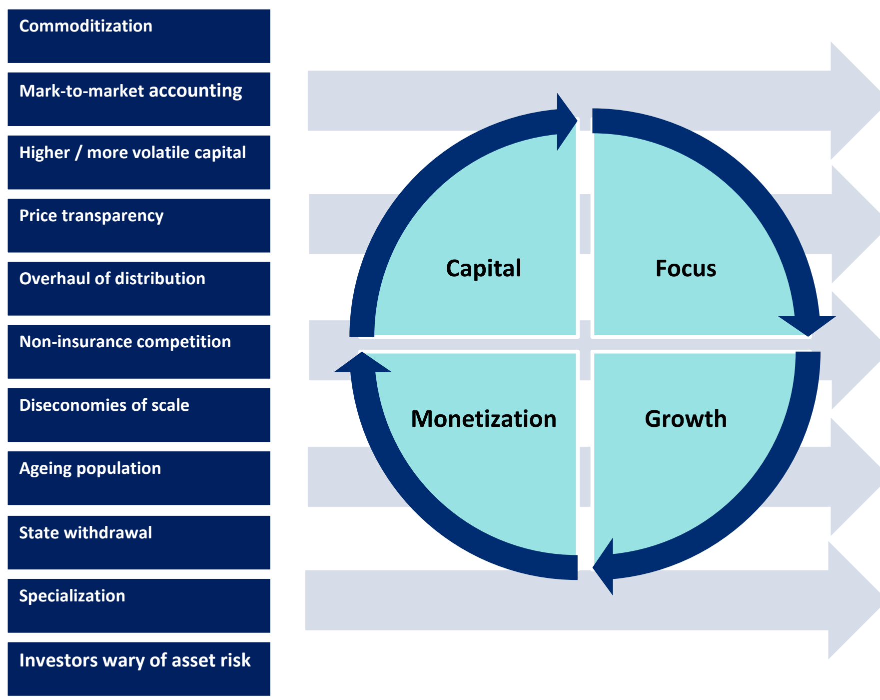
Key Conclusions for European Insurers

Cash Flow and Capital Strength Support Our Positive View

We have identified 'Four Forces' driving positive strategic change in European insurance

We remain positive on the European insurers, based on our opinion that the industry will successfully navigate some of the strategic challenges facing it the next decade (e.g. increased regulation, greater product commoditization) using Four Strategic Forces. We would refer you to our earlier report on this topic: The Four Forces of Insurance: Remaining Positive on the Sector. These include a drive to exit non-core areas and focus on areas of competitive advantage – potentially realizing cost savings and operational leverage (Focus) and positioning for premium and business growth in both mature and developing markets (Growth).

Figure 25. Strategic Challenges and how European Insurers are responding with Four Forces



Source: Citi Research

'Monetisation' – increased focus on cash – is a key strategic Force

Our thesis is also supported by two other key 'forces' that are addressed more closely in this note: namely a shift towards more robust capital positions and higher quality balance sheets (Capital), and increased management focus on cash generation (Monetisation). European insurers have faced a shift towards more conservative economic capital models (due to Solvency 2) and this has led to a substantial improvement in balance sheet strength in recent years through more conservative ALM and capital management. In addition, companies are responding to investor mistrust of insurer's financial statements and opaque business models by a greater focus on cash flow.

Improved Capital Return Confidence is a Key Catalyst

As we showed earlier in this note, we believe the European Insurance sector is generating above average holding company FCF yields (~7%) in both a market and global sector context. However, the desire to rebuild balance sheet strength after the financial crisis and in the face of Solvency 2, has limited the sector's confidence in returning a large proportion of this cash to shareholders.

Figure 26. Free cash flow metrics – European Life & Composite insurers – 2015e

European Life & Composites	Ageas	Aegon	Allianz	Aviva	AXA	Delta Lloyd	L&G	Generali	Prudential	Standard Life	Zurich
	€bn	€bn	€bn	£bn	€bn	€bn	£bn	€bn	£bn	£bn	US$bn
Life new business capex	-0.3	-1.5	-1.8	-0.3	-2.2	-0.2	-0.2	-1.6	-0.7	-0.3	-0.9
Life in-force cash flow	0.6	3.0	3.6	1.5	4.8	0.6	0.9	3.0	2.7	0.8	1.5
Life FCF	0.3	1.5	1.8	1.3	2.5	0.3	0.7	1.4	2.0	0.6	0.5
P&C capital required for growth	*0.0*	*0.0*	*-0.6*	*-0.1*	*-0.1*	*0.0*	*0.0*	*-0.1*	*0.0*	*0.0*	*-0.7*
P&C earnings	*0.2*	*0.0*	*3.7*	*0.6*	*2.8*	*0.1*	*0.0*	*1.2*	*0.0*	*0.0*	*3.1*
P&C FCF	0.2	0.0	3.1	0.5	2.7	0.1	0.0	1.1	0.0	0.0	2.4
Other FCF	0.0	0.0	1.7	0.0	0.5	0.0	0.3	0.3	0.4	0.1	0.9
Operational FCF	0.4	1.5	6.5	1.8	5.8	0.4	1.0	2.8	2.4	0.7	3.9
% remittance to HoldCo	*74%*	*91%*	*116%*	*79%*	*78%*	*85%*	*95%*	*75%*	*64%*	*76%*	*88%*
Dividends to HoldCo	0.3	1.3	7.6	1.4	4.5	0.4	0.9	2.1	1.5	0.6	3.4
HoldCo costs	0.0	-0.2	-1.2	-0.6	-1.2	0.0	0.0	-0.7	-0.3	-0.1	0.0
Holding company FCF	0.3	1.1	6.4	0.8	3.3	0.4	0.9	1.4	1.2	0.5	3.4
HoldCo FCF per share	1.34	0.54	14.06	0.28	1.37	1.78	0.16	0.90	0.48	0.21	22.80
HoldCo FCF yield	5%	8%	11%	5%	7%	9%	7%	6%	3%	5%	8%
Dividend cover from HoldCo FCF	0.9	2.2	2.1	1.7	1.5	2.1	1.5	2.0	1.2	1.2	1.3
HoldCo FCF / Earnings	42%	66%	95%	51%	58%	66%	91%	57%	44%	82%	78%
Life new business capex / PVNBP	-5.9%	-2.2%	-3.5%	-1.2%	-3.2%	-4.2%	-2.1%	-3.5%	-2.0%	-1.0%	-2.0%
Life in-force cash / Emb Value	9.6%	-	10.4%	8.8%	9.5%	11.6%	10.2%	9.9%	9.4%	11.0%	6.5%
P&C capital required / net premiums	40%	-	40%	40%	40%	1%	-	40%	-	-	45%

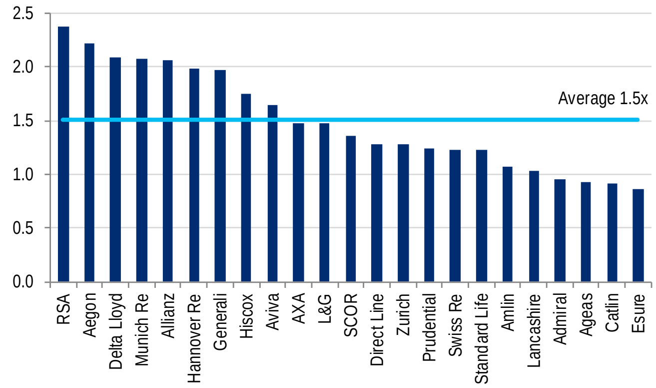
Source: Citi Research estimates

Figure 27. Free cash flow metrics – European P&C insurers – 2015e

European P&C	Admiral	Amlin	Catlin	Direct Line	Esure	Hiscox	Lancashire	Hannover Re	Munich Re	RSA	SCOR	Swiss Re
	£bn	£bn	$bn	£bn	£bn	£bn	$bn	€bn	€bn	£bn	€bn	US$ bn
Life new business capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.8	0.0	-0.2	0.0
Life in-force cash flow	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.9	0.0	0.4	0.9
Life FCF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	1.1	0.0	0.2	0.9
P&C capital required for growth	*0.0*	*-0.1*	*-0.1*	*-0.1*	*0.0*	*0.0*	*0.0*	*-0.1*	*-0.2*	*0.0*	*-0.3*	*-0.9*
P&C earnings	*0.3*	*0.2*	*0.3*	*0.4*	*0.1*	*0.2*	*0.2*	*0.7*	*2.0*	*0.6*	*0.6*	*2.0*
P&C FCF	0.3	0.2	0.2	0.3	0.1	0.1	0.2	0.6	1.8	0.6	0.3	1.1
Other FCF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0
Operational FCF	0.3	0.2	0.2	0.3	0.1	0.1	0.2	0.8	3.1	0.6	0.5	2.0
% remittance to HoldCo	*95%*	*95%*	*95%*	*95%*	*95%*	*95%*	*95%*	*97%*	*84%*	*90%*	*97%*	*95%*
Dividends to HoldCo	0.2	0.1	0.2	0.3	0.1	0.1	0.2	0.8	2.6	0.5	0.5	1.9
HoldCo costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	-0.2	-0.1	0.1
Holding company FCF	0.2	0.1	0.2	0.3	0.1	0.1	0.2	0.7	2.6	0.3	0.3	2.0
HoldCo FCF per share	0.87	0.29	0.47	0.23	0.15	0.37	1.06	6.18	15.59	0.34	1.84	5.26
HoldCo FCF yield	7%	7%	9%	8%	7%	6%	16%	10%	10%	7%	8%	7%
Dividend cover from HoldCo FCF	1.0	1.1	0.9	1.3	0.9	1.7	1.0	2.0	2.1	2.4	1.4	1.2
HoldCo FCF / Earnings	83%	68%	54%	81%	61%	71%	93%	91%	96%	95%	65%	73%
P&C capital required / net premiums	45%	60%	60%	45%	45%	60%	60%	70%	52%	40%	70%	58%

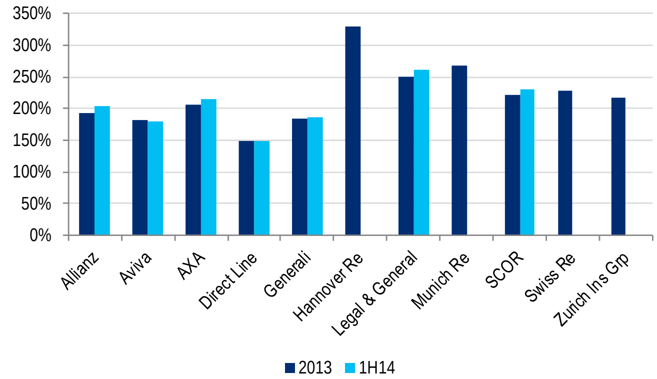
Source: Citi Research estimates

Figure 28. Dividend cover from HoldCo FCF (2015e)



Source: Citi Research estimates

Figure 29. Reported 'economic capital' ratios (99.5% VAR)



Source: Company data, Citi Research

European insurers have seen an improvement in cash coverage of dividends

Hence most of the companies in the sector have seen greater improvements in FCF generation than dividends or other capital return, which has resulted in robust dividend cover in the European insurance sector, despite a relatively high dividend yield (average 5% for 2015e in the European insurance sector). An exception has been the reinsurance and P&C sectors in Europe. With their relatively greater capital clarity and cash generative business models, buybacks and special dividends have been limited mainly to non-life insurers in recent years. For the reinsurers this has also been a response to excess capital in the industry and a weak pricing environment.

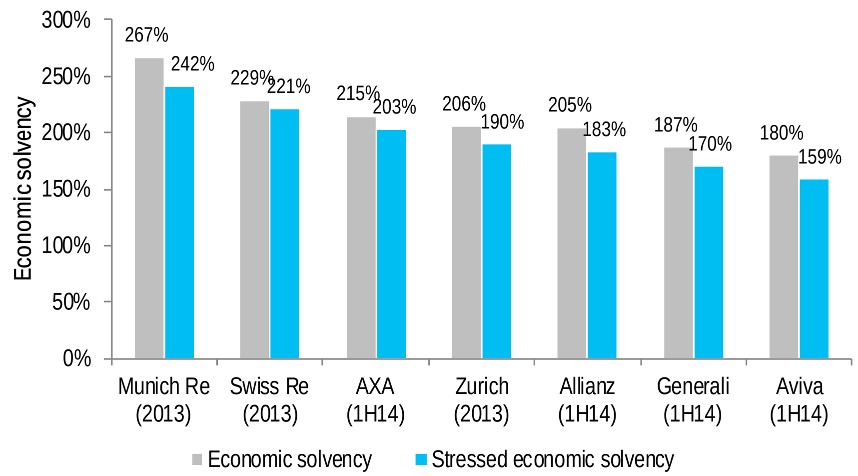
Overall, the scope to improve capital return or payouts to shareholders looks fairly attractive for European Insurers, in our view. We believe greater clarity over the implications of Solvency 2 in the next 1-2 years could be a catalyst for this, as insurers see a clearer 'line in the sand' on their capital requirements. We are fast approaching a finalization of some of the key details of this capital regime towards the end of the year, and we expect the majority of these details to be made public by early 2015.

As we show in Figure 29, many insurers who already disclose Solvency 2 like 'economic capital' ratios are reporting relatively robust capital positions. These ratios are based on internal model calculations, and it is likely that these numbers will change under a 'standard' Solvency 2 model – probably declining. However, our sense is that the major European insurers will still remain comfortable under the standard model. We illustrate some estimates of the sensitivity of published economic capital ratios to market movements in Figure 30.

We expect a more proactive policy to dividend growth and capital return, particularly with Solvency 2 clarity

We expect a more proactive dividend growth policy at many insurers in the next few years. These include some of the major composite insurers, where we expect management to signal greater dividend payout ratios and growth rates in the next five years. In addition, we believe some life & composite companies will also join the P&C sector in signaling a greater willingness to return additional capital to shareholders (subject to regulatory and commercial constraints). Given past investor concerns about the balance sheet strength of the European Insurers, valuation multiples that we believe still imply a relatively elevated cost of equity for the sector and improved dividend yield prospects – we believe this shift to better capital return could support the sector's outperformance.

Figure 30. Reported economic capital ratios and estimated impact of market stress scenario
Stress scenario assumes 50bps drop in yields, 25% drop in equities and 50bps credit spread widening

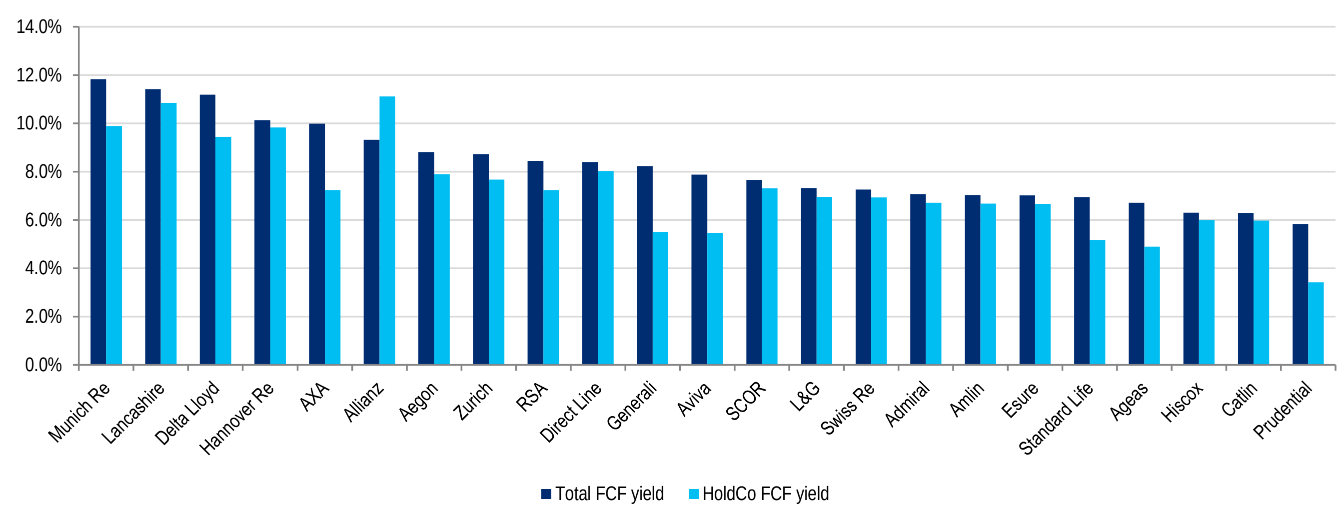


Source: Citi Research

Holding Company Cash Underestimates Underlying FCF

The European insurers provide greater granularity of cash flow disclosure than their global peers, and it is possible in Europe to identify the underlying operational FCF disclosure of each insurer. Due to dividend traps and regulatory restrictions, remittance of this capital to group holding companies is usually <100%, hence holding company FCF is usually less than underlying group FCF. We illustrated remittance ratios earlier in this note, suggesting that the ratio of dividends from operating subs to underlying cash flow is ~90%. As we illustrate in Figure 31, we believe European FCF yields would rise to ~8% if *all* cash generation were to be taken into account.

Figure 31. Total FCF yield versus holding company FCF yield (2015e) – average Total FCF Yield is ~8%, average HoldCo FCF yield is ~7%



Source: Citi Research estimates

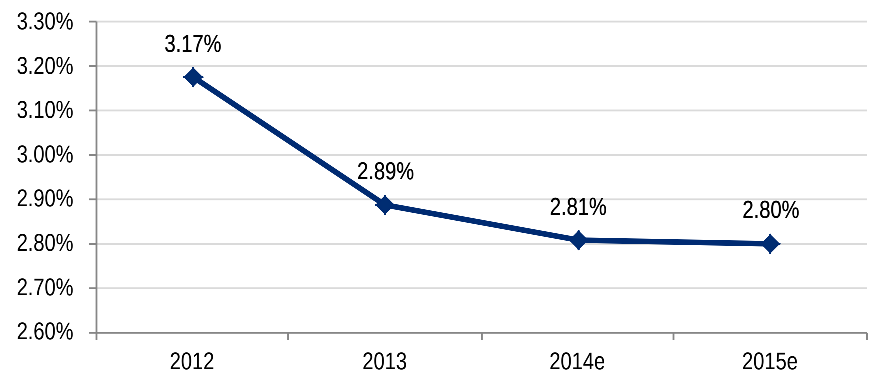
While it is impossible to apply this analysis to US insurers and other regions, given the lack of disclosure, we sense that the underlying drivers are similar and would conclude that overall global insurance holding company FCF yields understate the full cash generation potential of the sector.

Taking Steps to Improve Cash Flow Efficiency

The detailed disclosure provided by many life insurance groups in Europe allows us to analyse some of the components of life insurance cash flow in more detail. This is particularly useful in trying to forecast trends in the efficiency of cash generation and recognize the different drivers of cash flow from existing 'in-force' policies and capex spent on writing new business. Although we can only apply this analysis to the Europeans at the current time, like our discussion above on total FCF versus holding company FCF, we believe similar issues affect life insurers outside of Europe.

As we show in Figure 32, we believe European insurers are taking steps to improve the efficiency of cash generation and respond to higher capital requirements for certain product types under Solvency 2. As this shows, there is evidence that life insurers in Europe are writing more capital efficient business with lower new business capex costs per unit of new business premium. This is measured using the life new business strain as a proportion of PVNBP new business sales (present value of new business premiums).

Figure 32. European life insurance industry new business strain as a percentage of PVNBP



Source: Citi Research

Allianz – Our Preferred Cash / Capital Return Story

We upgraded Allianz to a Buy rating in July 2014 (Allianz: Substantial Degrees of Freedom on Capital - Upgrade to Buy) and added Allianz to the Citi Focus List Europe. We believe it is one of the more compelling examples in Europe of the cash flow and capital return theme discussed in this note.

Our positive view on the stock is driven by the following factors:

- **Greater capital clarity at the July 2014 Investor Day on cash generation.** Allianz provided some more concrete disclosure on its cash generation. Although this was close to our own estimate (group FCF of ~€5bn per year), what surprised us positively was Allianz's ability to upstream ~100% of this cash to the rest of the Group. Therefore, the rate at which Allianz is accumulating cash at the holding company was better than we expected, and as we illustrate in Figures z and y, Allianz offers one of the strongest holding company FCF yields in the European and global insurance sectors.

- **Improved capital return prospects.** Given greater clarity over its Solvency 2 capital position, we believe Allianz will take more proactive steps to return a larger proportion of its cash generation to shareholders. This will be mainly through dividend policy as Allianz, in our view, shifts its payout ratio from 40% of net income towards 50% by 2017e – allowing it to post ~10% p.a. DPS growth. Even after allowing for this, and making a conservative allowance for capital spent on external growth (e.g. M&A), we believe it could still accumulate a capital buffer of ~€7bn-€8bn in the next five years. In our opinion, Allianz may consider returning some of this additional buffer back to shareholders (e.g. through buybacks or special dividends). This should result in Allianz providing above average capital return prospects (and >5% dividend yield from 2015e).

- **PIMCO downside risks more priced in.** We also argued in our recent note that downside earnings risks at PIMCO (from fixed income fund net outflows and rising bond yields in the US) were better priced in to the Allianz share price. We value PIMCO at less than the lower quartile P/E ratio of US peer group asset managers, at ~10x P/E (compared to a range of ~12-16x P/E 2015e). We also expect net outflows at PIMCO to reduce in coming quarters and have priced in the potential implications of the recent departure of Bill Gross, assuming a more rapid outflow from the PIMCO Total Return Fund.

Global Insurance Comps

Figure 33. European and US Insurance Comps

Europe				Current	Market	P/E			P/BV			ROE			Div. Yield			P/EV			ROEV		
	RIC Code	Rec	Crncy	Price	Cap (US$mn)	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E
Composites																							
Ageas	AGES.BR	Neutral	EUR	26.0	7,550	10.4	11.0	8.2	0.68	0.62	0.60	6.2%	5.9%	7.4%	5.4%	5.5%	5.7%	0.69	0.64	0.61	6.4%	6.3%	7.8%
Aviva	AV.L	Buy	GBp	517.0	24,349	12.3	9.8	9.0	1.91	1.70	1.51	23.8%	17.1%	17.1%	2.9%	3.2%	3.5%	1.30	1.14	1.02	11.3%	13.2%	12.6%
AXA	AXAF.PA	Buy	EUR	19.1	57,802	10.9	8.6	8.0	1.02	0.87	0.81	9.2%	11.0%	10.5%	4.2%	4.9%	5.3%	1.08	0.99	0.88	11.1%	12.5%	12.3%
Delta Lloyd	DLL.AS	Buy	EUR	18.9	4,822	20.9	7.1	7.0	1.38	1.24	1.13	6.8%	18.4%	16.9%	5.4%	5.4%	5.4%	0.86	0.82	0.78	4.3%	12.1%	11.8%
Generali	GASI.MI	Neutral	EUR	16.2	31,719	19.1	11.4	10.4	1.26	1.04	0.98	9.4%	10.1%	9.8%	2.8%	3.5%	4.0%	1.06	0.85	0.78	6.4%	9.3%	8.2%
NN Group	NN.AS	Buy	EUR	22.8	10,063	24.6	24.0	10.0	0.57	0.46	0.45	1.6%	2.1%	4.5%	0.0%	2.2%	4.2%	0.77	0.68	0.63	3.8%	3.2%	6.8%
PZU	PZU.WA	Buy	PLN	472.4	12,226	12.9	13.1	17.7	3.11	3.06	3.21	24.1%	23.9%	17.7%	11.4%	7.2%	6.9%	1.50	1.50	1.52	12.1%	11.5%	8.5%
Talanx	TLXGn.DE	Buy	EUR	25.9	8,257	8.6	8.5	8.5	0.91	0.81	0.77	10.6%	10.1%	9.2%	4.6%	4.8%	5.0%	NM	NM	NM	NM	NM	NM
Zurich Ins Grp	ZURN.VX	Neutral	CHF	286.7	44,596	11.8	10.1	9.8	1.56	1.23	1.18	12.0%	13.6%	12.3%	5.9%	5.9%	5.9%	1.68	1.31	1.20	12.6%	16.5%	13.4%
Composite Average						13.5	10.6	9.6	1.4	1.2	1.1	12.0%	12.4%	11.7%	4.5%	4.7%	5.1%	1.2	1.0	0.9	9.6%	11.7%	10.8%
Life																							
Aegon	AEGN.AS	Neutral	EUR	6.5	17,434	21.9	9.6	7.9	0.78	0.73	0.68	3.1%	7.8%	8.9%	3.4%	3.7%	4.3%	NM	NM	NM	NM	NM	NM
Legal & General	LGEN.L	Neutral	GBp	226.8	21,599	15.1	14.0	13.2	2.38	2.24	2.11	16.1%	16.6%	16.6%	4.1%	4.6%	5.1%	1.42	1.35	1.29	10.1%	10.1%	10.2%
Prudential	PRU.L	Buy	GBp	1388.0	57,216	15.3	14.5	13.2	3.68	3.03	2.64	13.5%	23.7%	21.7%	2.4%	2.7%	2.9%	1.52	1.37	1.22	11.1%	10.5%	10.4%
Standard Life	SL.L	Neutral	GBp	403.0	15,368	15.9	16.4	15.0	2.25	2.13	2.01	10.9%	12.5%	13.2%	3.9%	4.2%	4.4%	1.17	1.13	1.10	7.5%	7.1%	7.5%
Life Average						16.4	13.9	12.6	2.8	2.4	2.1	12.0%	18.3%	17.5%	3.1%	3.4%	3.8%	1.2	1.1	1.0	8.7%	8.3%	8.3%
Non Life																							
Admiral Grp	ADML.L	Neutral	GBp	1290.0	5,781	13.5	13.2	12.2	7.57	7.37	6.84	56.5%	57.0%	58.3%	7.3%	7.4%	7.4%	NM	NM	NM	NM	NM	NM
Direct Line	DLGD.L	Buy	GBp	287.5	6,852	11.5	12.4	10.6	1.54	1.54	1.47	11.1%	10.7%	14.9%	7.2%	6.3%	5.6%	NM	NM	NM	NM	NM	NM
esure Group	ESUR.L	Buy	GBp	226.9	1,506	10.1	10.1	9.2	3.45	3.26	2.95	36.9%	33.1%	33.7%	7.0%	7.4%	8.2%	NM	NM	NM	NM	NM	NM
Mapfre	MAP.MC	Sell	EUR	2.8	10,635	10.7	9.6	8.7	1.08	1.02	0.96	10.1%	10.9%	11.3%	4.7%	5.1%	5.4%	3.14	3.04	2.93	30.3%	32.6%	34.8%
RSA Ins	RSA.L	Neutral	GBp	470.2	7,649	-10.8	10.8	13.1	1.41	1.19	1.15	-11.1%	12.1%	8.9%	2.2%	2.1%	3.7%	NM	NM	NM	NM	NM	NM
Sampo	SAMAS.HE	Neutral	EUR	38.1	26,913	15.0	13.9	13.1	1.99	1.88	1.77	13.7%	13.9%	14.0%	4.1%	4.5%	4.7%	NM	NM	NM	NM	NM	NM
Non Life Average						10.2	12.4	11.8	2.3	2.2	2.0	14.3%	17.4%	17.8%	4.7%	4.8%	5.2%	0.6	0.5	0.5	5.4%	5.8%	6.2%
Lloyds																							
Amlin	AML.L	Neutral	GBp	435.1	3,485	7.4	10.3	10.2	1.29	1.23	1.18	18.8%	12.3%	11.9%	6.0%	6.2%	6.5%	NM	NM	NM	NM	NM	NM
Catlin Grp	CGL.L	Buy	GBp	522.0	2,999	5.1	6.0	5.9	0.58	0.55	0.52	12.8%	10.0%	9.6%	9.5%	10.4%	10.9%	NM	NM	NM	NM	NM	NM
Hiscox	HSX.L	Neutral	GBp	649.0	3,327	10.2	12.1	12.3	1.61	1.46	1.34	17.1%	12.8%	12.1%	8.8%	3.4%	3.6%	NM	NM	NM	NM	NM	NM
Lancashire	LRE.L	Buy	GBp	658.5	1,983	5.5	5.7	5.8	0.96	0.96	0.93	15.9%	16.1%	15.5%	12.1%	14.4%	14.9%	NM	NM	NM	NM	NM	NM
Lloyds Average						7.3	8.9	9.0	1.1	1.1	1.0	16.3%	12.5%	12.0%	8.7%	7.9%	8.2%	NM	NM	NM	NM	NM	NM
Reinsurers																							
Hannover Re	HNRGn.DE	Neutral	EUR	62.9	9,526	8.5	8.4	9.3	1.29	1.11	1.06	15.0%	14.2%	11.7%	4.8%	4.9%	5.1%	NM	NM	NM	NM	NM	NM
Munich Re	MUVGn.DE	Neutral	EUR	151.7	32,992	8.2	8.6	9.3	1.04	0.91	0.88	12.5%	11.3%	9.6%	4.8%	4.9%	5.1%	NM	NM	NM	NM	NM	NM
SCOR	SCOR.PA	Buy	EUR	24.5	5,914	8.3	9.1	8.6	0.92	0.86	0.82	11.3%	9.7%	9.7%	5.3%	5.5%	5.7%	NM	NM	NM	NM	NM	NM
Swiss Re	SRENH.VX	Neutral	CHF	75.0	29,162	6.9	10.1	10.5	0.88	0.82	0.84	13.6%	9.3%	8.8%	10.7%	11.3%	6.3%	NM	NM	NM	NM	NM	NM
Reinsurers Average						7.7	9.2	9.7	1.0	0.9	0.9	13.1%	10.8%	9.6%	7.0%	7.4%	5.6%	NM	NM	NM	NM	NM	NM
North America																							
Brokers / Composites																							
ACE	ACE.N	Neutral	USD	106.2	35,651	11.4	11.4	11.5	1.25	1.14	1.07	13.3%	10.3%	9.7%	1.9%	2.4%	2.4%	NM	NM	NM	NM	NM	NM
AIG	AIG.N	Buy	USD	52.8	75,297	11.9	11.5	10.4	0.77	0.68	0.63	9.2%	7.4%	6.3%	0.4%	0.5%	0.0%	NM	NM	NM	NM	NM	NM
Arthur Gallagher	AJG.N	Neutral	USD	45.8	7,276	21.4	18.0	15.5	2.93	2.00	1.91	14.3%	12.0%	11.2%	3.1%	3.1%	3.2%	NM	NM	NM	NM	NM	NM
Aon	AON.N	Buy	USD	87.3	25,348	17.9	15.7	14.2	3.21	2.99	2.78	14.0%	16.9%	17.7%	0.2%	0.2%	0.2%	NM	NM	NM	NM	NM	NM
Marsh & McLennan	MMC.N	Neutral	USD	52.4	28,522	21.2	18.1	16.6	3.59	3.45	3.28	18.6%	19.6%	20.4%	1.8%	2.0%	2.2%	NM	NM	NM	NM	NM	NM
Brokers / Comp Average						14.6	13.5	12.4	1.8	1.6	1.5	12.5%	11.6%	11.2%	1.0%	1.2%	1.0%	NM	NM	NM	NM	NM	NM
Life																							
Aflac	AFL.N	Neutral	USD	57.8	26,186	9.4	9.4	9.1	1.82	1.43	1.33	20.6%	16.9%	14.5%	2.5%	2.6%	2.8%	NM	NM	NM	NM	NM	NM
Ameriprise	AMP.N	Neutral	USD	121.9	22,818	17.3	14.5	13.0	2.60	2.39	2.33	14.1%	16.8%	18.1%	1.6%	1.9%	2.1%	NM	NM	NM	NM	NM	NM
CNO	CNO.N	Buy	USD	17.0	3,618	15.8	13.9	11.6	0.76	0.72	0.69	9.6%	-0.4%	5.5%	0.6%	1.4%	1.8%	NM	NM	NM	NM	NM	NM
Hartford	HIG.N	Buy	USD	37.0	16,555	12.8	11.9	9.9	0.94	0.86	0.81	0.9%	3.9%	8.1%	1.2%	1.7%	2.0%	NM	NM	NM	NM	NM	NM
Voya	VOYA.N	Neutral	USD	39.0	9,623	11.9	13.5	12.2	0.66	0.57	0.54	3.8%	3.5%	1.9%	0.1%	0.3%	1.2%	NM	NM	NM	NM	NM	NM
Lincoln	LNC.N	Neutral	USD	52.5	13,709	10.4	9.3	8.7	1.03	0.85	0.79	8.8%	9.8%	9.1%	0.9%	1.2%	1.5%	NM	NM	NM	NM	NM	NM
Metlife	MET.N	Buy	USD	53.0	59,599	9.4	9.5	8.6	0.94	0.84	0.78	5.1%	7.7%	8.7%	1.9%	2.5%	2.9%	NM	NM	NM	NM	NM	NM
Principal	PFG.N	Neutral	USD	51.5	15,124	14.5	12.0	11.4	1.52	1.36	1.29	8.9%	11.4%	11.2%	1.9%	2.5%	3.1%	NM	NM	NM	NM	NM	NM
Prudential	PRU.N	Buy	USD	86.8	39,910	9.0	8.9	8.5	1.18	0.96	0.90	-2.0%	11.3%	10.0%	2.0%	2.5%	2.8%	NM	NM	NM	NM	NM	NM
RGA	RGA.N	Neutral	USD	79.2	5,429	16.0	9.9	9.2	0.94	0.79	0.74	6.5%	9.5%	7.9%	1.4%	1.6%	1.7%	NM	NM	NM	NM	NM	NM
Torchmark	TMK.N	Neutral	USD	52.4	6,848	13.8	12.7	11.8	1.90	1.49	1.40	13.0%	12.7%	12.0%	0.8%	0.9%	1.0%	NM	NM	NM	NM	NM	NM
Unum	UNM.N	Neutral	USD	34.0	8,662	10.3	9.6	8.7	1.02	0.90	0.83	9.9%	10.0%	9.5%	1.6%	1.8%	2.1%	NM	NM	NM	NM	NM	NM
Life Average						11.3	10.6	9.7	1.3	1.1	1.1	7.2%	10.4%	10.5%	1.7%	2.1%	2.5%	NM	NM	NM	NM	NM	NM
Non Life																							
Allstate	ALL.N	Neutral	USD	61.6	26,706	10.9	12.1	10.7	1.33	1.18	1.11	10.8%	10.8%	10.0%	1.2%	1.8%	1.9%	NM	NM	NM	NM	NM	NM
Chubb Corp	CB.N	Sell	USD	93.1	22,384	11.6	13.2	12.2	1.44	1.32	1.23	14.7%	11.5%	10.8%	1.9%	2.1%	2.2%	NM	NM	NM	NM	NM	NM
Progressive	PGR.N	Buy	USD	25.6	15,142	16.1	15.0	14.2	2.46	2.15	1.96	19.1%	17.0%	14.4%	1.1%	1.2%	1.2%	NM	NM	NM	NM	NM	NM
Travelers	TRV.N	Sell	USD	94.7	32,103	10.0	10.5	10.8	1.37	1.24	1.16	14.6%	12.5%	11.2%	2.1%	2.3%	2.4%	NM	NM	NM	NM	NM	NM
Non Life Average						11.6	12.3	11.6	1.5	1.4	1.3	14.3%	12.5%	11.3%	1.6%	1.9%	2.0%	NM	NM	NM	NM	NM	NM
Reinsurers																							
Axis Cptl Hldngs	AXS.N	Sell	USD	47.2	4,971	8.6	9.4	10.3	1.00	0.89	0.84	13.1%	10.5%	8.5%	2.2%	2.1%	2.2%	NM	NM	NM	NM	NM	NM
Renaissancere	RNR.N	Neutral	USD	100.2	4,061	7.1	11.9	11.7	1.25	1.17	1.11	20.1%	11.2%	9.7%	1.1%	1.1%	1.2%	NM	NM	NM	NM	NM	NM
Third Point	TPRE.N	Neutral	USD	14.3	1,486	5.6	9.2	6.1	1.06	0.95	0.82	20.1%	11.2%	15.1%	0.0%	0.0%	0.0%	NM	NM	NM	NM	NM	NM
XL Group	XL.N	Sell	USD	33.3	8,849	10.3	9.5	10.6	0.94	0.84	0.76	10.3%	5.3%	10.0%	1.7%	1.8%	2.0%	NM	NM	NM	NM	NM	NM
Reinsurers Average						8.8	10.0	10.4	1.0	0.9	0.9	13.8%	8.3%	10.0%	1.6%	1.6%	1.8%	NM	NM	NM	NM	NM	NM

Source: Datacentral, Citi Research estimates

Figure 34. Asian and Australasian Insurance comps

Asia				Current	Market		P/E			P/BV			ROE			Div. Yield			P/EV			ROEV	
	RIC Code	Rec	Crncy	Price	Cap (US$mn)	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E	2013	2014E	2015E
Composites																							
Cathay	2882.TW	Neutral	TWD	50.0	20,650	20.4	16.9	17.1	2.24	2.10	2.02	11.0%	12.8%	12.0%	2.9%	2.8%	2.9%	0.81	0.75	0.69	4.1%	4.8%	4.4%
China Pacific	2601.HK	Buy	HKD	27.6	9,877	27.0	21.2	17.8	2.53	2.25	1.94	9.5%	11.2%	11.7%	1.4%	1.8%	2.1%	1.73	1.55	1.42	6.8%	8.2%	8.7%
CTIH	0966.HK	Neutral	HKD	18.2	5,690	23.5	13.1	15.6	1.56	1.82	1.69	9.1%	13.0%	11.2%	0.0%	0.0%	0.0%	0.76	0.87	0.76	6.0%	5.8%	5.6%
Fubon	2881.TW	Neutral	TWD	48.2	16,216	14.6	12.4	11.8	1.56	1.49	1.39	10.5%	12.3%	12.2%	2.2%	2.5%	2.6%	NM	NM	NM	NM	NM	NM
PICC Group	1339.HK	Neutral	HKD	3.2	17,724	16.9	14.4	11.7	1.92	1.62	1.44	11.9%	12.2%	13.0%	0.3%	0.3%	0.5%	1.66	1.37	1.19	10.5%	11.5%	11.7%
Ping An	2318.HK	Buy	HKD	59.2	23,891	16.8	13.7	11.9	2.56	2.13	1.79	16.4%	17.0%	16.3%	1.1%	1.4%	1.6%	1.42	1.20	1.05	9.8%	10.4%	10.0%
Composite Average						18.7	15.1	13.9	2.1	1.9	1.7	12.2%	13.5%	13.2%	1.5%	1.7%	1.8%	1.1	0.9	0.8	6.4%	7.1%	7.0%
Life																							
AIA Grp	1299.HK	Buy	HKD	41.3	64,145	22.7	19.6	16.9	2.60	2.19	2.00	11.0%	12.1%	12.4%	1.0%	1.2%	1.4%	1.90	1.72	1.54	9.0%	9.7%	10.2%
Bangkok Life	BLA.BK	Sell	THB	86.5	3,216	23.8	25.9	17.2	4.70	4.14	3.51	21.0%	17.0%	22.0%	1.1%	1.0%	1.4%	3.21	2.65	2.22	14.9%	12.4%	15.4%
China Life	2628.HK	Buy	HKD	21.9	20,965	24.9	19.5	16.3	2.80	2.47	2.15	11.2%	13.5%	14.1%	1.4%	1.5%	2.0%	1.80	1.51	1.38	7.3%	9.3%	9.3%
Dai-ichi Life	8750.T	Buy	JPY	1569.0	17,168	48.4	20.0	21.7	0.96	0.80	1.13	2.5%	4.3%	4.7%	1.0%	1.3%	1.6%	NM	NM	NM	NM	NM	NM
Great Eastern	GELA.SI	Neutral	SGD	23.7	8,785	16.6	13.3	15.6	2.21	1.96	1.81	13.7%	15.6%	12.1%	2.3%	2.3%	2.3%	1.22	1.14	1.05	7.8%	9.1%	7.3%
Hanwha Life	088350.KS	Neutral	KRW	6890.0	5,598	12.8	11.5	10.3	0.85	0.85	0.81	6.9%	7.4%	8.0%	2.2%	2.2%	2.9%	0.85	0.71	0.64	6.0%	7.4%	6.9%
New China Life	1336.HK	Buy	HKD	27.4	3,654	19.3	13.2	11.5	2.17	1.83	1.52	11.8%	15.0%	14.4%	0.5%	0.6%	1.1%	1.33	1.10	0.95	7.8%	10.0%	9.6%
Samsung Life	032830.KS	Buy	KRW	106000.0	19,833	22.7	21.2	18.7	0.99	1.11	1.05	4.8%	4.9%	5.8%	1.4%	1.4%	1.9%	0.85	0.83	0.74	3.9%	4.0%	4.4%
Sony Fin	8729.T	Buy	JPY	1710.0	6,837	16.5	18.4	15.6	1.71	1.60	1.65	11.5%	9.0%	10.4%	1.5%	1.8%	2.3%	NM	NM	NM	NM	NM	NM
T&D Hld	8795.T	Buy	JPY	1363.0	8,329	14.6	11.6	11.5	1.01	0.87	0.93	8.0%	8.0%	7.8%	1.7%	1.8%	1.8%	NM	NM	NM	NM	NM	NM
Tong Yang Lf Ins	082640.KS	Neutral	KRW	11350.0	1,142	9.0	8.0	7.4	0.77	0.85	0.78	9.9%	10.1%	10.9%	3.1%	3.1%	3.5%	0.62	0.59	0.52	7.7%	7.7%	7.9%
Life Average						24.2	18.6	16.7	2.1	1.8	1.7	9.4%	10.4%	10.7%	1.3%	1.4%	1.7%	1.3	1.2	1.0	6.3%	6.9%	7.1%
Non Life																							
Dongbu Ins	005830.KS	Neutral	KRW	58600.0	3,881	9.5	10.6	9.6	1.44	1.42	1.27	16.3%	13.1%	13.5%	2.1%	2.0%	2.3%	0.84	0.78	0.69	10.6%	8.0%	8.1%
Hyundai Mar & Fire	001450.KS	Sell	KRW	29100.0	2,434	7.6	8.3	7.4	1.17	1.18	1.06	16.3%	13.6%	14.5%	3.6%	3.1%	3.4%	0.61	0.54	0.46	9.4%	7.4%	7.3%
LIG Ins	002550.KS	Sell	KRW	27750.0	1,558	9.5	7.9	7.1	1.07	1.05	0.92	10.9%	12.7%	13.1%	2.0%	2.0%	2.5%	0.52	0.47	0.40	6.4%	6.5%	6.6%
MS&AD HD	8725.T	Buy	JPY	2317.0	13,117	17.2	15.4	13.7	0.72	0.65	0.62	3.5%	3.4%	4.4%	2.3%	2.4%	2.5%	NM	NM	NM	NM	NM	NM
Sompo JP Nppnkoa	8630.T	Buy	JPY	2587.0	9,701	24.6	24.1	45.6	0.84	0.77	0.80	5.5%	3.7%	1.8%	2.3%	2.3%	2.3%	NM	NM	NM	NM	NM	NM
PICC P&C	2328.HK	Neutral	HKD	14.3	25,085	18.0	15.7	14.4	3.38	2.84	2.49	20.5%	19.7%	18.4%	3.2%	0.0%	1.9%	NM	NM	NM	NM	NM	NM
Samsung Fire Ins	000810.KS	Buy	KRW	279000.0	12,366	17.7	20.0	16.8	1.58	1.72	1.59	9.3%	8.0%	9.5%	1.3%	1.3%	1.6%	1.10	1.07	0.95	7.1%	5.5%	6.4%
Tokio Marine	8766.T	Buy	JPY	3364.0	23,727	19.9	14.0	14.9	1.09	0.95	0.90	2.8%	3.6%	5.4%	1.6%	2.1%	2.2%	NM	NM	NM	NM	NM	NM
Non Life Average						18.3	16.1	17.5	1.7	1.5	1.4	10.0%	9.4%	9.7%	2.3%	1.5%	2.1%	0.2	0.2	0.2	1.8%	1.4%	1.5%
Reinsurers																							
Korean Re	003690.KS	Buy	KRW	11200.0	1,261	7.1	8.3	6.8	0.77	0.74	0.67	10.8%	8.4%	9.8%	1.6%	2.2%	2.5%	NM	NM	NM	NM	NM	NM
Reinsurers Average						7.1	8.3	6.8	0.8	0.7	0.7	10.8%	8.4%	9.8%	1.6%	2.2%	2.5%	NM	NM	NM	NM	NM	NM
Aus / NZ																							
Composites																							
Suncorp Grp	SUN.AX	Neutral	AUD	14.1	15,852	31.5	14.0	12.9	1.30	1.31	1.33	3.5%	5.3%	9.9%	5.3%	7.5%	7.5%	NM	NM	NM	NM	NM	NM
Composite Average						31.5	14.0	12.9	1.3	1.3	1.3	3.5%	5.3%	9.9%	5.3%	7.5%	7.5%	NM	NM	NM	NM	NM	NM
Life																							
AMP Ltd	AMP.AX	Neutral	AUD	5.4	14,074	18.5	15.3	14.2	1.97	1.95	1.91	8.7%	10.1%	12.1%	4.2%	4.7%	5.3%	NM	NM	NM	NM	NM	NM
Challenger	CGF.AX	Neutral	AUD	7.3	3,589	9.5	11.6	12.8	1.98	1.79	1.58	22.9%	16.6%	13.9%	2.8%	3.6%	3.9%	NM	NM	NM	NM	NM	NM
NIB Hld	NHF.AX	Sell	AUD	2.8	1,089	17.9	16.9	18.9	3.81	3.49	3.69	21.4%	20.4%	18.1%	3.5%	7.1%	6.7%	NM	NM	NM	NM	NM	NM
Life Average						16.7	14.7	14.2	2.1	2.0	2.0	12.1%	11.9%	12.8%	3.9%	4.6%	5.1%	NM	NM	NM	NM	NM	NM
Non Life																							
Insur Aust Grp	IAG.AX	Neutral	AUD	6.1	12,435	11.3	10.7	12.3	2.63	2.15	2.12	17.1%	21.8%	15.4%	5.9%	6.4%	5.6%	NM	NM	NM	NM	NM	NM
QBE Ins	QBE.AX	Buy	AUD	11.5	13,719	18.1	14.6	10.4	1.23	1.11	1.05	-2.3%	7.8%	10.2%	2.6%	3.3%	4.7%	NM	NM	NM	NM	NM	NM
Tower Ltd	TWR.NZ	Neutral	NZD	2.0	274	10.0	14.1	13.3	0.91	0.89	0.86	21.5%	6.4%	6.6%	6.0%	4.0%	4.0%	NM	NM	NM	NM	NM	NM
Non Life Average						14.8	12.7	11.3	1.9	1.6	1.6	7.0%	14.4%	12.6%	4.2%	4.8%	5.1%	NM	NM	NM	NM	NM	NM

Source: Datacentral, Citi Research estimates

Appendix A-1

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