

## Global Insurance

### Show Us the Money – A Global Analysis of Free Cash Flow



- **Free cash flow – an increasingly important metric for insurance investors** — In our view, FCF will attract greater focus as a way to analyse insurance companies globally given their complex nature and scepticism over their quality of earnings. Cash is one of the few ways to compare insurers across regions and accounting regimes. We expect a greater correlation between cash flow and stock valuations going forward in the US and Europe – and increasing focus on this topic in Asia. We encourage more transparency globally and believe companies focusing on cash will benefit.
- **We analyse 'holding company free cash flow' on a global basis** — This is cash insurers can upstream to their holding companies after funding growth and other restrictions (e.g. regulatory). In our view, this is the most comparable measure globally. We look at: i) absolute free cash flow, ii) growth in cash flow and how this relates to 'capex' and iii) capital generation: the ability to cover dividends and generate surplus capital. This is a complex topic and disclosure varies greatly. Currently, the Europeans give the best disclosure and the Asians the patchiest (except AIA) in our view.
- **Our conclusions: cash flow metrics are supportive for global insurance** — We estimate an average global insurer holding company FCF yield of 7% (2014e), with the highest yields in Europe. However we estimate it could rise to ~8% if companies were able to remit all the FCF generated in their operations to their holding companies. Insurers are generating a healthy level of capital, with FCF of ~60% of net income globally. In addition, most companies have high cash flow coverage of dividends, supporting dividend growth – US life insurers especially have strong dividend growth and buyback potential. We also see a good link between capex on new business and growth in cash, particularly notable in Asia.
- **This ties in with our positive strategic view of insurers** — Our European strategists recently upgraded Insurance to overweight ([Buy the Dip - Insurance to Overweight](#)) based on its cheap valuation, improving ROE, restructuring benefits, cashflow and positive correlation to rising bond yields. In the US, we believe the US life insurance sector is in the midst of a multi-year revaluation as investor focus shifts from the risks of rates to the potential upside leverage of EPS and ROE to higher yields.
- **Buy AIA, Ameriprise and AXA** — These are Buy-rated stocks that screen well on cash flow metrics:
  - **AIA** has the lowest FCF yield at ~3%. However, this reflects high capex and is more than offset by exceptional FCF growth (11% forecast CAGR); >2x the global average.
  - **Ameriprise's** earnings are close to FCF (80-90% of earnings), and we expect it to return the majority of earnings via dividends / buybacks, boosting EPS growth ROE.
  - **AXA** offers the best holding company FCF yield in our global analysis at ~10%, with decent growth potential, supporting dividends and rebuilding capital strength.

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#### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Investment Summary

**We expect a greater correlation between cash flow and stock valuations of global insurers going forward**

In this report, we present what we believe to be a fairly unique analysis of insurance sector free cash flow on a *global* basis. We believe free cash flow is an increasingly important metric to analyse the fundamentals of global insurers. The wide disparity in regulations, products and accounting standards in the sector make it difficult to compare insurers across regions, and have led to scepticism over the quality of reported earnings – raising the sector's cost of equity. Free cash flow provides a tangible measure of value creation that makes the sector more globally comparable. We expect a greater correlation between cash flow and stock valuations in the US and Europe – with increasing focus on this topic also in Asia.

**In this report, we focus on 'holding company free cash flow'**

We focus on 'holding company free cash flow', which measures how much cash insurers can upstream from their operating subsidiaries to their holding companies. This appears to be the most comparable measure of free cash based on current disclosure. Disclosure is currently good in Europe, improving in the US but still poor in Asia – with the notable exception of AIA. We call for greater transparency.

**Our analysis is supportive for the sector**

Our analysis is supportive for the global insurance sector. We focus on three aspects of free cash flow in this report:

- The absolute level of free cash flow yield and how free cash flow compares to reported earnings;
- Capital generation: the ability to cover dividends and accumulate surplus capital;
- Cash flow growth potential, and how this relates to capex on new business.

**We estimate a ~7% global holding company FCF yield – with higher yields in Europe**

We estimate average sector holding company FCF of 7% (2014e). However, we estimate FCF yield could rise to ~8% if companies were able to remit all the free cash flow generated in their operations to their holding companies. In the global insurance sector, holding company FCF represents ~60% of reported net income. The European insurers have the strongest FCF yields, helped by the improved management focus on cash flow and the benefits of restructuring.

**We also see attractive capital generation, with strong potential to return capital to shareholders in the US**

We see attractive levels of capital generation in the global insurance sector overall, with estimated dividend cover of ~2x from 2014e holding company free cash flow. This rises to ~3x for the US life insurers, who we think show some of the best potential globally to grow dividends and return capital to shareholders. We estimate US life insurers may return ~100% of free cash flow to shareholders through buybacks and dividends in 2014e.

**We also see a link between capex and cash flow growth – important for Asian insurers with strong growth and low FCF**

Finally, we see a good relationship between the capex insurers spend on new business and the potential cash flow growth they can generate. Although we have limited data, it appears that the Asian life insurers are spending the most capex, which limits their free cash flow, but are likely to generate strong growth in cash flow as this translates into future streams of cash.

**AIA, Ameriprise and AXA screen as the best cash flow stories in each region**

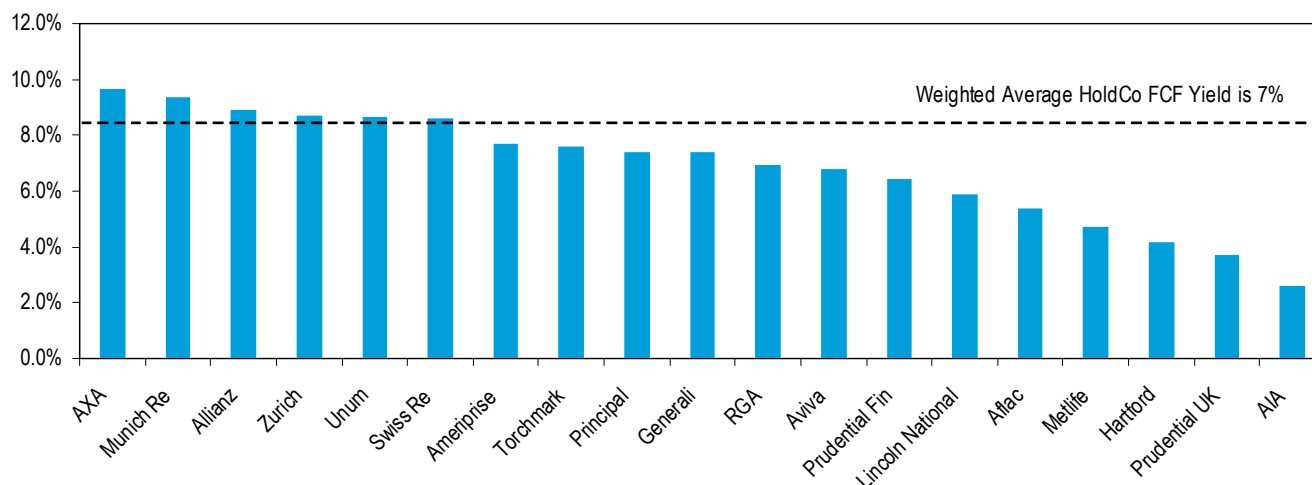
AIA, Ameriprise and AXA screen as the best cash flow stories in each region:

- AXA, our top cash flow stock pick in Europe, has the strongest global FCF yield in our analysis of ~10% (2014e).
- Ameriprise is our favoured cash flow pick in US life insurance, helped by its move to a capital-light business mix.
- AIA is our top cash flow pick in Asia and is likely to generate strong growth in cash flow (~11% CAGR), despite its low current FCF yield.

## Free Cash Flow Chart & Table

**Figure 1. Global insurance holding company free cash flow yield – 2014e**

European insurers offer the strongest yields; the US life names show strong capital generation; AIA offers strong cash flow growth despite a low FCF yield



Source: Citi Research estimates

**Figure 2. Global Free Cash Flow Summary Table – priced at July 4, 2013**

Company	Ticker	Rating	Currency	Market Cap (mn)	2013E FCF (bn)	2014E FCF (bn)	FCF Yield	FCF % of Net Income	Dividend Coverage	Capex as % of FCF	Dividend Yield	2014E Buybacks	2014E Capital Return as % FCF
<b>European Insurers</b>													
Allianz	ALVG.DE	1	EUR	51,705	3.5	4.6	8.9%	67.5%	1.9	20.7%	4.0%	N/A	51.3%
Aviva	AV.GB	1	GBP	10,355	0.5	0.7	6.8%	60.3%	1.5	29.2%	5.6%	N/A	67.2%
AXA	AXAF.FR	1	EUR	37,349	3.0	3.6	9.7%	63.2%	1.7	33.3%	4.0%	N/A	59.0%
Generali	GASI.IT	3	EUR	21,656	1.8	1.6	7.4%	74.8%	1.8	46.4%	1.5%	N/A	54.3%
Munich Re	MUVGn.DE	2	EUR	25,206	2.9	2.4	9.4%	81.6%	1.7	27.6%	5.0%	N/A	59.0%
Prudential UK	PRU.GB	1	GBP	28,741	1.0	1.1	3.7%	49.0%	1.3	25.0%	2.7%	N/A	76.8%
Swiss Re	SRENH.CH	2	USD	27,477	1.7	2.2	8.6%	72.9%	1.5	N/A	10.7%	N/A	65.6%
Zurich	ZURN.CH	2	USD	38,597	3.8	3.4	8.7%	73.2%	1.3	23.1%	6.9%	N/A	78.0%
Average							7.9%	67.8%	1.6	29.3%	5.0%		63.9%
<b>US Life Insurers</b>													
Aflac	AFL.US	1	USD	26,388	1.2	1.4	5.4%	48.2%	2.0	N/A	2.4%	750	103.9%
Ameriprise	AMP.US	1	USD	16,348	1.2	1.2	7.7%	84.7%	2.7	N/A	2.6%	1,200	133.3%
Hartford	HIG.US	1	USD	13,809	0.8	0.6	4.2%	68.5%	2.8	N/A	1.3%	700	153.2%
Lincoln National	LNC.US	2	USD	9,928	0.5	0.6	5.9%	47.2%	3.4	N/A	1.3%	400	99.3%
Metlife	MET.US	2	USD	50,666	1.6	2.4	4.8%	44.2%	1.8	N/A	2.4%	2,000	137.6%
Principal	PFG.US	2	USD	10,848	0.6	0.8	7.4%	77.4%	2.5	N/A	2.5%	400	90.2%
Prudential Fin	PRU.US	1	USD	34,409	2.0	2.2	6.5%	59.1%	2.6	N/A	2.2%	1,000	84.3%
RGA	RGA.US	2	USD	4,954	0.3	0.3	6.9%	61.3%	4.0	N/A	1.4%	200	84.7%
Torchmark	TMK.US	2	USD	6,088	0.4	0.4	7.6%	83.8%	7.6	N/A	1.0%	380	100.2%
Unum	UNM.US	2	USD	7,920	0.6	0.6	8.7%	81.4%	3.9	N/A	1.8%	400	88.2%
Average							6.5%	65.6%	3.3	N/A	1.9%		107.5%
<b>Asian Insurers</b>													
AIA	1299.HK	1	HKD	399,861	1.2	1.4	2.6%	37.0%	1.8	52.0%	1.1%	N/A	54.5%
<b>Global Insurance Average</b>							<b>6.9%</b>	<b>65.0%</b>	<b>2.5</b>	<b>32.2%</b>	<b>3.2%</b>		<b>86.3%</b>

Source: FactSet, Citi Research estimates

## Why Cash is Important and How We Define It

In our view, cash flow is becoming an increasingly important metric for evaluating insurers given investor focus on capital return and quality of earnings. Cash flow offers a way to compare insurers with different accounting regimes and it is one of the few ways to compare insurers globally. Given increasing investor skepticism about the quality of insurers' reported earnings, we believe cash flow provides a more tangible measure of value. We expect there to be greater correlation between cash and stock valuations going forward in the US and Europe – and we expect increasing focus on this topic also in Asia.

**In this report we attempt a global comparison of insurer free cash flows**

In this report, we have put together a global comparison of insurance company free cash flow. This is not a straightforward task given vast differences in the quality and form of disclosure on this topic and also the fact that in growth markets (e.g. Asia ex-Japan) it does not yet appear to be a significant valuation driver for most investors.

**We focus initially on European insurers, US life insurers and AIA**

We have collected cash flow data on a number of European life insurers, composites and reinsurers, US life insurance players, and a single Asian insurer, AIA. While there are significant holes in our analysis – notably US P&C insurers, Japanese insurers, and Australian insurers – which we intend to address in the future – we feel that this report yields some interesting data and conclusions about cash flow for different regions and types of business.

**We urge global insurers to pay more attention to cash to address opacity and raise the attraction of the sector**

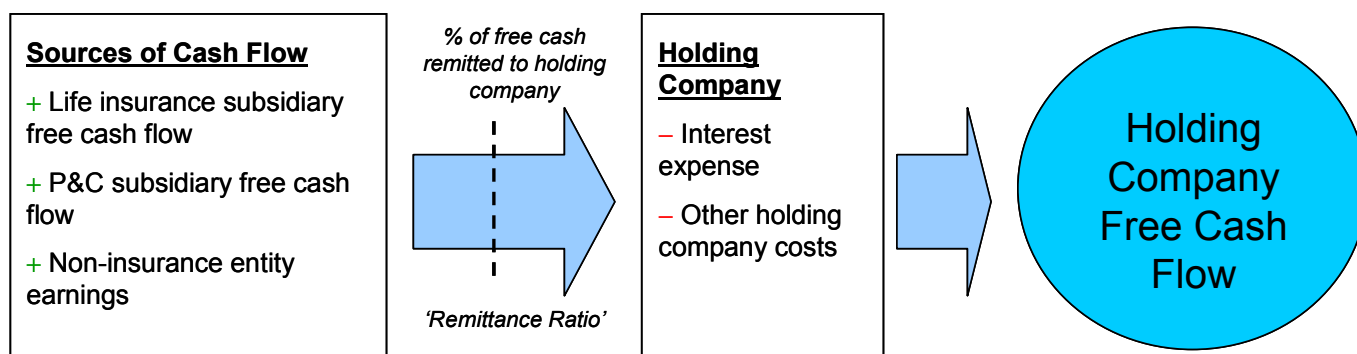
We urge insurers to pay more attention to this topic, where they are not already doing so. It appears that global differences in regulation, product-design and accounting for insurers are here to stay in the medium-term and continue to act as a drag on the multiples that investors are willing to pay – especially for insurers in mature markets. Our analysis appears to show that cash generation in the global insurance sector is, on the whole, reasonably attractive and could provide fundamental support to valuation if disclosed properly.

## How We Define Free Cash Flow for Insurers

**We use the concept of 'holding company free cash flow' – the most comparable measure of cash generation, in our view**

We use the concept of 'holding company free cash flow', which we believe is the most comparable measure of cash generation across companies and sectors. We define this as the amount of money that an insurer brings to the holding company minus after-tax interest expense and other hold co expenses.

Figure 3. The definition of 'holding company free cash flow'



Source: Citi Research

Companies may not be able to upstream all of their operating cash flow to their holding companies

There are three primary sources of cash flow: 1) dividends from insurance subsidiaries, 2) earnings from non-insurance entities (such as asset management businesses), and 3) income at the holding company (primarily investment income). The dividends from insurance subsidiaries may not represent all of the free cash generation in the operating units; there may be some free cash that is retained locally. The 'remittance ratio', which is the proportion of cash generation in operating subsidiaries that a company can transfer to its holding company, is an important driver. There may be regulatory restrictions on the transfer of capital from an insurance subsidiary, or companies may simply prefer to build capital buffers in their subsidiaries (e.g. to attract new business).

Life insurance cash flows are the combination of in-force cash flow less capex to fund new business growth

### Drivers of Free Cash Flow

Insurance is a highly cash generative business over time, but there is a long-tail for certain lines of business (such as life insurance), with cash flow emerging over time. This is particularly true for growing companies given the cash strain related to new business.

Life insurers have two basic drivers of cash flow:

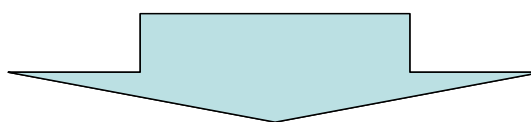
- The cash flow emerging from existing policies, which includes the release of required capital on this book as it runs-off.
- The 'capex' or strain incurred in writing new business, which includes paying acquisition costs, such as commission and policy set-up costs, and the required buffer capital to back the new liability.

We can examine these components in European embedded value disclosure

We can derive both of these elements in Europe (and for AIA) using embedded value disclosure, which usually shows the movement in required capital and free surplus separately from the movement in the 'present value of in-force profits'.

Figure 4. Key drivers of insurance subsidiary cash flow

<u>Life Insurance</u>	<u>P&amp;C Insurance</u>
+ Earnings from in-force block	+ Reported earnings
+ Release of capital from in-force block	+/- Capital needed for growth
- Acquisition costs (commissions, underwriting expenses)	
- New business required capital	



**Insurance Free Cash Flow**

Source: Citi Research

**Lack of equivalent disclosure means we have to look at statutory profits in the US**

US insurers do not provide equivalent disclosure, so for these companies we estimate statutory dividends as a percentage of operating earnings. This percentage tends to fluctuate from year to year, but is relatively consistent over time for most companies. Statutory earnings are typically conservative and approximate cash accounting. On a statutory basis, acquisition costs (including commissions and underwriting expenses) are expensed as incurred rather than deferred. As a result, the first year cash flow on a new policy, especially long-duration life contracts, is typically negative.

**P&C insurers have a less complex cash flow model**

Deriving free cash flow for P&C insurers is less complicated as contracts are generally shorter duration and the accounting treats acquisition costs more like an ongoing expense. There is less of a material difference between reported accounts and cash for P&C companies. Therefore, in our approach we simply use reported earnings as cash, but then we adjust this for our estimate of the capital required to fund growth. This is usually driven by premium volumes (there is a rough correlation between the level of capital required in a P&C business and its premiums).

The other factors which affect cash flow for both life and P&C insurers are investment losses and changes in required reserves. While P&C reserves are typically released if shown to be redundant, most life products are a “one-way street” and do not allow for the early release of reserves.

**Cash Flow Disclosure has Room for Improvement, Especially in Asia**

**We anticipate better disclosure on cash over time, as investors start to demand it**

In compiling this report it has become clear that assessing free cash flow is not always a straightforward exercise, and insurers could improve disclosure and transparency in our view. Currently, we believe European insurers offer the best view of cash flow as a result of embedded value accounting. We have seen some US companies offer expanded disclosure at recent investor days, but most of our analysis relies on historical statutory earnings and dividends (which is more backward looking). Over time we expect disclosure to improve further as investors place greater emphasis on differentiating companies on the basis of FCF.

**We look for Asian insurers, in particular, to bring their standards of disclosure up to that of AIA**

In particular, we would like to be able to do more detailed analysis of cash flow generation for Asian insurers. However, we have found this difficult due to a lack of disclosure and focus on this topic in the region from the companies themselves. We are hoping this will improve in the near-term, and we note the detailed disclosure from AIA. We have included the segmental disclosure on cash generation from Prudential (UK) on its Asian business for comparison. We hope to address cash flow in Asia on a wider selection of companies soon.

## Global Insurance Cash Flow: Conclusions

Our analysis suggests that cash generation provides increasingly important valuation support for global insurers. We consider not only the level of holding company free cash flow, but also the ability to pay dividends and generate surplus capital, as well as the potential for growth in cash. We highlight three stock picks that we like regionally and also compare well in our global cash flow analysis: **AIA** – for its strong cash flow growth potential, **Ameriprise** – for its capital return potential and **AXA** – for its strong absolute free cash flow yield.

### Top Global Cash Flow Picks: AIA, Ameriprise, AXA

While there are significant disclosure gaps globally, cash flow is moving up the management agenda

In our view, current limitations in the quality and consistency of insurance cash flow disclosure globally prevent a true understanding of insurer fundamentals. We believe this contributes to the industry's elevated cost of equity – particularly for the more opaque life insurance sector. However, things are changing, especially in some of the more developed markets such as Europe and the US where we are seeing improved disclosure on how complex traditional insurance business models generate cash. It appears that cash flow is moving up the management agenda.

We highlight three top stock picks from our cash flow analysis: **AIA**, **Ameriprise** and **AXA**

Citi's Global Insurance Equity Research team is increasingly factoring in cash flow into our understanding of insurers' fundamentals and valuation. We believe the conclusions from our analysis help to support some of our top global insurance stock picks, namely: **AIA** in Asia ex-Japan, **Ameriprise** in the US and **AXA** in Europe. These are all Buy-rated stocks we find attractive in a regional context, that also screen very well globally on a number of cash flow metrics. In choosing these stocks, we have looked for the following characteristics:

We focus on the absolute level of holding company free cash flow yield...

■ **The level of holding company free cash generation**, i.e. ability to generate cash *and* upstream this to the Group holding company. Capital trapped in subsidiaries may help to boost local solvency and growth but cannot always be considered 'free' if it cannot be used to pay shareholder dividends or fund growth elsewhere in the business. We look for companies generating high 'holding company free cash flow yields' that demonstrate the value from their operations that may not necessarily be priced in by the market (often due to the opaque nature of their businesses).

...future cash flow growth potential...

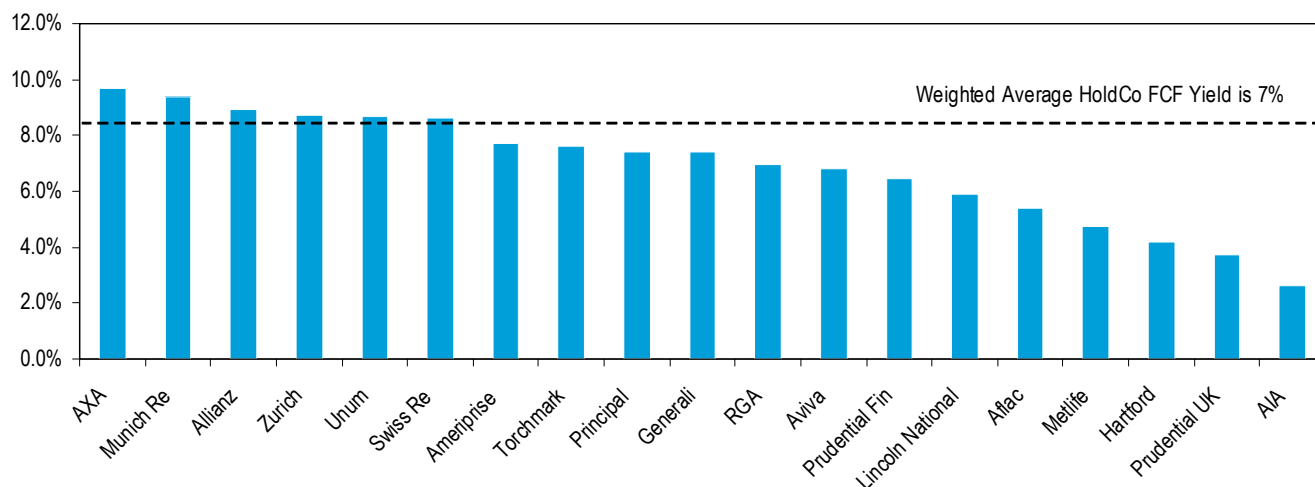
■ **Future cash flow growth potential**. As well as looking at absolute cash flow, we also examine growth potential. We believe low FCF yields today are acceptable if there is likely to be strong sustainable growth in future cash generation. There may often be a trade off between absolute cash flow generation today and the growth going forward. Life insurers could improve near-term cash flow considerably by eliminating capex on growing volumes of new business, due to rich margins generated from existing mature blocks of business. However, lack of investment in new business growth should ultimately lead to a decline in cash as these policies start to run-off.

...the ability to generate surplus capital and pay attractive cash returns

■ **Net capital generation and dividend cover**. We also examine dividend growth potential and how much flexibility insurers have in spending their cash. We believe it is increasingly important for insurers to use dividends as a way of demonstrating value – particularly those with more complex businesses (e.g. mature traditional life insurers, multi-national insurers or insurance conglomerates). However, dividends need to be adequately covered by cash upstreamed to the holding company, and ideally companies should be in a position to retain capital after paying dividends to fund future growth, acquisitions or just rebuild capital buffers. Therefore, we look for companies with strong net capital generation, or potential to significantly grow future dividends or payouts to shareholders.

**Figure 5. Holding company free cash flow yields 2014e**

AXA offers the strongest holdco FCF yield in our analysis, AIA the lowest



Source: Citi Research estimates

We have chosen our top stock picks by taking these metrics into account, and combining them with our bottom up regional fundamental views:

**AIA offers a low absolute free cash flow yield currently**

■ **AIA – low cash flow yields now, but growing strongly.** AIA is one of our core insurance stock picks in Asia ex-Japan, due to its strong growth potential, defensive business mix (with an increasing focus on protection products) and low sensitivity to capital markets. In a global context, its cash generation looks relatively weak with the lowest holding company free cash flow yield of ~3%, less than half of the global insurance average of ~7%. However, this is offset by strong growth potential in cash flow in future years:

**However, this mainly reflects its high capex to fund new business growth**

- AIA is experiencing very strong new business growth (13% in 2013e) and its cash flow is suppressed by the capex required to fund this growth. We estimate that AIA reinvests ~55% of the cash flow from its existing life policies into new business capex. This compares to an average new business capex ratio of ~35% of operating cash flow.
- We believe this will translate into superior growth, with double-digit EPS growth and ~11% annualized cash flow growth in the next three years – well above the average global insurance cash flow growth of ~5%. This should be helped by the growing maturity of some of its emerging markets businesses which should start to improve their level of cash production over time.
- We believe AIA will continue to generate attractive new business growth in spite of the near-term macroeconomic backdrop in its key markets, given its focus on protection products and still supportive structural growth factors (e.g. urbanization, low insurance penetration).

**We believe AIA will deliver superior growth in cash flow, of 11% CAGR, well above the global average**

**Ameriprise offers attractive capital returns for shareholders as it shifts to a less capital intensive business model**

**A large proportion of AMP's earnings come from asset and wealth management**

**Management is disciplined about returning cash to shareholders**

**We believe AMP deserves to trade at a premium P/E**

**AXA has the strongest holding company free cash flow in our analysis**

**We estimate a ~10% holding company free cash yield**

**This should support strong dividends**

**Improving fundamentals in US variable annuities may support cash and capital**

■ **Ameriprise – strong cash flow driving superior capital return story.**

Ameriprise has a hybrid business model and currently generates about half of its earnings from insurance products and the other half from less capital-intensive asset management and wealth management segments. Over time, we expect the mix to continue shifting toward asset management. This should allow AMP to continue generating free flow of 80-90% of earnings, the highest ratio of any company in our analysis. In addition:

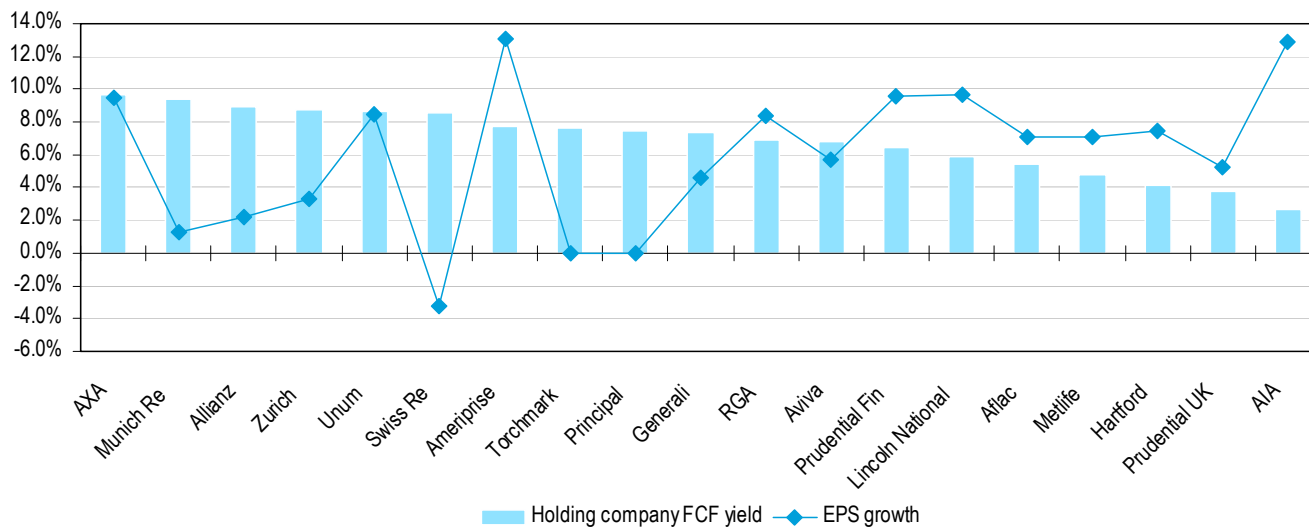
- Much of AMP's earnings come from non-regulated entities, making it easier to get cash flow to the holding company. Both the company's asset management and advice and wealth management units are owned directly by the holding company, so the only factor limiting cash flow is the capital needed to grow the business.
- Management has been disciplined about returning cash to shareholders through dividends and share repurchases. We estimate its current dividend yield is covered 2.7x by holding company free cash flow, allowing decent growth potential. In addition, we expect the company to return \$1.4bn in 2013 and \$1.2bn in 2014 through share buybacks, which boosts EPS growth and ROE and limits downside risk.
- AMP's strong cash flow and consistent capital return support a P/E premium. The current FCF yield is in the middle of the range for global insurers, but we believe this is somewhat misleading given its business mix. In our view, AMP is in the middle of a multi-year revaluation as its mix continues to shift to higher growth and less capital-intensive products. While the stock already trades at a significant premium to the US life insurance sector, it still looks attractive on a sum-of-the-parts basis in our view.

■ **AXA – one of the strongest free cash flow yields in the sector.** AXA is one of our top Buy recommendations in the European Insurance sector, and is on the Citi Focus List Europe. We believe 2013 will be an inflexion year for the company as it addresses key debates that have affected its performance in recent years, including an improvement in its US variable annuities business, stable investment margins and better profitability in property & casualty. In addition, AXA is likely to strengthen its capital position and is showing a welcome focus on cash generation:

- AXA offers the strongest holding company free cash flow yield in our analysis, at ~10% in 2014e. This is based on our assumption that AXA is able to upstream ~80% of free cash flow generated in its subsidiaries up to its holding company. If it was able to upstream 100%, then its implied group free cash flow yield would rise to ~12%.
- We believe this will support a relatively strong dividend yield of ~6% (2014e), which also compares well with global peers, and which we estimate is covered reasonably well by holding company free cash flow (1.6x).
- We believe cash flow and capital will be supported by improving fundamentals in AXA's US variable annuities business, which has been beset by reserving issues in recent years, to address changing policyholder behaviour and hedging volatility. Reserving levels appear to have reached conservative levels (in our view) and the rising US 10-year yield should also relieve levels of economic capital in this business.

**Figure 6. Holding company free cash flow yield 2014e vs. reported EPS growth 2013-15e**

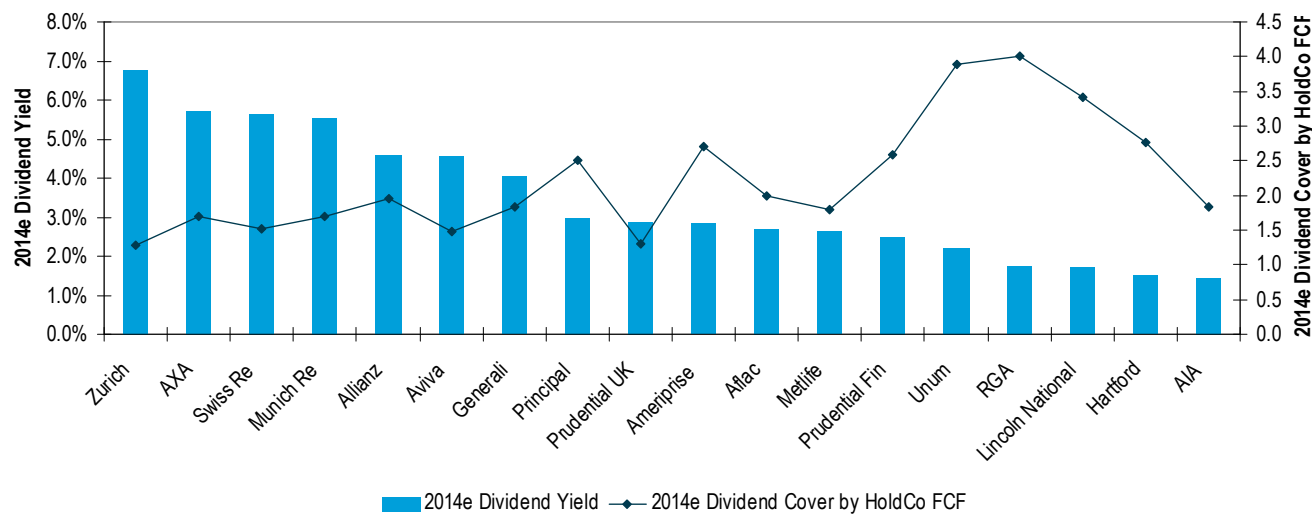
AIA's low holding company free cash flow yield is compensated by its strong reported EPS (and cash flow growth potential)



Source: Citi Research estimates

**Figure 7. Dividend yield vs. dividend cover by holding company free cash – 2014e**

Ameriprise offers strong dividend cover and decent potential for dividend growth, especially as it shifts to less capital intensive business areas



Source: Citi Research estimates

## Global Insurance FCF – What We Learn About the Sector

**Our free cash flow conclusions are supportive of the global insurance sector**

We believe our free cash flow analysis allows us to draw a number of supportive conclusions on the valuation (and value creation) of the sector. It also gives us a useful tool for comparing company performance across regions and with other sectors. Over time, we hope to further our analysis by including additional regions (Australia, Japan) and industry sub-sectors (notably US property & casualty).

We highlight the following key sector conclusions from our cash flow modeling:

- On average, the global insurers our analysis covers are generating free cash flows yields of 7%, which we believe is supportive for valuation and is similar to average global equities average. We estimate that FCF yield for global insurers would rise to ~8% if they were able to upstream 100% of the cash flow in their subsidiaries. European insurers currently have the strongest FCF yields.
- Most insurers have strong dividend coverage ratios (average is 2x), supporting dividend growth. This is particularly true in the US life sector, where dividend cover is 3x on average and we anticipate a significant return of capital to shareholders through dividend growth and share buybacks.
- Where cash flow is subdued due to capex spent on growth, we believe there is a good correlation between the level of capex and future improvement in earnings and cash. This is particularly in Asia, which remains a high growth market.
- While there is a disparity between reported net income and cash flow, for many insurers (especially those with P&C businesses or less capital intensive business models) earnings are a good reflection of cash.

We cover each of these points in a little more detail in the following sections.

### Attractive Cash Generation Supportive of Insurers' Valuations

**We estimate an average global insurance holding company free flow yield of ~7%**

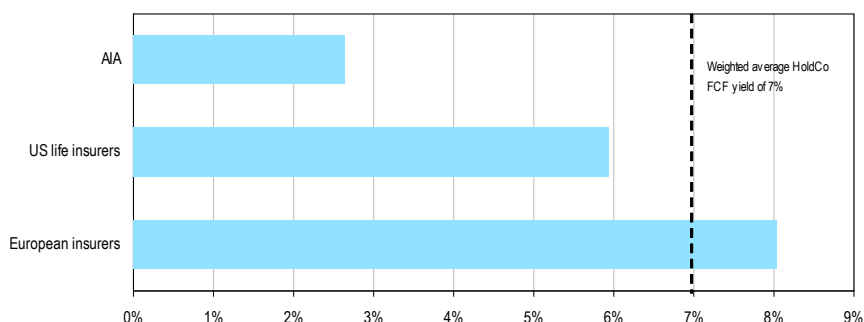
The average holding company free cash flow yield for the insurers covered in our analysis is 7%. As shown in Figure 8, there is considerable disparity in cash flow between insurers, and many stocks (particularly in Europe) offer significantly higher yields. Bearing in mind some gaps on our analysis (e.g. the US P&C insurers), our calculations suggest that European insurers appear to be generating FCF yields at the higher end of the global range, with the US life insurers somewhere in the middle, and high-growth Asian life companies at the lower end.

**European insurers generate the highest FCF yields in our comparison, reflecting business mix and valuation**

The greater FCF yields of European insurers partly reflect their weaker market performance during the financial crisis and the lower investor weightings to the region, which have depressed their relative valuation. It also reflects business mix: the European insurers studied in this report include composite insurers with P&C businesses, or reinsurers, both of which benefit from the highly cash generative nature of non-life insurance.

**Figure 8. Holding company free cash flow yields by region – 2014e**

European insurers currently offer relatively strong holding company free cash flow yields



Source: Citi Research estimates

**The Europeans are putting greater emphasis on cash flow – with a similar trend in the US**

However, it is also clear to us that management teams in Europe have started to put a greater emphasis on cash in the way they manage their businesses. In anticipation of Solvency 2, European life insurers have re-evaluated business models, asset allocation and product strategy. This has led to more selective growth and greater effort on extracting value and cash flow from existing in-force policy books. We are seeing similar trends in the US where a number of life insurers are deemphasizing capital-intensive long-tail business.

We believe our free cash flow calculations are highly supportive of the valuation of the global insurance sector, for the following reasons:

**Some insurers offer relative attractive FCF yields of 9-10%, mostly Europeans**

- As we show in Figure 5, there are many stocks generating holding company FCF yields of 9-10%, such as AXA, Munich Re and Allianz in Europe. As well as looking good in a wider market context, we believe this demonstrates that often opaque insurance business models can actually generate attractive levels of cash.

**We only consider free cash remitted to holding companies – this may be conservative for some companies**

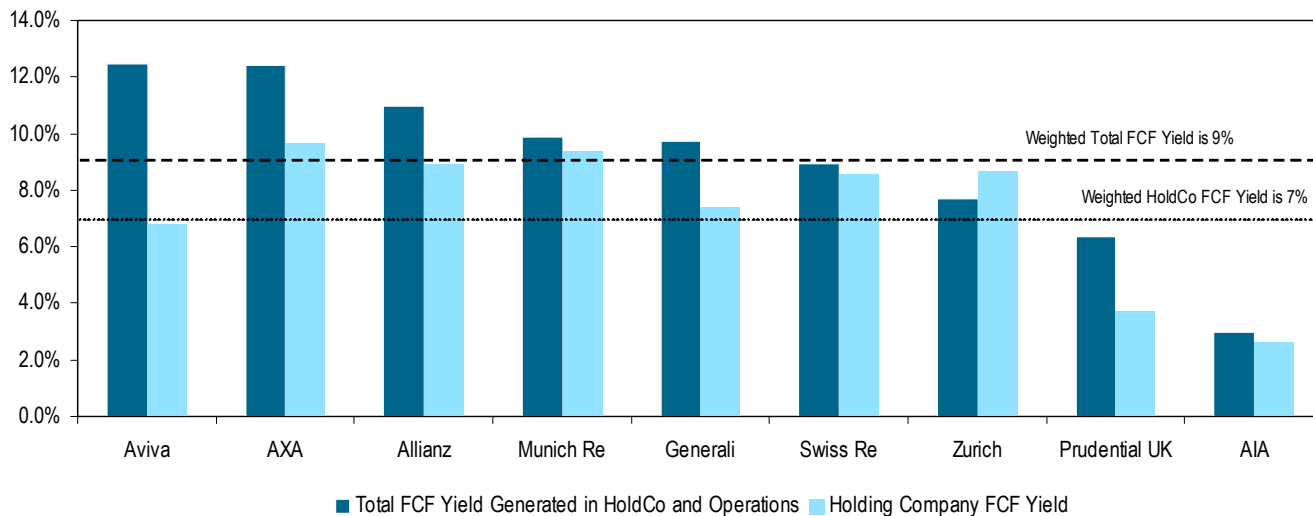
- We believe our numbers understate the total underlying free cash flow of global insurance groups, since we only consider free cash upstreamed to holding companies. However, this may not represent 100% of free cash generated. This is difficult to estimate for US insurers, however for the Europeans (and AIA), we can use embedded value and other disclosure on cash to estimate *total* group free cash flow. As we show in Figure 10, we estimate holding company free cash flow represents ~85% of total group free cash flow, i.e. 15% of free cash flow is, on average, not remitted to the holding company. If we consider total free cash flow, we estimate global insurers offer average FCF yields of ~8%.

**Restrictions on remittance may include regulation or a desire to rebuild capital buffers, and may change over time**

- Limits on remittances of cash to holding companies may result from 'dividend traps', such as regulatory restrictions on moving capital out of a particular jurisdiction. They may also reflect a desire to improve capital buffers in a subsidiary. Such dividend traps tend to be more common in life than P&C companies, given their potentially greater capital and investment risks. One could argue that we should ignore cash that is not remitted to the holding company, since it cannot be used freely. However, we think this is slightly harsh, given the potential for remittance ratios to improve in the future. In addition, this cash is available to fund growth (or even M&A) in the subsidiaries. There are also clear examples of companies (e.g. Aviva in Europe) where we expect remittances to improve substantially in the next few years.

**Figure 9. Total group free cash flow vs. Holding company free cash flow – 2014e**

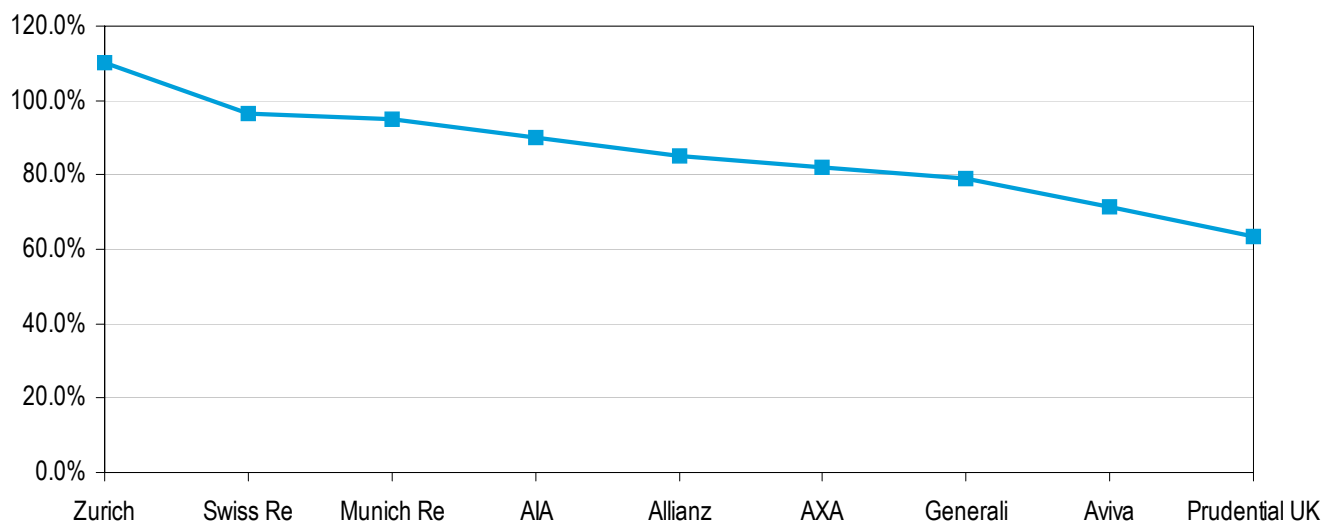
If we assume 100% of free cash generated in operating subsidiaries could be remitted to holding companies, average free cash flow yields would rise from 7% to 9% in the global insurance sector



Source: Citi Research estimates

**Figure 10. Estimated remittance ratios: % of operating free cash flow upstreamed to group holding companies – 2014e**

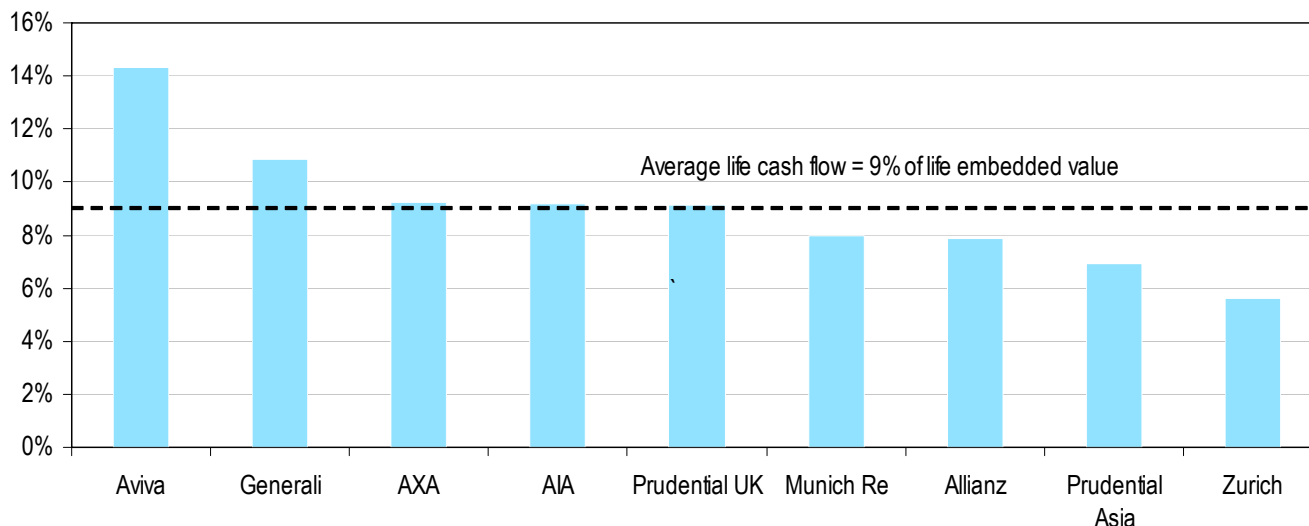
Average remittance ratios of cash to holding companies is ~85% in the global insurance sector, suggesting that cash flow is fairly fungible in global insurance groups



Source: Citi Research estimates

**Figure 11. Operating cash flow from in-force life business as a % of embedded value – 2014e**

On average, in-force cash flows (ignoring new business) from life insurers are ~9% of embedded value, suggesting that embedded values will liquidate into real cash flows over a reasonable time frame (~10-11 years)



Source: Citi Research estimates

**We believe embedded values are valid guide to life insurers' cash flow potential**

■ We believe cash flow data in Europe and Asia also supports the validity of life insurance embedded values as a valuation metric. Figure 11 shows the expected cash flow emergence from existing in-force business (i.e. excluding any cash strain or capex spent on writing new business). On average, cash generated from existing life policies is ~9% of life embedded value. Put another way, this suggests that 'intangible' life embedded values will typically liquidate into real cash over a period of 10-11 years. This is roughly consistent with the average outstanding duration of life insurance policies globally, and supports our view that life insurance embedded values provide us with a window into real future cash generation potential.

**Global insurers offer a ~4% dividend yield, with decent growth potential**

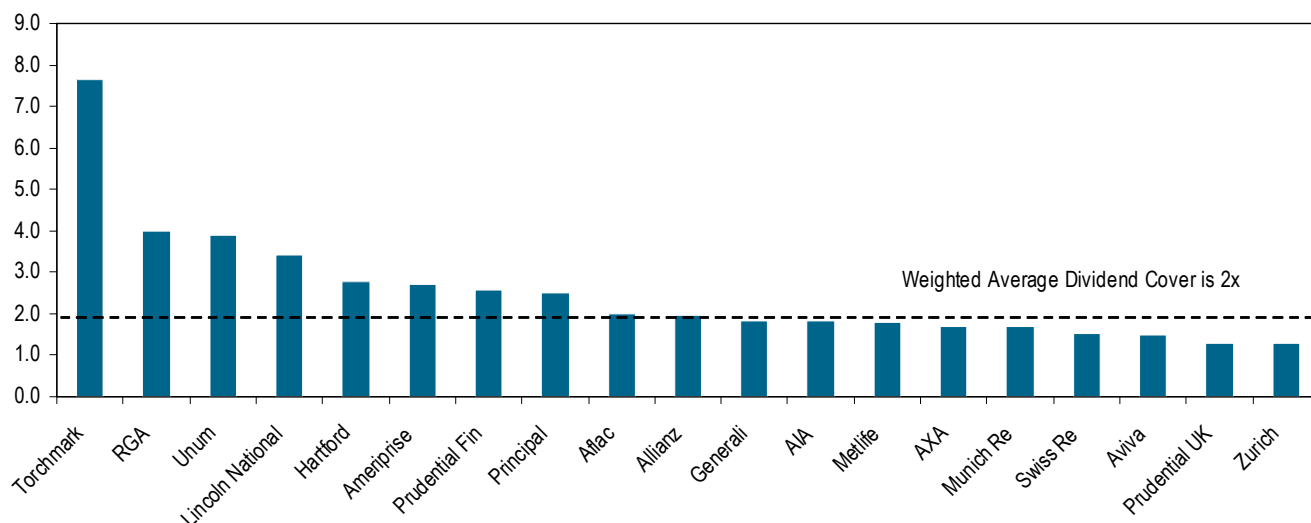
Based on the companies analysed, we estimate the global insurance sector offers a ~4% dividend yield (2014e), with the highest dividend yields available in Europe and the lowest in Asia – mirroring holding company FCF yields. However, our cash flow analysis suggests these are very well covered by holding company free cash flow. Therefore, we believe there is good dividend growth potential in the global insurance sector, at least in-line with average cash flow growth of ~5% CAGR.

**We estimate dividends are covered well by holding company cash flow (2x)**

Figure 12 shows that our holding company free cash flow forecasts cover expected dividends by 2x, on average, in the global insurance sector. Coverage from reported earnings is even greater. US life insurers, in particular, have substantially higher levels of dividend cover than their global peers, with average dividend cover of ~3x by holding company cash flow.

**Figure 12. Coverage of declared dividends by holding company free cash flow – 2014e**

We estimate weighted average dividend cover by holding company free cash of ~2x, with the strongest levels of cover in the US life insurance sector



Source: Citi Research estimates

We think this paints a fairly positive picture of the dividend potential and capital flexibility of global insurers:

**We see particularly attractive dividend growth potential in the US life sector**

- There is plenty of room for attractive dividend growth, in our opinion, especially in the US life sector. Some of this is due to insurers cutting or freezing dividends during the financial crisis, so current yields are relatively modest. We are seeing more emphasis on dividends from several US management teams.

**We are also seeing a greater appetite for capital return in the US, and in some areas of European insurance**

- In some regions we are starting to see a greater appetite for capital return, which we attribute to both stronger balance sheets post crisis and improved cash flow. We project US life insurers on average to return 6% of shareholders equity via buybacks and dividends in 2013. Capital deployment is a key rung of our positive view on Ameriprise, which we expect to spend \$2.6bn on share repurchases over 2013-14e, helping to drive one of the strongest levels of EPS growth in the global insurance sector. We have also seen numerous examples of capital return in the global P&C sector, including Swiss Re in Europe. If markets stabilize, yields recover or we see further improvements in global insurance capital buffers, we believe we could see further examples of capital return in the sector – especially from global reinsurers and P&C companies.

**High cash flow coverage of dividends bodes well for future capital flexibility**

- High cash flow coverage of dividends suggests that global insurers are also improving capital flexibility. This potentially makes the sector better able to cope with future market downturns, by improving regulatory capital buffers and liquidity. In addition, it gives companies more strategic flexibility in being able to reinvest capital into new growth areas, or in some cases acquisition-led growth. Importantly, it should continue to reduce investor concerns about capital adequacy, which affected US and European insurers in particular during the financial crisis.

A common criticism is that global insurers' reported net income does not always resemble cash flow

However, for some insurers we see a very good link between cash and earnings – e.g. Ameriprise

The relationship between cash flow and reported earnings varies with business and geographical mix

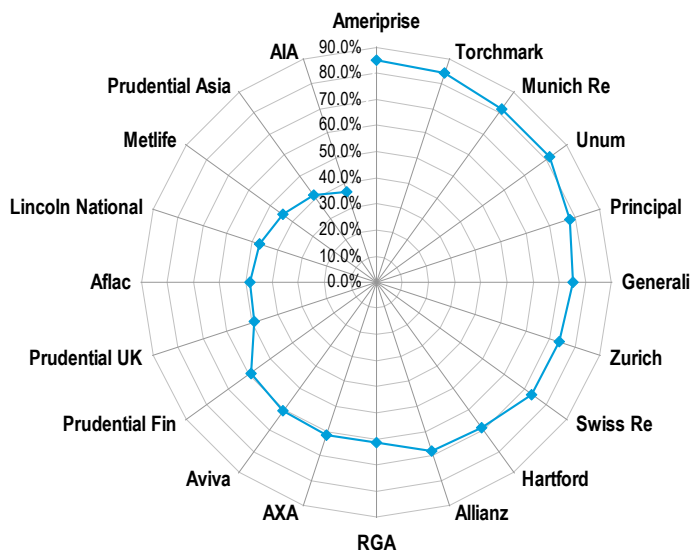
## The Link Between Free Cash Flow and Reported Profits

One of the criticisms commonly leveled against global insurers is that their reported net income does not always bear any resemblance to cash generation, and therefore is not a good guide to their economics or dividend potential. While this is true in some cases, we believe this is an over-simplification for most insurers. Figure 13 shows our estimate of the ratio of holding company free cash flow to reported net income for the insurers analysed in this report. We would highlight the following points on this chart:

- For many insurers, net income is a fairly good proxy for holding company cash generation, especially Ameriprise in the US. From the data shown, we estimate that the average ratio of holding company free cash flow to net income is ~60%. However, many insurers across the US and Europe report profits that are quite a good representation of underlying cash flow.
- Much of the difference in the cash / net income ratio between companies can be explained by business mix or geographical diversification. For example, Ameriprise benefits from getting >50% of earnings from its capital light asset and wealth management businesses, where earnings and cash are almost equal. Different insurance products also require very different amounts of initial capital, affecting cash flow. Generally longer-tail products (traditional life, annuities) or contracts with guarantees (variable annuities, participating life contracts in Europe) are more capital-intensive and generate modest cash flow as a percentage of earnings in the early years. By contrast, shorter tail products such as group benefits or P&C convert earnings to cash flow more quickly. As a result, European multi-line insurers (such as AXA and Allianz) tend to have stronger cash flow than pure life insurers.

Figure 13. Holding company free cash flow as a % of reported net income – 2014e

On average cash flow is 60% of reported net income, but with many companies showing a very close relationship between cash and earnings – we would highlight Ameriprise



Source: Citi Research estimates

**Growth rates may also affect the ratio of free cash flow to reported earnings**

- As discussed in more detail in the next section, growth rates also matter. In our view, investors are willing to overlook low free cash flow as a percentage of earnings if an insurer is growing (such as AIA or Prudential UK). Where they become more sceptical is when mature companies with modest growth rates consistently report FCF <50% of earnings (such as Lincoln and MetLife).

**Low FCF is not a disadvantage if it is caused by high capex on future growth**

As we discussed earlier, one of the factors we take into account in choosing our stock picks has been potential future growth in cash flow. A company generating low holding company free cash flows today may be doing so because it is simply reinvesting a lot of its cash generation into capex for future growth.

**Lack of disclosure in the US makes it difficult to analyse capex**

Unfortunately, it is difficult to analyse capex for US life insurers, since statutory data does not explicitly delineate the capital strain from new business. However, for European and Asian insurers disclosing 'free surplus' and 'required capital' metrics for their life insurance businesses in embedded value disclosure, we can draw some interesting data.

We show data on capex and potential growth in future cash flows in Figure 14. As we defined in the previous chapter, 'capex' is the incremental capital required to write new life business or grow volumes in other business units (e.g. P&C). This is the sum of incremental acquisition costs to write new life business, and increased capital requirements to fund new life growth or higher premiums in P&C. In the chart, we look at the percentage of cash flow generated from existing business (i.e. operational cash flow *before* capex) that is reinvested to help fund growth and new business. We plot this against our forecasts of the growth in operational cash flow (before capex) in the next three years. We would highlight some of the following conclusions from the data in Figure 14:

**Our analysis suggests a good relationship between capex and future cash flow growth**

- On the whole, we believe there is strong a relationship between the level of capital expenditure and growth in future cash flows. AIA and Prudential UK's Asian business are set to generate far stronger cash flow growth than peers in Figure 14. High new business growth in life insurance should translate into higher embedded value and, ultimately, stronger future cash flows. Therefore, a low FCF yield in itself is not necessarily a bad thing if it is compensated by high growth potential – as, we believe, is the case with AIA.

**There is a wide range of capex with AIA and Prudential UK's Asian subsidiary reinvesting >50% of operating cash flow**

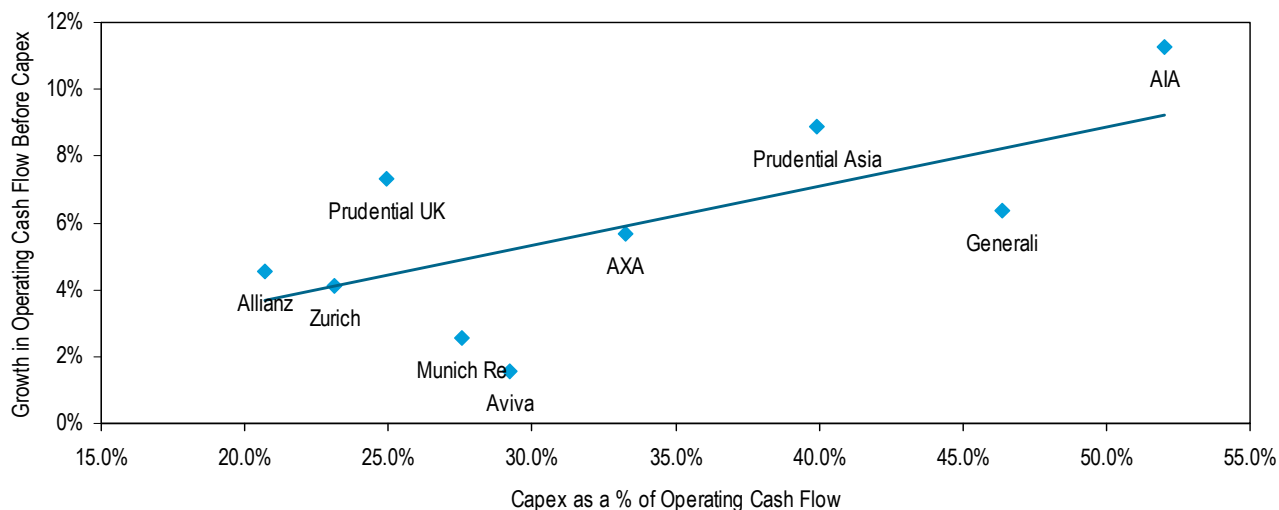
- There is a wide range of capital investment among the insurers considered in our analysis. Perhaps unsurprisingly, 'high growth' insurers, such as AIA and Prudential UK's Asian subsidiary, reinvest 50% or more of their cash into funding growth. European insurers, such as Allianz and Zurich, invest less. Average capex reinvestment is ~35% in the global insurance sector.

**If we exclude all capex, or just allow for maintenance capex, underlying cash flows in the sector appear high**

- If we exclude capex, we believe underlying cash flows generated by insurers are quite high – as we illustrate in Figure 15, which shows operating cash flow yields if we assume insurers do not invest in growth. There are two data sets shown in this chart – FCF excluding all capex, and FCF including only capex required to maintain value. This is *maintenance capex*, which we define as the level of minimum capex necessary to keep cash flows at least flat (and in the context of life insurance business, keep life embedded values constant). Note again that we are only able to make these kinds of calculations where sufficient embedded value disclosure is available, i.e. not for US life insurers.

**Figure 14. Capex expenditure on growth (2014e) vs. growth in underlying cash flow before capex – 2012-2015e**

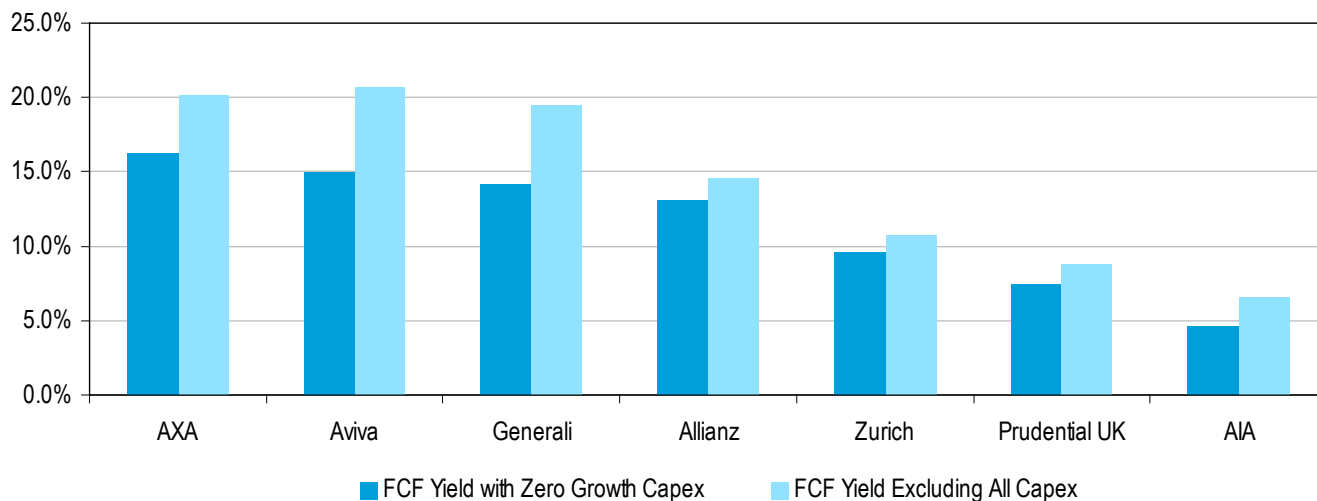
This chart suggests a good correlation between the amount of capex on growth and our forecast of underlying cash flow growth



Source: Citi Research estimates

**Figure 15. Cash flow yield excluding all capex and cash flow excluding only growth capex – 2014e**

There is a substantial improvement in free cash generation if we assume companies do not invest capex to grow



Source: Citi Research estimates

**Most US life insurers do not report capex, but we believe this has been trending lower due to business mix**

- While most US life insurers do not directly report capex, we can estimate capital strain based on sales volumes and mix. Over the past few years, sales, particularly for more capital-intensive products (such as annuities and whole life) have generally been trending lower. This suggests that new business strain has likely declined for most insurers, boosting FCF. If volumes reaccelerate as interest rates rise and the economy recovers, this could weigh on FCF generation, but it should be a positive for long-term earnings growth.

## Focus on European Insurers

The European insurers provide the best disclosure of cash globally in our view. They also currently produce the highest holding company free cash flow yields, helped by an increased focus on cash by management and the benefits of restructuring. This should continue to support attractive dividend yields, and we see the focus on cash as a positive investment catalyst for the European insurers. Our top pick is AXA, which produces the highest FCF yield in our analysis

### European Insurers: Good Cash Flow Disclosure

European insurers provide the best FCF disclosure globally

The European Insurance sector provides the most comprehensive disclosure of cash relative to other regions. This is a byproduct of the standardization of embedded value reporting in Europe in the mid-2000s, called "European Embedded Value", which required insurers to give more details on how cash emerged from their life businesses and the capital spent on writing new business. Specifically, European Embedded Value requires insurers to show the different components of embedded value including the "required capital" and "free surplus".

Investor focus on cash has increased markedly since the crisis

After the onset of the financial crisis, with rising concerns about the balance sheet strength of the sector, the importance of cash flow generation has increased. Many European insurers now provide their own internal calculation of free cash flow as a standard part of management disclosure. We believe cash flow generation has risen up management agendas in Europe, with companies increasingly considering the cash flow impact of their growth, geographical and distribution strategy.

### Strong Free Cash Flow Yields in a Global Context

European insurers have the strongest holding company free cash flow yields globally

The European Insurers studied in this report offer relatively strong free cash flow yields in a global context. We believe this is a highly supportive investment theme for the sector and it is a key factor in our positive view of the European insurers (recently moved to Overweight by our European Strategists). As we have highlighted, our top pick within this space, which also produces one of the highest holding company FCF yields, is AXA.

Figures 16 and 17 show some of the data on free cash flow for the European Insurers. We would highlight the following points.

- **Holding company free flows above global average.** European insurers generate relatively strong free cash flow yields in a global context, with average Holding Company Free Cash Flow yields of 8%, compared to the global average in our analysis of ~7%.
- **Holding company cash may not represent total FCF generated.** We estimate European insurers remit ~85% of free cash generated in their subsidiaries to the Group holding company. This may be due to a desire to keep capital in local subsidiaries, rebuild local capital buffers or due to regulatory restrictions. If we assume these restrictions were not in place, we estimate the implied 'total group FCF' of the European insurers would rise to ~10% on average, with companies such as Aviva and AXA generating in excess of 12%.

European insurers remit ~85% of operational free cash flow to their holding companies

**Figure 16. A summary of European Insurer holding company free cash flow – 2014e**

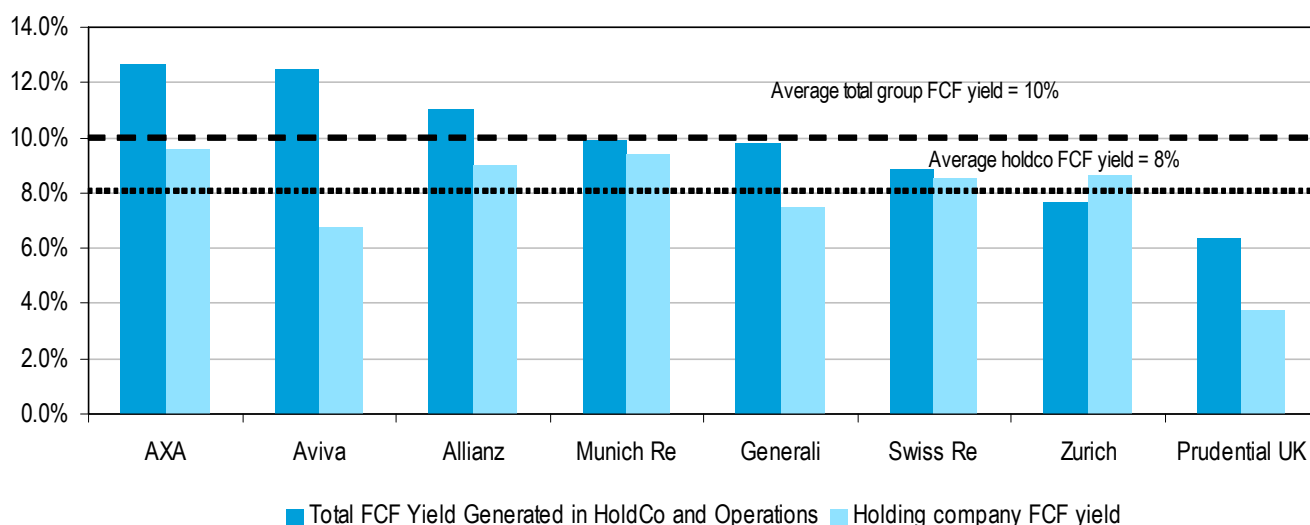
AXA offers the strongest holding company free cash flow yield, followed closely by Allianz and Munich Re; Prudential offers the lowest FCF yield

€bn	Allianz	Aviva	AXA	Generali	Munich Re	Prudential UK	Swiss Re	Zurich
Life new business capex	-1.6	-0.6	-2.4	-1.6	-0.6	-0.7		-0.8
Life cash flow from in-force	2.8	2.2	5.2	3.0	1.3	2.4		1.2
<b>Life operating free cash flow</b>	<b>1.1</b>	<b>1.6</b>	<b>2.7</b>	<b>1.4</b>	<b>0.8</b>	<b>1.7</b>	<b>0.8</b>	<b>0.4</b>
Life new business capex / premiums (%)	-3.6%	-3.1%	-3.5%	-3.7%	-2.9%	-13.9%	0.0%	-2.1%
Life profits from in-force / embedded value (%)	7.9%	14.3%	9.2%	10.9%	8.0%	9.1%	0.0%	5.6%
P&C earnings	3.5	0.6	2.8	1.2	2.1	0.0	1.9	2.1
P&C capex to fund growth	-0.2	-0.3	-0.4	-0.4	-0.4	0.0	-0.4	-0.3
<b>P&amp;C operating free cashflow</b>	<b>3.3</b>	<b>0.3</b>	<b>2.4</b>	<b>0.7</b>	<b>1.7</b>	<b>0.0</b>	<b>1.5</b>	<b>1.8</b>
P&C capital required / net earned premiums (%)	45%	35%	45%	45%	64%		64%	45%
<b>Asset mgmt operating free cash flow</b>	<b>2.5</b>	<b>0.0</b>	<b>0.5</b>	<b>0.4</b>	<b>0.0</b>	<b>0.4</b>	<b>0.0</b>	<b>0.0</b>
<b>Other operating free cash flow</b>	<b>0.0</b>	<b>0.1</b>	<b>0.0</b>	<b>-0.2</b>	<b>0.0</b>	<b>0.0</b>	<b>0.1</b>	<b>1.7</b>
<b>Total FCF from operating units</b>	<b>7.0</b>	<b>2.0</b>	<b>5.6</b>	<b>2.4</b>	<b>2.5</b>	<b>2.1</b>	<b>2.3</b>	<b>3.9</b>
% of earnings remitted to holdco	85.0%	71.3%	82.0%	79.0%	95.0%	63.6%	96.4%	110.3%
Dividends from operating units	5.9	1.5	4.6	1.9	2.4	1.3	2.2	4.3
Holding company costs (interest, central costs etc.)	-1.3	-0.8	-1.1	-0.3	0.0	-0.2	0.0	-0.9
<b>Holding company free cash flow</b>	<b>4.6</b>	<b>0.7</b>	<b>3.6</b>	<b>1.6</b>	<b>2.4</b>	<b>1.1</b>	<b>2.2</b>	<b>3.4</b>
<b>Holding company FCF yield</b>	<b>8.9%</b>	<b>6.8%</b>	<b>9.7%</b>	<b>7.4%</b>	<b>9.4%</b>	<b>3.7%</b>	<b>8.6%</b>	<b>8.7%</b>

Source: Citi Research estimates

**Figure 17. Total group free cash flow (assuming 100% remittance) vs. Holding company free cash flow - 2014e**

Holding company cash flow does not include all free cash generated, FCF yield would rise to ~10% if 100% of cash was remitted to holding companies. Aviva has the lowest remittance ratio of this group.



Source: Citi Research estimates

## Drivers of Strong Free Cash Flow in Europe

### Strong European cash flow reflects...

### ...business mix, helped by exposure to cash generative P&C....

### ...an increased management focus and targeting of cash...

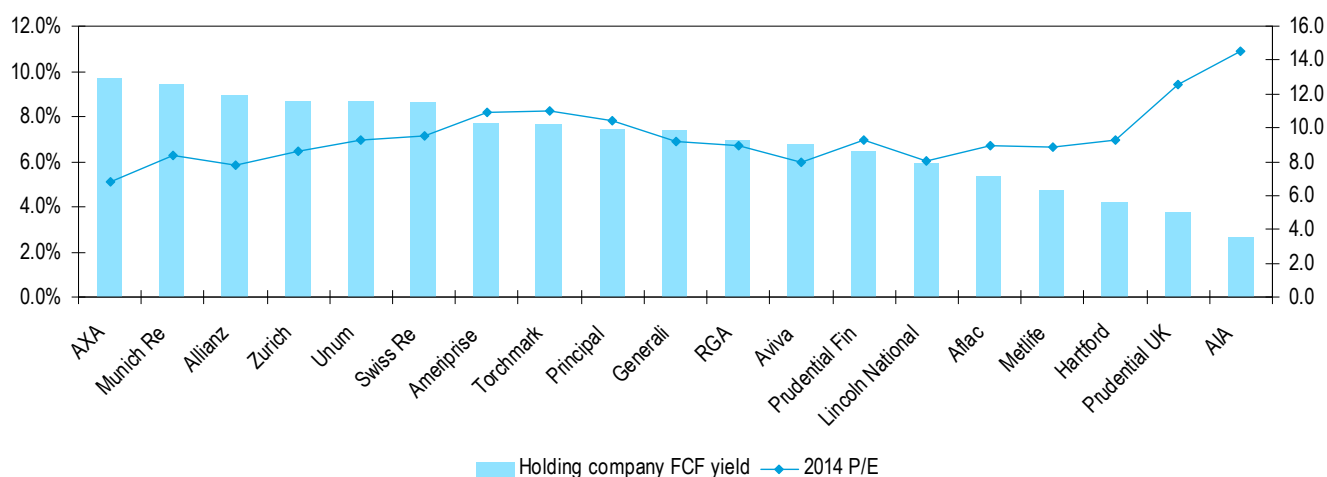
### ...restructuring benefits, e.g. cost savings

Figure 18 compares P/E ratios for the companies analysed in this report relative to holding company free cash flow yields. P/E differentials may explain some of the variation in free cash flow between companies and regions, however we believe there are other factors also supporting European insurer cash flows:

- **Business mix.** Most of the European insurers in our analysis have P&C insurance, reinsurance or asset management subsidiaries that are highly cash generative, and where cash generation is usually quite 'fungible' in the group (and subject to lower regulatory restriction on the flow of capital). This mixture of P&C clearly contributes to the higher cash flow yields relative to the US life sector and AIA.
- **An increased focus on cash by management.** Cash generation increasingly important focus of management in Europe. Opaque accounting (including a lack of comparability in accounting numbers between different regions and companies) and investor frustration with long-term value metrics such as embedded value have forced insurers to re-think their product strategy and put a greater weight on quicker payback periods. Insurers are also re-visiting the profitability of their policy back-books and back offices rather than focusing mainly on new business growth.
- **The benefits of restructuring.** Many of the European Insurers in our coverage are undergoing significant restructuring programmes to address costs, reflect the strategic implications of economic capital methodologies (and Solvency 2) and re-think strategy (including disposals of underperforming assets). On the whole, these have also contributed to improved cash generation, either through improving the profitability of the existing policy portfolio or through reduced new business strain.

**Figure 18. Holding company free cash flow yield vs. P/E – 2014e**

P/E differentials only partly explain differences in free cash flow yields between insurance companies globally



Source: Citi Research estimates

## Cash Flow Supports Attractive Dividends

**We estimate a ~5% dividend yield in Europe, well covered by cash flow**

**Remittance ratios are likely to remain stable, with the exception of Aviva where there is scope for this to increase**

**Share buyback potential is more limited in Europe than the US, partly due to Solvency 2**

**Stronger dividend cover by cash in the US allows a greater degree of dividend growth and capital management**

**European reinsurers are very well capitalized and may consider buybacks to manage returns**

As we show in Figure 19, the European insurers in our analysis currently offer an average dividend yield of ~5%, which compares well in a global insurance and market context. We believe this is also well supported by cash generation, with average cover from holding company free cash for of ~1.6x, which gives some room for growth.

Figure 20 shows the 'remittance ratio' of operating cash flow generated in subsidiaries, i.e. how much of the free cash generated in operating earnings can actually be upstreamed to an insurance company's HoldCo. While there are variations, and P&C companies find it easier to remit cash, the average remittance ratio is ~85%, which suggests a healthy ability in the sector to redeploy capital within insurance groups. For most companies we expect remittance ratios to grow slightly or stay close to current levels in the next few years. One exception is Aviva, where we see potential for significant growth in cash remittance.

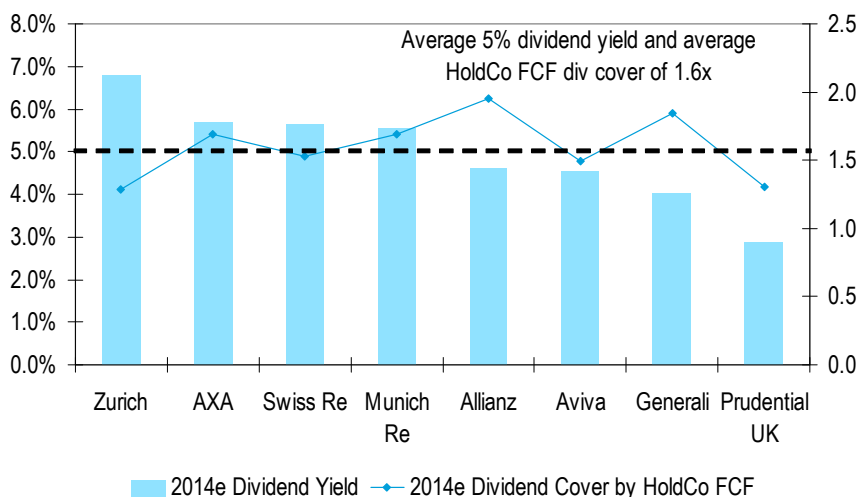
In our view, the potential for share buybacks in Europe is more limited than for US insurers. While capital buffers under existing calculation methods have improved strongly in recent years, there remains significant uncertainty over the final outcome of Solvency 2. European insurers are naturally reluctant to return capital ahead of understanding how Solvency 2 will affect their capital management, especially with a still uncertain macroeconomic environment.

In the US life sector, dividend cover from holding company cash flows is far stronger, and after a period of capital rebuilding during the financial crisis (and with many insurers pulling out of capital intensive products), the US insurers have very strong capital buffers on their regulatory bases.

There have been a few examples of share buybacks or special dividends in Europe for very well capitalized companies, e.g. at Munich Re and Swiss Re. The reinsurers in particular were early adopters of economic capital models, and have been running their businesses on 'risk-based capital' methodologies for quite a long period of time.

**Figure 19. Dividend yield vs. Dividend cover by holding company free cash flow – 2014e**

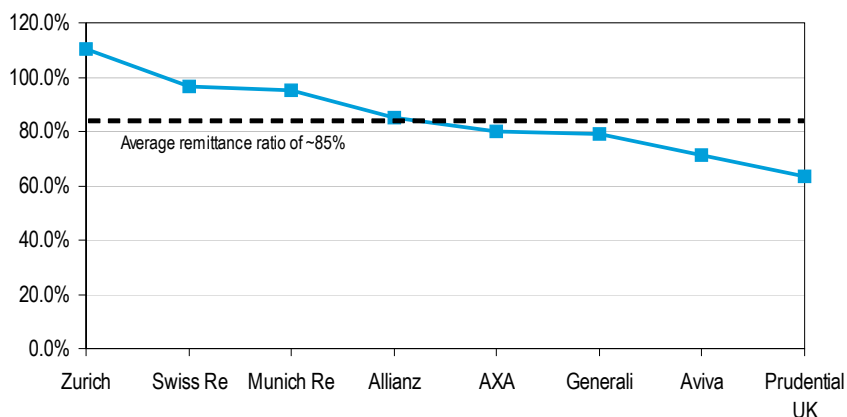
We estimate an average 5% dividend yield, covered ~1.6x by cash flow



Source: Citi Research estimates

**Figure 20. Remittance ratio of operating cash flow to the holding company – 2014e**

We see an average remittance ratio of ~85%, with Aviva and Prudential at the lower end



Source: Citi Research estimates

European reinsurers have also significantly de-risked their asset portfolios in recent years to reduce the level of capital tied up to cover market risk in their asset portfolios. This promotes lower volatility in capital requirements than in other sub-sectors. We expect the major reinsurers to continue to use buybacks and special dividends as one of the key tools to manage their returns on capital in the next few years.

## Cash Flow From Existing Policies Vs. New Business

European disclosure allows us to delineate cash flow from existing in-force business and capex on new business

If insurers spent zero capex, clearly their cash flow would improve considerably

However, in a life insurer, this would eventually lead to a run-off in cash flow

Therefore, life companies need to invest in 'maintenance capex'

The high quality of cash flow disclosure for many stocks in the European Insurance sector allows us to disaggregate the different components of cash flow. This is especially useful to separate the cash flows generated from a company's existing portfolio of business and capital reinvested to write new business.

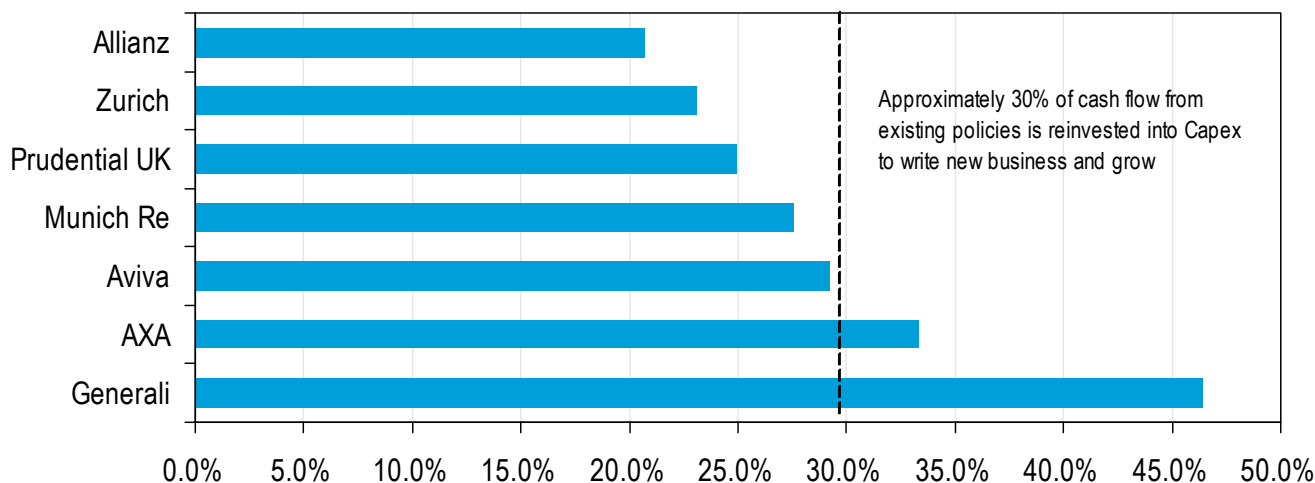
If companies did not invest any capital to write new business, or grow, they would experience temporarily high cash flows as capital normally diverted to write new business could instead be upstreamed to the Group. As we show in Figure 21, this could be quite a significant number for some insurers. We estimate that ~30% of operating cash flow generated in the business is re-diverted into funding growth or new business (with higher than average capex at AXA and Generali).

However, this would not go on forever. In a life insurance business, a lack of new business would ultimately cause a run-off of the existing portfolio and declining future cash flows. In a non-life business, as long as premium volume does not grow, and there is no significant change in business mix or market conditions, then there is (theoretically) little need for additional capital in the business.

Therefore, for a life insurance company, a certain amount of 'maintenance capex' is necessary to keep the portfolio of life companies generating at least flat cash flow (i.e. so the overall book of policies is not growing or shrinking in the longer-term).

**Figure 21. Capex on new business and growth as a % of pre-capex operating cash flow – 2014e**

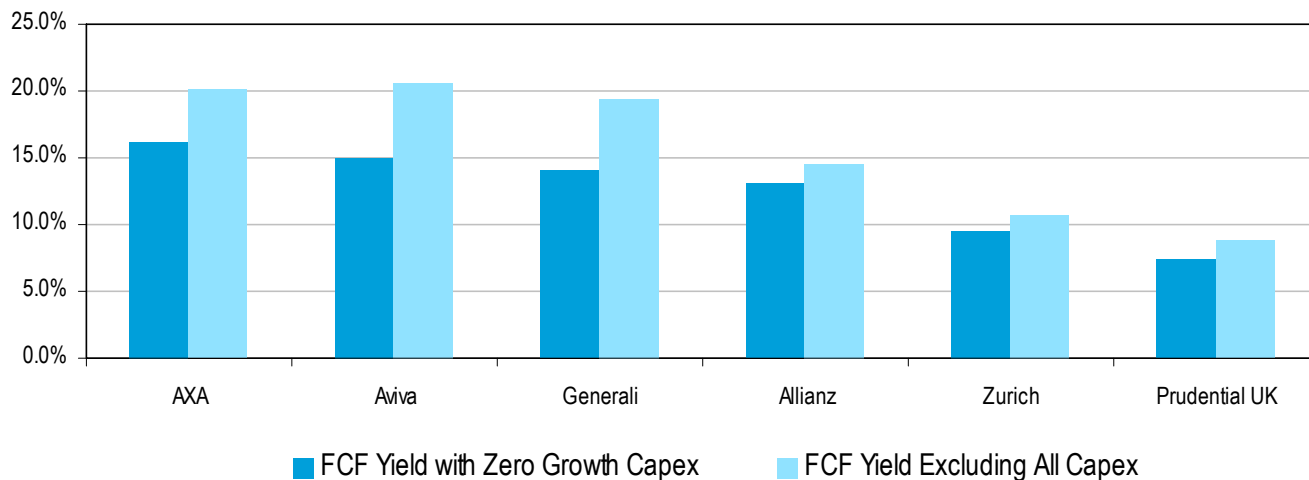
On average, the European insurers reinvest ~30% of operating cash flow from existing business into new business and growth



Source: Citi Research estimates

**Figure 22. Free cash flow yield assuming excluding all capex vs. free cash flow excluding only *growth capex* – 2014e**

Cash flows would grow considerably if companies didn't invest capex to grow, with FCF yields including maintenance capex of ~15% for AXA and Aviva



Source: Citi Research estimates

**We have tried to make a rough estimate of growth vs. maintenance capex for the European insurers**

We have tried to estimate the proportion of a company's capex is 'maintenance' (i.e. keeping the book flat) and what proportion is 'growth capex'. We can do this by estimating the amount of life new business necessary to keep embedded value roughly flat in value. The levels of growth vs. maintenance capex vary by company, but generally we have found that *approximately half* of the European Insurers' capex on new business is 'growth capex'.

**Free cash flow grows strongly if we assume insurers do not grow their policy books**

Figure 22 shows how much free cash flow yields rise for the European insurers if we assume they do not grow. We show operating cash flow yields assuming zero capex (i.e. businesses going into run-off) and operating cash flow yields assuming only maintenance capex (and no growth capex), enough to keep existing cash flows steady at current levels.

**Assuming only maintenance capex European insurance free cash flow rises to an average of ~12%**

With some maintenance capex allowed for to keep the size of the portfolio constant, this suggests that European insurers could be generating ~12% free cash flow if they decided not to pursue growth. With no capex at all, we estimate near-term free cash flow yields would rise to ~15%, although this would obviously decline over time as the business goes into run-off.

## Company Highlights

### AXA: Strong Holding Company FCF Yield

**AXA has one of the strongest free cash yields in the global insurance sector**

AXA is one of our most preferred European Insurance stocks, and also generates one of the strongest holding company free cash flow yields in the global insurance sector, of ~10% (2014e), approximately 25% better than the global average. If we look at *total* Group FCF, including cash not remitted to the holding company, this yield rises to ~12%. Hence AXA is in a good position to pay attractive dividends, in our view, and we forecast a 6% yield in 2014e (covered 1.6x by 2014e holding company cash). We expect reasonable ~5% per annum cash flow growth in the next few years.

**We expect AXA to gradually grow remittances of cash to its holding company**

As some of the analysis in this report shows, we expect AXA to grow its remittance ratio of operating cash to the holding company to ~80% by 2014e, from the 2012 level of ~75%. This could be helped by improving capital buffers in domestic businesses, or lower reserving requirements (e.g. due to higher yields in some markets). AXA has a target remittance ratio of 75-85%, and it is possible that this grows further in the next few years, especially if surplus capital levels in the business continue to improve.

Strong and growing cash generation is an important factor in our positive view on the stock, and we believe evidence of strong progression in cash flow in 2013 (in-line with our forecasts) should be positive for the stock. In addition:

**We also anticipate ongoing improvements in US variable annuities..**

- We expect a continued repair in the fortunes of its variable annuities business in 2013e, with a major reduction in reserving charges and less volatility from hedging. Having reduced interest rate hedging in the US at the beginning of the year, AXA should particularly benefit (in economic capital and value terms) from the rising US 10-year Treasury yield. An improvement in economic capital in the US could improve AXA's ability to upstream capital from this business.

**...further improvements in P&C underwriting profits...**

- We also forecast better underwriting profitability in the P&C business, in-line with management's target of a 96% combined ratio by 2015e. Since P&C is a highly cash generative part of the group, this is an important driver of growth in cash flows in the medium-term.

**...and improved economic solvency, helped by its surplus cash generation**

- Finally, we expect further positive news on AXA's balance sheet; especially, its economic capital position and debt gearing. We expect economic solvency to reach ~185% by year end 2013e, and for AXA's Solvency 1 ratio to remain substantially above 200%.

**Aviva does not screen well on a holding company cash flow basis, given internal dividend traps**

**The holding company structure of the UK P&C company is one such trap, leading to the build up of 'internal debt'**

**Remittances from other areas (e.g. UK life) have also been low**

**We expect Aviva's remittance ratio to improve substantially**

**Allianz offers an above average holding company FCF yield, but has restricted dividend growth in recent years**

**We see dividend growth potential from 2013e**

**Despite concerns about asset flows in its asset management operations, we see attractive SOTP upside**

## Aviva: Repairing Remittance Ratio

Aviva does not screen well in our analysis of 'holding company free cash flow'. Although it generates attractive free cash flow in its group as a whole, it suffers from numerous dividend traps in its structure that lead to a relatively low remittance ratio of free capital to its holding company. As Figure 17 illustrates, Aviva offers one of the lowest holding company free cash flow yields of ~7%. However, the total FCF generation in the group implies a total group FCF yield almost double this level, of ~13%. Aviva suffers from a relatively unimpressive remittance ratio of ~50% (2012) due to a number of factors, including the following:

- The historic multi-layered company structure of its UK P&C business has acted to suppress liquidity between this business and the holding company. Aviva used the medium of 'interdivisional balances' (internal debt) to pass liquidity to the holding company. Aviva has since announced a restructuring of its UK P&C structure that will allow it to remit real cash. It has also agreed with the UK regulator to start reducing its internal debt balance of £5.8bn (with £600mn expected over 2013 and 2014, and potentially more thereafter). In future, it is looking at 'non-cash' means to help adjust this internal debt balance (e.g. through improving the efficiency of its capital usage in the group).
- Remittances from Aviva's UK life businesses were also low (at 23% in 2012) and well below the level of peers, mainly due to inefficiencies in the business. This has already started to improve in 2013, and we expect to improve further in future years.

Taking all of Aviva's initiatives together we expect its remittance ratio to improve to ~70% by 2014e, however this still remains below the levels we expect at peers such as AXA and Zurich; therefore, there is room for further improvement in future years. We remain positive on Aviva as a longer-term restructuring story, helped by cost-cutting and other initiatives to improve cash flow. However its medium-term free cash flow outlook does look weaker than AXA.

## Allianz: Strong Cashflow and Attractive SOTP

Allianz also offers an above average holding company free cash flow yield (at the upper end of the range in the global insurance sector), of ~9%. However, its dividend yield is below the average of the European names studied in this report, at ~4.5% and it therefore has a relatively strong level of dividend cover from holding company cash.

Based on its cash generation, and a strong economic and Solvency 1 capital position, we believe Allianz is in a good position to strongly grow its dividend payout in future years and we expect it to raise the dividend in 2013, having kept it flat for three years.

Otherwise, we continue to see attractive valuation upside potential in the stock given its relatively large exposure to asset management earnings (~30% of operating profits before central items in 2013e) and our view that these earnings, and net inflows into its flagship PIMCO business, could remain quite stable despite its gearing to underperforming fixed income markets. The performance of the asset management business, in terms of assets under management, net inflows and performance-related fees, will be a key driver for the stock after 2Q 2013 results in our view.

## Munich Re & Swiss Re: Capital Management Discipline

**The major reinsurers have cash generative business models and attractive dividends**

Munich Re and Swiss Re generate relatively attractive holding company free cash flow yields of ~9% 2014e. In both cases this helps support above sector-average dividend yields of ~6% (2014e).

Both companies benefit from a highly cash generative business model, with a relatively high transferability and fungibility of cash flow around the group. We estimate remittance ratios of operational cash flow to their group holding companies of >95%, due to their ability to use internal reinsurance arrangements to transfer risk and capital.

**Both have exhibited pricing discipline in recent years, and have been prepared to return capital if returns are unfavourable**

Expenditure on capex for growth purposes is highly dependent on pricing conditions in their P&C reinsurance markets. As we have seen in recent years, both companies have exhibited pricing discipline and have been prepared to give back capital to shareholders rather than reinvest this at pricing terms they do not find favourable. Munich Re and Swiss Re have been early adopters of risk-based capital models and economic capital (as have most global reinsurers), and are very well capitalized on both rating agency basis and internal economic capital models.

**We think this will continue in future years, subject to losses and pricing conditions**

Therefore, we believe both companies will continue to be in a position to execute more special dividends and share buybacks if they believe there are insufficient growth areas to reinvest growth capex profitably. We expect continued strong cash flow at both companies, supporting dividends and buffer capital generation.

## Zurich: Strong Dividend, Low Dividend Cover

**Zurich generates strong holding company free cash flow**

Zurich, like many of its European peers, has a strong holding company free cash flow, with a yield of ~9%. However, we estimate that it is currently able to remit a greater amount of cash than generated from ongoing operations, mainly due to the release of capital from its non-core operations and efforts to de-risk these in recent years. In addition, it is able to upstream almost all of its P&C statutory profits to the holding company due its versatile corporate structure (e.g. using a branch structure to write European P&C risks from a single balance sheet).

**It is paying a large proportion of free cash out as dividend (1.3x cover)**

Zurich also offers one of the highest dividend yields in the European insurance sector at ~7% (2014e). However, this is funded by a relatively low cover from holding company cash flow of ~1.3x. Given the high remittance ratio and low dividend cover, we see little room for dividend growth at Zurich in the next few years. This low dividend cover derives from the fact that Zurich denominates its dividend in Swiss Francs, but generates the majority of its revenues in other currencies (Euros and US Dollars). The strong appreciation of the Swiss Franc in recent years has led to its payout ratio declining mainly due to currency translation.

**This may limit Zurich's capital flexibility and dividend growth potential**

While Zurich's discipline of paying a large proportion of its cash flow to shareholders may be viewed as positive, we believe it limits some of its capital flexibility and runs the risk of pressure in future years if there is any sustained pressure on earnings. We prefer both AXA and Allianz that offer better underlying cash flows, in AXA's case an almost equivalent dividend level, and in Allianz's case a similarly strong balance sheet.

### Generali: Relatively Low FCF Compared to Composite Peers

**Generali's holding company free cash flow yield is in-line with the average but lower than European composites**

Generali's ~7% holding company free cash flow yield is only slightly lower than peers in Europe and is consistent the global insurance sector average, based on an assumed remittance ratio at the same level as AXA's by 2014e. Generali's dividend yield is significantly below peers at ~4%, however we believe there is significant room of improvement in dividends given a holding company free cash flow cover of 1.7x.

**We believe the stock is relatively expensive even after taking into account restructuring benefits**

Generali could see numerous earnings and profitability improvements in the next few years, as it executes its latest restructuring initiatives in the next few years, including stronger growth in its P&C business, more focused growth in higher margin areas in life insurance and cost-efficiencies. However, we believe the stock remains relatively expensive in the European Insurance sector, even if we take these restructuring benefits into account.

### Prudential: Low FCF Yield, Decent Free Cash Flow Growth

Prudential's 2014e holding company free cash flow yield is substantially below peers at ~4%. This is driven by two main factors:

**Prudential's low holding company free cash flow partly reflects a low remittance ratio**

- A relatively low remittance ratio of ~65%. Prudential keeps a larger proportion of its operating cash flow generation in its subsidiaries to help fund growth than peers, especially due to the growth prospects in its Asian business. There are also potentially some regulatory factors restricting dividend outflows (e.g. from Jackson National Life, its US life subsidiary).

**Capital is withheld to fund high new business capex growth requirements**

- Even if we strip out the impact of the remittance ratio, Prudential's total group free cash flow yield grows to ~6% (Figure z). This reflects its exposure to Asia, which now accounts for half of the company's value generation, and the relatively immature cash flow profile of this business – mirrored by its main competitor, AIA. We discuss Prudential Asia in a little more detail in a later chapter.

**We anticipate strong growth in cash flows from Asia of ~9% p.a.**

Despite its low free cash flow yield, we anticipate relatively strong growth in cash flows of 7% per annum in the medium-term, with ~9% per annum growth in its Asian division. We remain positive on Prudential, due to our view that it still offers attractive sum-of-the-parts valuation upside, and continues to have strong growth potential in its Asian business despite recent concerns about GDP growth in the region. Prudential's ability to convert this growth into cash generation over time also supports our positive view.

## Focus on US Life Insurers

We forecast the US life insurers in our coverage universe to generate free cash flow of about 60% of operating earnings in 2013, roughly consistent with global peers. Healthy FCF, coupled with current excess capital positions, should enable most companies to continue returning capital to shareholders. In our view, companies with superior cash flow and greater flexibility for buybacks and dividends should command premium valuations. Ameriprise Financial (AMP) stands out in both its ability to generate cash flow as well as management's shareholder-friendly uses of capital, which is a key reason for our positive stance on the stock.

### Healthy FCF Supports Capital Return Theme

Investors are placing greater emphasis on cash flow in the US life sector

In our view, investors are likely to continue placing greater emphasis on US insurers' ability to generate capital and get cash flow to the holding company. Given the lack of consistency in definitions of operating earnings and the increasing number of below-the-line items, we believe cash flow is becoming an increasingly important metric for comparing insurance franchises.

Those generating high FCF as a percentage of earnings are rewarded with higher valuation multiples

Insurers that generate greater free cash flow as a percentage of earnings are beginning to be rewarded with higher valuation multiples, particularly if they consistently return capital to shareholders through buybacks and dividends. On the other hand, products that have the potential for significant capital calls under adverse scenarios (such as variable annuities and universal life with secondary guarantees) are likely to continue being assigned a high cost of equity. Management teams are beginning to acknowledge this, and a number of insurers are trying to shift their business mix toward products with more favorable cash flow dynamics (such as group insurance, retirement, and asset management).

Figure 23. 2013 Free Cash Projections for US Life Insurers

\$ in millions

	AFL	AMP	HIG	LNC	MET	PFG	PRU	RGA	TMK	UNM
Dividends from life insurance subs	1,411	780	1,500	767	3,417	400	1,923	335	501	700
Dividends from P&C subs		-	800	-	100	-	-	-	-	-
Earnings from non-insurance entities		645	84	13	86	313	668	65	-	70
Gross free cash flow to hold co.	1,411	1,424	2,384	780	3,603	713	2,591	400	501	770
Holding company interest expense	(125)	(65)	(251)	(164)	(735)	(91)	(492)	(76)	(53)	(88)
Other holding company expenses	(85)	(203)	(1,340)	(90)	(1,300)	-	(75)	(7)	(21)	(20)
<b>Total enterprise free cash flow</b>	<b>1,202</b>	<b>1,157</b>	<b>793</b>	<b>526</b>	<b>1,568</b>	<b>622</b>	<b>2,024</b>	<b>317</b>	<b>427</b>	<b>662</b>
Operating earnings	2,892	1,398	1,619	1,245	6,113	989	3,915	546	523	863
<b>FCF as % of operating earnings</b>	<b>41.5%</b>	<b>82.7%</b>	<b>48.9%</b>	<b>42.2%</b>	<b>25.6%</b>	<b>62.9%</b>	<b>51.7%</b>	<b>58.0%</b>	<b>81.7%</b>	<b>76.7%</b>
<u>Capital Return Summary</u>										
Common dividends	656	406	216	134	1,118	275	768	73	61	143
Share repurchases	600	1,410	545	500	-	275	750	200	360	500
Total capital return	1,256	1,816	761	634	1,118	550	1,518	273	421	643
Capital return as % of FCF	104.6%	157.0%	96.1%	120.5%	71.3%	88.4%	75.0%	86.2%	98.4%	97.1%
Capital return as % of op earnings	43.4%	129.9%	47.0%	50.9%	18.3%	55.6%	38.8%	50.0%	80.4%	74.5%

Source: Company Reports and Citi Research Estimates

**Regulatory rules limit flexibility to extract cash flow from insurance subsidiaries**

In the US, life insurance companies are allowed to pay ordinary dividends from their insurance subsidiaries equal to the greater of prior year statutory earnings or 10% of statutory surplus. Special dividends above that level require regulatory approval. Statutory earnings differ from GAAP net income in a few key ways, most notably that acquisition costs are not deferred in stat accounting and reserve assumptions tend to be more conservative. As a result, companies that are growing typically report statutory earnings that are lower than GAAP. This is a key reason why cash flow for insurance subsidiaries is usually below operating earnings.

**Business mix is the primary driver of FCF variations between companies**

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. Therefore, business mix is a meaningful determinant of FCF.

**A good example is Lincoln National vs. Ameriprise**

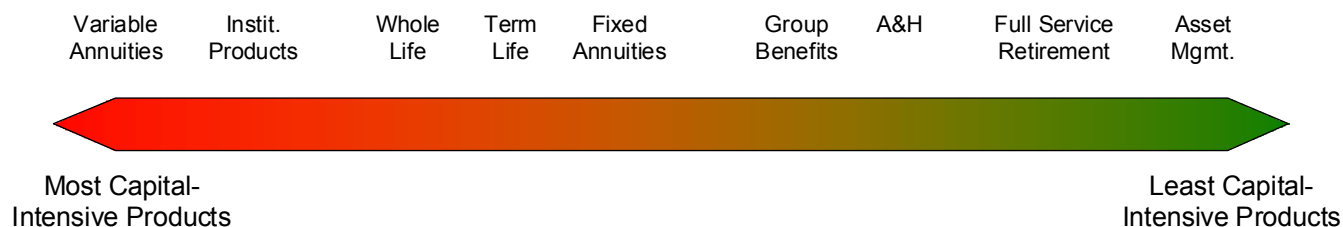
A good example is comparing Lincoln National (which gets over 50% of earnings from variable annuities and individual life) with Ameriprise (>50% of earnings come from asset and wealth management). While the short-term cash flow dynamics of less capital-intensive products are certainly more appealing, there are other factors to consider as well. Capital-intensive products tend to have high persistency and create a significant long-term earnings stream, whereas short-duration products need to be constantly re-sold to maintain earnings.

**Growth rates also affect the level of free cash flow**

Most sales of new insurance products, especially those with longer durations, are cash flow negative in the first year given high acquisition costs (most notably commissions). As discussed above, new business acquisition costs are not deferrable under statutory accounting, so sales create strain on statutory earnings and near-term dividend potential. Therefore, all else being equal, a company that is growing faster will have lower FCF than a slower growth company. Given relatively modest current sales, there is less new business strain, which is likely helping to boost cash flow for select insurers. While many European companies break out the capex expense for new business directly, with US companies it is embedded within statutory earnings. This makes it harder to distill the factors driving cash flows.

**Figure 24. Spectrum of Life Insurance Products by Capital Intensity**

Product placement is representative and may vary by company or contract design



Source: Citi Research

Company-specific factors also play a role in relative cash flow generation, e.g. geographical diversification

Other items that affect cash flows include historical losses and the presence of international subsidiaries. If a US insurance subsidiary has negative retained surplus (potentially from investment losses) it is ineligible to pay an ordinary dividend, even if the entity has positive statutory earnings. This affected cash flows for several insurers following the financial crisis. Similar to the US, dividends from foreign subs are also subject to regulatory approval. Regulatory regimes vary by country, but most rely on some form of statutory accounting that differs from US GAAP. Some countries, notably Japan, have more conservative standards than the US, resulting in a relatively low percentage of US GAAP earnings being available for repatriation.

We note that some companies have developed other means of accessing cash from international subsidiaries, including intra-company borrowing. Our analysis looks at cash flow available for repatriation, whether or not it is actually brought to the hold company (as some insurers may choose not to repatriate for tax reasons, but still retain access to the cash flow should an attractive opportunity to deploy it arise).

## Most US Life Insurers Have Excess Capital

We define excess capital as money that could be used without jeopardizing a company's rating

In our view, most of our coverage US life companies have some degree of deployable excess capital, which we expect to be used for share repurchases, dividend increases, and M&A. We define "excess" capital 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.

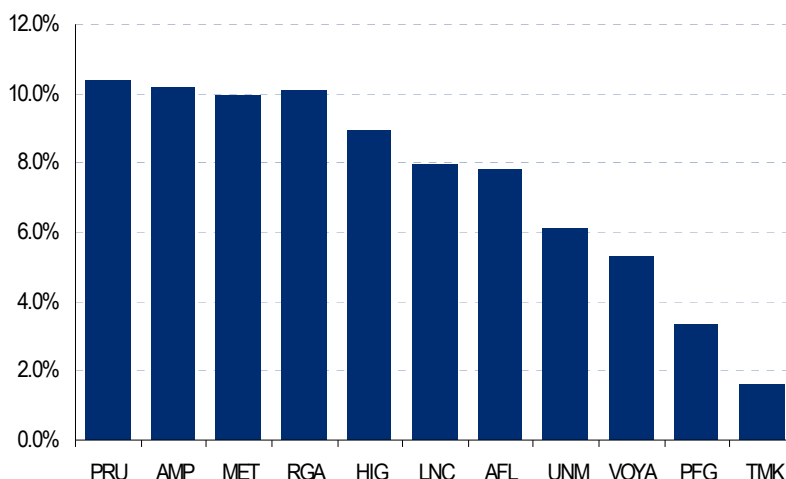
**Figure 25. We Estimate that Most of Our Coverage Companies Have Excess Capital**

RBC ratios as of 12/31/12; \$ in millions

	Current RBC Ratio	RBC Ratio Threshold	Excess Capital	Hold Co. Liquidity	Target Liquidity	Excess Liquidity	Calculated Excess Capital
AFL	633%	500%	1,899	770	600	170	2,069
AMP	525%	400%	776	1,300	400	900	1,676
HIG	421%	375%	757	1,900	1,400	500	1,257
LNC	488%	450%	598	700	500	200	798
MET	466%	400%	4,063	3,700	2,700	1,000	5,063
PFG	415%	400%	164	500	300	200	364
PRU	455%	400%	1,593	3,185	1,200	1,985	3,578
RGA	272%	250%	152	650	300	350	502
TMK	348%	325%	96	53	50	3	99
UNM	394%	375%	186	800	500	300	486
VOYA	451%	425%	386	450	450	-	386

Source: Company Reports and Citi Research Estimates

**Figure 26. Excess Capital a Meaningful Percentage of Market Cap for Many Insurers**  
Estimated excess capital divided by market cap (as of 7/3/13)



Source: Company Reports and Citi Research Estimates

**There appears to be sufficient capital flexibility for returning cash to shareholders or acquisitions**

On average, US life companies have excess capital of about 8% of their current market cap. In our view, this also suggests ample flexibility to return cash to shareholders or pursue acquisitions. Among the companies that we estimate have the most excess capital currently are Prudential Financial and MetLife. We expect both to be named non-bank systemically important financial institutions (SIFIs), which will subject them to Federal regulation and potentially more onerous capital restrictions. As a result, we expect both to maintain higher capital buffers until there is greater regulatory clarity.

## Capital Buffers Suggest Cash Flow Is Deployable

**We believe there is ample scope for deploying FCF for dividends, share buybacks and M&A**

Given current capital buffers, we view free cash flow for most companies as deployable capital. As a result, we expect most cash flow to be used for dividends, share buybacks, and M&A. Some companies are also continuing to de-lever. On average, we expect our coverage universe to return almost 100% of FCF to shareholders through buybacks and dividends in 2013. Total capital return is expected to be ~6% of beginning equity.

## Cash Flow Provides Healthy Dividend Coverage

**We believe US life insurers are covering dividends ~3x by holding company FCF**

Based on our cash flow projections, none of the companies we cover appears to be stretching in terms of its dividend payout, and we estimate average holding company cash flow coverage of dividends of ~3x for the US life insurers. If anything, we believe life insurers have room to continue raising dividends at a faster pace than earnings, boosting payout ratios. Currently, the sector has a median yield of 2%, about in-line with the broader market but below that of many other financials. While some management teams (notably Ameriprise, Principal, and Prudential Financial) have talked about placing greater emphasis on dividends, we do not forecast overall dividend yields to rise meaningfully.

## Liquidity Risk Significantly Lower than Pre-Crisis

**Most US life insurers are now holding at least 18 months of required liquidity at their holding companies**

During the financial crisis, liquidity became a significant issue for a handful of insurers due to reliance on capital markets funding, collateral posting requirements, and losses on securities lending. Most companies are now holding at least 18 months of required liquidity at the holding company (rather than funding using commercial paper) and have reduced securities lending balances. There is still risk to cash flow from insurance subsidiaries if investment losses spike (which could prevent management from taking dividends), which is why we view an 18-24 month liquidity buffer as critical. The other key risk that we see is statutory reserve charges in a sustained low interest rate environment. In our view, most insurers have limited disintermediation risk if interest rates rise further, although we view buying protection against a spike in rates as prudent.

**Figure 27. We Forecast Buybacks/Dividends of ~6% of Equity in 2013**

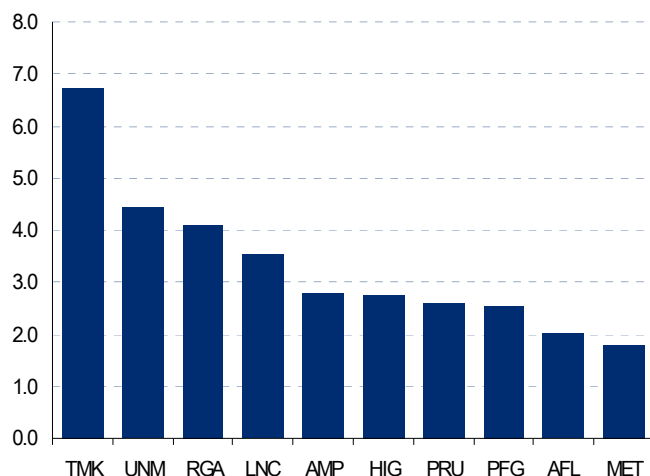
\$ in millions; based on Citi Research projections

Company	2012E				2013E				
	Buybacks	Dividends	% Equity	% Income	Buybacks	Dividends	% Equity	% Income	% FCF
AFL	107	627	6.0%	25.6%	600	656	8.9%	44.5%	104.5%
AMP	1,340	308	21.5%	160.1%	1,410	405	24.6%	135.2%	159.0%
HIG	149	195	1.7%	NA	545	216	3.9%	92.4%	96.1%
LNC	492	100	5.5%	45.3%	500	134	5.6%	57.0%	121.4%
MET	-	808	1.6%	67.2%	-	1,113	2.1%	22.3%	71.9%
PFG	258	231	5.8%	63.2%	275	257	6.1%	59.8%	84.7%
PRU	650	747	5.1%	326.4%	750	767	5.6%	85.3%	75.7%
RGA	-	62	1.4%	9.8%	200	73	5.5%	46.7%	86.2%
TMK	361	58	12.8%	79.1%	360	55	12.2%	82.8%	97.2%
UNM	501	137	8.2%	71.3%	500	143	8.0%	81.5%	97.3%
VOYA	-	-	NA	NA	-	-	NA	NA	NA
Group Average			5.3%	86.0%			6.4%	63.4%	92.6%
Group Median			5.5%	65.2%			5.6%	59.8%	94.0%

Source: Company reports and Citi Research estimates

**Figure 28. Insurers Have Healthy Dividend Coverage**

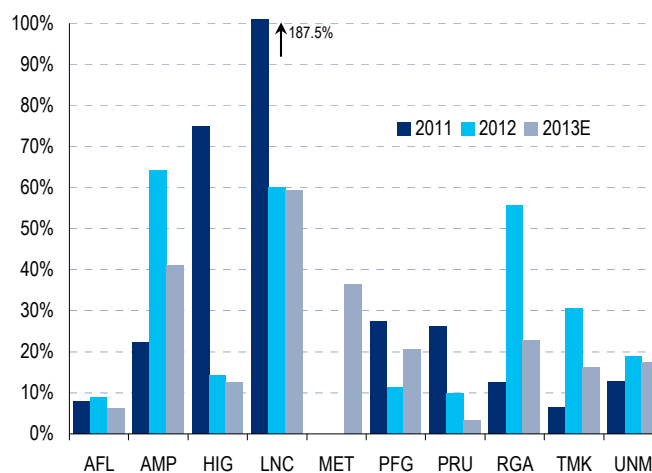
2014E dividends / 2014E free cash flow



Source: Company Reports and Citi Research Estimates

**Figure 29. Most US Life Insurers have been Raising their Dividends**

Year over year change in dividend per share



Source: Company Reports and Citi Research Estimates

## Company Highlights

**We see Ameriprise as the best cash flow and capital return story in the US life space**

In our view, Ameriprise (AMP) is the best cash flow and capital return story in our coverage universe and this is a key reason for our Buy rating. We also believe Hartford Financial (HIG) is an emerging capital return story and expect cash flow to accelerate over the next few years as the company's variable annuity block runs off. Finally, more favorable cash flow dynamics are one reason we favor Prudential (PRU) over MetLife (MET) or Lincoln National (LNC). The following section goes through some of the company-specific highlights in more detail.

**AMP's superior cash flow should allow it continue to make share buybacks and grow dividends**

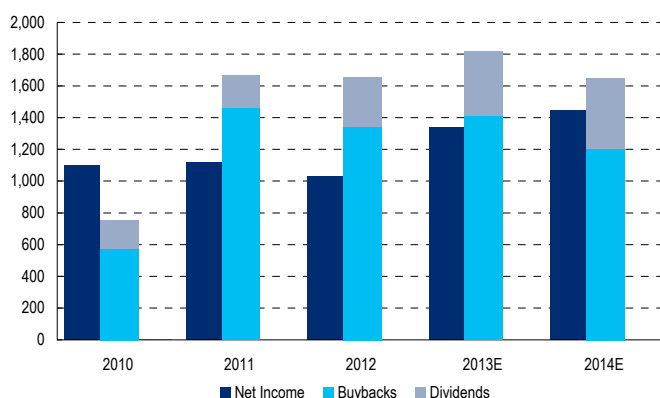
### Ameriprise (AMP): Superior Capital Return Story

We project AMP to generate free cash flow equal to 80-90% of net income, which should enable the company to continue deploying significant capital for buybacks and dividends. The key driver of AMP's superior cash flow is its focus on less capital-intensive businesses that generate predominantly fee income (notably wealth and asset management). 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.

**Capital management should help drive above average EPS growth and ROE expansion**

In addition, given recent modest sales volumes for annuities and more capital-intensive protection products, there has been limited strain from new business. If sales were to accelerate, this would modestly reduce free cash flow (as a percentage of net income). Given AMP's cash flow dynamics and current excess capital position (see table below), 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 significant ROE expansion.

**Figure 30. AMP is Returning >100% of Net Income to Shareholders**  
\$ millions



Source: Company Reports and Citi Research Estimates

**Figure 31. We Estimate AMP has Deployable Excess Capital of \$1.7B**  
\$ in millions; as of 12/31/12

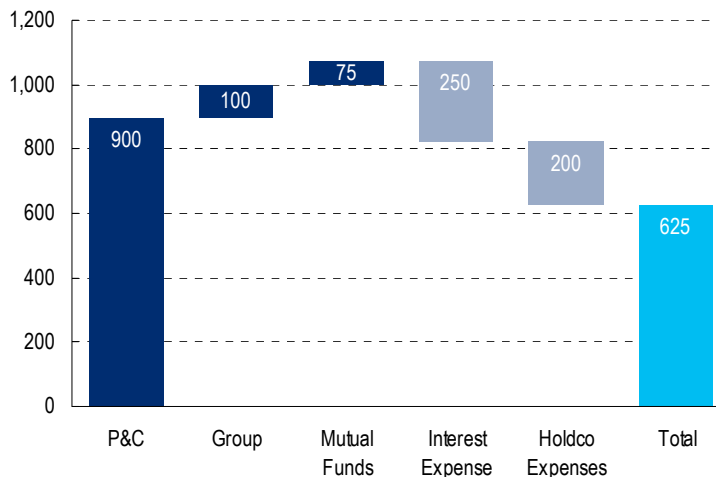
Life Insurance Subsidiary		Holding Company	
Total adjusted capital	3,256.9	Current liquidity	800.0
Required capital	620.2	Target liquidity	(397.5)
RBC Ratio	525%	Other allocated equity	1,082.0
Minimum RBC threshold	400%	Capital freed from bank in 1Q13	125.0
		Required equity	(700.0)
<b>Estimated excess capital</b>	<b>776.2</b>	<b>Estimated excess capital</b>	<b>909.5</b>

Source: Company Reports and Citi Research Estimates

## Hartford Financial (HIG): Emerging Capital Return Story

Figure 32. HIG's Core Business Generating ~\$600M of FCF

\$ in millions



Source: Company Reports and Citi Research Estimates

**We expect HIG to ramp up buybacks and dividends over time as cash flows from its Talcott Resolution run-off accelerate**

We expect HIG to steadily ramp up buybacks and dividends over time as cash flows from its Talcott Resolution (runoff annuity) segment accelerate. The P&C, group benefits, and mutual funds segments are currently generating about \$1.0-\$1.1B of capital annually, and we expect that to steadily increase as earnings improve. After-tax interest costs and other holding company expenses are \$400-500M, yielding free cash flow of ~\$600M. While we do not anticipate meaningful dividends from Talcott near term, it should begin to contribute over \$500M annually to cash flow in 2015. Some of this cash will need to be used for de-leveraging as earnings from Talcott decline, but we anticipate much of it will be returned to shareholders.

**HIG is currently awaiting the rating agencies' blessing for the next phase of its capital plan**

The company is currently awaiting the ratings agencies' blessing for the next phase of its capital plan, which we anticipate will be announced either before or concurrent with 2Q13 earnings. Management has already indicated that the focus will be returning capital to shareholders as it does not plan additional proactive de-leveraging through 2014. We estimate that between current holding company liquidity and expected cash flow, HIG should have about \$1.9B available for buybacks and dividends between now and the end of 2014.

## Aflac (AFL): Higher Capital Repatriation to Boost Buybacks

**AFL recently raised targets for capital repatriation from Japan, which accounts for >75% of its earnings**

AFL derives the majority of its cash flow from Japan, where it generates over 75% of earnings. Repatriation is tied to both the level of FSA earnings as well as the company's solvency margin ratio (SMR). Management recently raised its repatriation target for 2013 to ¥70-75B, and it expects to repatriate ¥96-98B from Japan in 2014 assuming minimal investment losses. In our view, this percentage could increase as AFL's SMR is projected to be well above management's target range of 500-600% even after repatriation. However, this will depend on market conditions closer to the time AFL submits its filings with the FSA in 2014 (in particular the outlook for JGB yields).

**There may be some upside to share buyback potential dependent on market conditions (e.g. JGB yields)**

The company has already begun hedging a portion of this exposure. Given the pickup in cash flow, we project share buybacks to increase from \$600M in 2013 to \$750M in 2014. In our view, there is scope for upside to this number if market conditions remain favorable (guidance is for buybacks of \$600-900M). Higher buybacks should help drive reacceleration in EPS growth, which we expect to drive multiple expansion over time.

**We believe PRU will generate FCF of slightly over 50% of earnings, compared to <50% for MET and LNC**

### **Prudential (PRU) Generating Stronger Cash Flow than MetLife (MET)**

In 2013, we project PRU to generate FCF of slightly over 50% of operating earnings, compared to 25% for MET and 42% for LNC. PRU benefits from having strong cash flow from its international division (~60% of earnings) as well as sizable asset management and full service retirement segments. We project cash flow to remain at the current level near term, although results could benefit from a slowdown in variable annuity and universal life sales (which are more capital-intensive products). Over time, MET is targeting cash flow in the range of 40-50% of earnings as it shifts its business mix toward international and less capital-intensive products (namely group insurance and individual protection). However, we see this as a gradual process.

**LNC's cash flow may be affected by lower reserve financing benefit in the next few years**

### **Lincoln National (LNC): Sustainability of Cash Remains a Concern**

LNC projects free cash flow of about \$400M, or 42% of operating earnings, in 2013. Over the past 5 years statutory earnings have averaged 83% of GAAP earnings, but they were only 60% of GAAP excluding reserve financings. Given the decline in term and universal life sales, we expect a lower reserve financing benefit going forward. Management still expects statutory earnings to grow roughly in-line with GAAP earnings, although there is some uncertainty. Assuming stat earnings remain 60-70% of GAAP earnings, this implies total free cash flow (before dividends) of about 40-50% of operating earnings. This compares to an average of about 60% for our overall coverage universe. In our view, the primary driver of LNC's lower FCF is its focus on more capital-intensive businesses (namely annuities and individual life).

## Focus on Asian Life Insurers

Data on Asian insurers' cash flow lags substantially behind global peers, despite their widespread use of embedded value. Asian insurers are rightly concentrating on new business growth and value-based measures. However, we believe investor focus on cash will increase over time and we encourage companies to improve their disclosure. AIA stands out in a global context, not only for cash disclosure, but also for its very high cash flow growth potential – which makes it a core holding for us in the region. Despite recent macroeconomic concerns, we believe the structural factors supporting AIA's growth potential remain in place. We also take a brief look at Prudential's Asian operations in this section.

### Ample room for improvement in disclosure of cash

**Embedded value disclosure in Asia provides limited granularity on cash flow**

The transparency of free cash flow generation at Asian life insurers lags significantly behind global peers, despite the widespread use of embedded value methodologies used by investors to assess valuation. In many cases the embedded value data can be quite limited (e.g. headline EV and value of new business figures only). For those companies with a longer history of EV disclosure (e.g. Chinese life insurers), only the movement of overall EV is available, while the components of free surplus and required capital are still a little bit of black box. In addition, statutory profit figures, upon which we can derive cash flow data for the US life companies, are typically not released publicly in Asia.

**Asian life insurers are rightly focused on value-based measures, rather than cash, given their strong growth potential**

Like the European insurers about a decade ago, Asian life insurers are rightly focused on new business growth and building up 'future profits'. For companies that are growing rapidly in their markets, and are having to spend considerable capital and new business costs to fund this growth, value-based measures such as embedded value and new business profit growth make a lot of sense as valuation drivers for the Asian life insurers. Asian insurers also have generally solid solvency and capital positions – therefore it is understandable that investors and the companies themselves have a tendency to overlook the importance of cash flows.

**However, our experience of other regions teaches us that investors will start to care more about cash in the future**

However, we believe this situation is likely to change over time, particularly as the level of maturity of some core Asian life insurance markets increases over time. At some point, we believe the appetite from investors to get better data on how stores of 'future value' can be converted into tangible cash resources can only increase. This is especially important as other regions, starting with Europe but moving also to the US, start to focus increasingly on cash generation. As we have also pointed out, cash flow also acts as a useful metric to compare insurers with other sectors.

**We would encourage Asian insurers to improve their disclosure on cash – AIA should benefit from its early focus**

We would encourage more companies to start disclosing data on cash flow. Ultimately, it is our view, that companies lagging on cash flow disclosure could see themselves at a disadvantage, especially if we start to see examples of Asian life insurers that can start to produce good cashflows *and* growth.

AIA stands out among the listed Asian insurers as providing free cash flow data as a routine part of its disclosure, as well as good sensitivity analyses in its embedded value data. We believe it should be commended for providing this data – and as we try to show in the rest of this chapter, we also think it has a strong cash flow growth story.

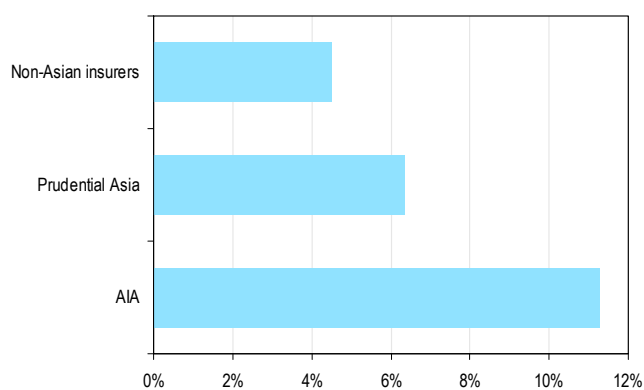
**Figure 33. AIA & Prudential Asia: Holding Company Free Cash Flow Summary**

Although free cash flow is at a low level in Asia – we forecast strong FCF growth, especially for AIA

€bn	AIA	Prudential Asia
Life new business capex	-1.9	-0.3
Life cash flow from in-force	3.6	0.9
<b>Life operating free cash flow</b>	<b>1.7</b>	<b>0.5</b>
<i>Life new business capex / premiums (%)</i>	-54.0%	-13.4%
<i>Life profits from in-force / embedded value (%)</i>	9.2%	6.9%
P&C earnings	0.0	0.0
P&C capex to fund growth	0.0	0.0
<b>P&amp;C operating free cashflow</b>	<b>0.0</b>	<b>0.0</b>
<i>P&amp;C capital required / net earned premiums (%)</i>	0%	0%
<b>Asset mgmt operating free cash flow</b>	<b>0.0</b>	<b>0.0</b>
<b>Other operating free cash flow</b>	<b>0.0</b>	<b>0.0</b>
<b>Total FCF from operating units</b>	<b>1.7</b>	<b>0.5</b>
<i>% of earnings remitted to holdco</i>	90.0%	77.0%
Dividends from operating units	1.5	0.4
Holding company costs (interest, central costs etc.)	-0.2	-0.1
<b>Holding company free cash flow</b>	<b>1.4</b>	<b>0.3</b>
<b>Holding company FCF yield</b>	<b>2.6%</b>	

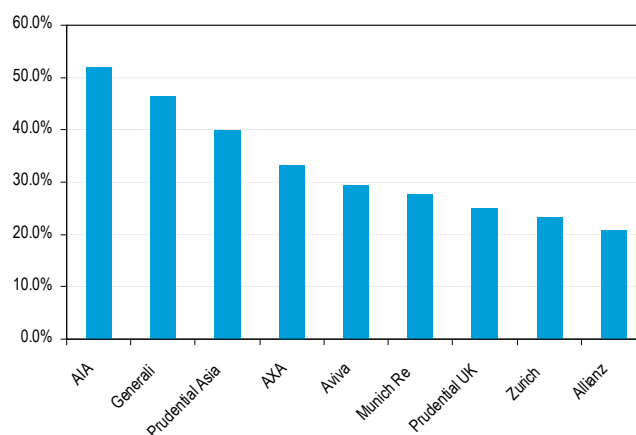
Source: Citi Research estimates

**Figure 34. Free Cash Flow Growth 2013-15e - ~11% p.a. for AIA**



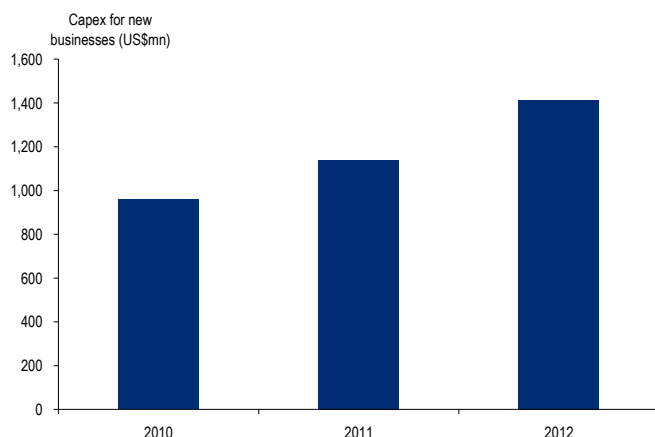
Source: Citi Research estimates

**Figure 35. Capex as % of Operating Cash Flow (2014e)**



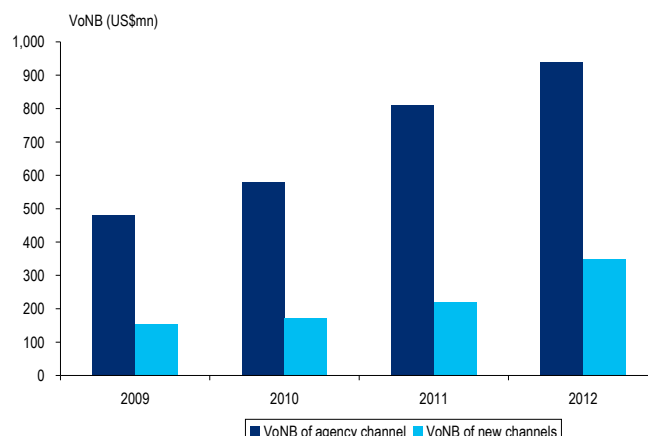
Source: Citi Research estimates

Figure 36. AIA's capex for New Businesses Has Been on the Rise...



Source: Company data, Citi Research

Figure 37. ...Due to Investment in Growth as the Company Restores Its Agency Force and Builds New Distribution Channels



Source: Company data, Citi Research

## AIA – Strong Cash Flow Growth Potential

**AIA has one of the strongest cash flow growth profiles globally**

Despite currently generating relatively low holding company free cash flow yields, AIA stands out as having one of the strongest cash flow growth profiles in the global insurance sector. We also expect it to outperform global peers in sustainable earnings growth. Therefore, we believe it offers attractive value generation potential.

**AIA's low holding company FCF yield reflects high capex to fund new growth and the immature cash flow profile of some of its business**

AIA's holding company free cash flow yield is among the lowest of the global insurance companies considered in this report. However, this reflects a relatively high expenditure on 'growth capex', that we believe will translate into strong growth in value and future cash flow – see Figures 33 and 34. In addition, some of AIA's 'emerging market' businesses (which account for approximately half of its new business), are likely to have less mature cash flow profiles than more developed business. We would expect the efficiency of cash generation in these businesses to improve over time, as they mature. For completeness, and to provide some comparison, we have added data on Prudential UK's Asian operations.

**We believe its growth prospects remain robust....**

We believe AIA continues to have excellent growth opportunities in its multi-regional Asian life insurance business, and we see the pattern of significant capex spend on funding new business growth continuing:

**...given structural growth factors offsetting macroeconomic concerns**

- Despite recent concerns about the GDP growth outlook for the region, there are structural growth factors that we believe will continue to support new business growth in the region. These include the still low penetration of life products in many of the countries in which AIA operates, the emerging middle class, urbanization and an increasing desire to protect wealth (and health) that may even be heightened by economic uncertainty.

**Management has returned to 'growth mode'**

- In addition, AIA has returned to "growth mode" after the new management team came on board post financial crisis. In particular, AIA has been investing in the build-out of new distribution channels (in addition to the traditional agency channel), such as bancassurance and direct marketing – and we see decent growth coming through from these new distribution sources.

**AIA continues to emphasise higher-margin protection products, that are also capital-intensive**

- As a profitability-focused insurer, AIA continues to emphasise higher-margin protection products that typically involve capital strains in the first year of new sales, but are far less economically sensitive than traditional single premium savings products.

We believe this investment in new business growth can translate into decent growth in cash flow:

**New business growth should add to the future stock of cash flows**

- AIA provides data on the undiscounted cash flows emerging from its embedded value calculation, which we show in Figure 38. While much of this is 'back-end-loaded' beyond 2032, we expect more than 50% of its embedded value to generate cash in the next 20 years. New business growth in the mean time should add to the stock of future cash flows.

**Its track record of improving cash flow is good, with ~12% p.a. growth 2010-12**

- AIA has shown very decent growth in cash flow in the past two years (with ~12% per annum growth in Group FCF 2010-12), and we see little reason for this to change in the medium term.

**We also forecast strong reported earnings growth**

- We also expect AIA to demonstrate one of the strongest levels of earnings growth among global peers, owing to good, stable operating profit trends given the company's focus on protection products and balanced investment mix.
- AIA has been doing a great job in remitting capital/cash from local markets (e.g. Thailand) to headquarters.

**This should allow robust dividend growth at AIA**

AIA has a short track record of good DPS growth since its listing (from nil in 2010 to HK\$0.33 in 2011 and HK\$0.37 in 2012). We expect DPS to grow steadily to HK\$0.42 in 2013E and HK\$0.48 in 2014E. The company has also made acquisitions recently, such as the US\$1.7bn purchase of ING Malaysia in 2012, through internal resources, which, in our view, these reflects the company's excess capital position, and its capital generation ability.

**AIA remains a core holding in Asia and is one of our top picks**

AIA remains a core holding within the Asian insurance space, in our view, with developing markets in Asia accounting for almost half of its new business profits (e.g. Thailand, Malaysia, China, Indonesia, the Philippines). Despite likely growth deceleration after two years of robust new business growth, we still expect AIA to demonstrate high-teens growth rates in the period to 2015, helped by stable margin trends and some of the growth factors we identified above (e.g. expansion of distribution channels including direct marketing and bancassurance).

**We believe the stock is defensive in some respects given low sensitivity to equity markets**

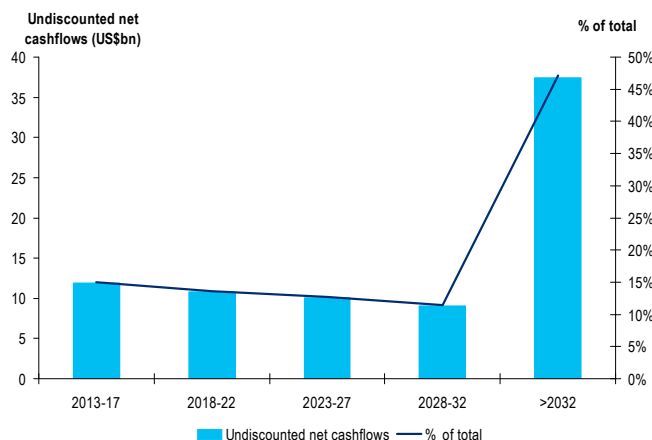
We also believe AIA is quite defensive in some respects, due to its focus on protection products rather than being geared to the potentially more volatile earnings from short-term savings. The company's sensitivity to equity markets is also low, owing to its balanced investment mix.

## AIA vs. Prudential Asia

**Prudential's Asian business shares many characteristics with AIA, including high capex**

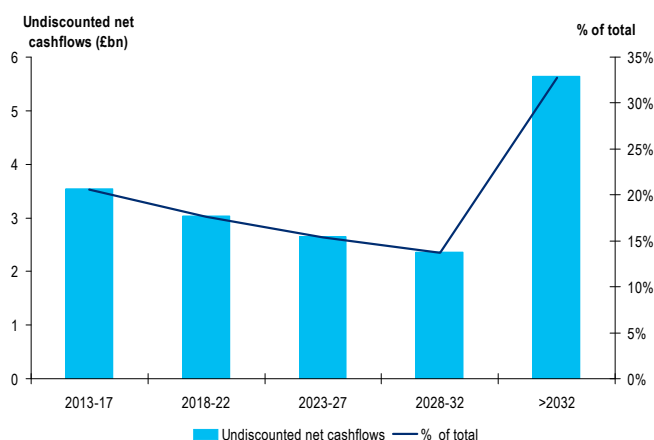
Prudential Asia is the nearest competitor to AIA in Asia, and shows a very similar cash flow generation profile to AIA. This includes a high level of reinvestment of capex into funding new business, and above average potential cash flow and earnings growth rates.

**Figure 38. AIA: Cash Flows Emerging from Existing Life Policies**  
>50% of cash flows are expected to emerge in the next 20 years



Source: Company data, Citi Research

**Figure 39. Prudential Asia: Cash Flows from Existing Life Policies**  
>65% of cash flows are expected to emerge in the next 20 years



Source: Company data, Citi Research

**Like AIA, we expect strongly growing remittances from Prudential Asia**

Prudential is in very similar markets to AIA and, therefore we should expect there to be a lot of overlaps between the two companies. For example, both are experiencing high cash flow generation growth rates, and we expect Prudential to start increasing cash remittances from Asia at a robust rate.

However, we would highlight some of the following slight differences:

**Prudential reinvests slightly less of its cash flow into capex on growth, potentially reflecting business mix**

- Prudential reinvests slightly less of its operating cash flow into new business capex than AIA. This is likely to be a function of new business product and geographical mix. We estimate Prudential's sales are split approximately equally between protection, unit-linked and participating (or traditional guaranteed savings) products. AIA aims to focus to on protection products in the next few years, which may create slightly greater new business strain initially.

**It also shows quicker cash payback in its embedded value, although this may be affected by projection assumptions**

- Prudential's Asian business appears to have a quicker payback of cash flow in its existing portfolio of business – also due to differences in business and geographical mix. Based on its 2012 disclosure, Prudential expects >65% of its embedded value cash flows to emerge in the next 20 years, compared to ~50% at AIA. This may be affected by embedded value and projection assumptions, as much as reflecting the timing of cash flow payback. However, it does suggest that some of AIA's investment in more initially capital-intensive protection business may lead to a longer 'duration' of profit emergence than at Prudential.

## Global Valuation Sheets

Figure 40. Global insurance valuation table

Prices and valuations at 3<sup>rd</sup> July 2013

RIC	Name		Rtg	Ccy	M Cap (US\$m)	Share Price	Target Price	P/EV(x)		NBM(x)		P/B(x)		P/E(x)		Div yield(%)		ROE (%)	
								13E	14E	13E	14E	13E	14E	13E	14E	13E	14E	13E	14E
Asia																			
2628.HK	China Life		1	HKD	63,797	17.50	26.00	1.1	1.0	1.1	-0.2	1.6	1.4	14.2	12.1	2.5	2.9	11.8	12.2
2601.HK	China Pacific		1	HKD	28,110	24.05	34.00	1.2	1.1	3.5	1.8	1.6	1.3	16.4	13.9	1.9	2.3	10.2	10.3
0966.HK	CTIH		2	HKD	2,407	10.94	15.00	0.7	0.6	-5.4	-7.1	1.2	1.0	12.1	9.8	0.0	0.0	10.4	11.0
1339.HK	PICC Group		2	HKD	18,385	3.36	4.20	1.3	1.1	6.6	2.9	1.6	1.4	13.6	11.4	0.7	0.9	12.1	12.8
2328.HK	PICC P&C		2	HKD	14,757	8.41	10.00	na	na	na	na	1.5	1.3	7.5	7.4	3.2	3.5	21.9	19.1
2318.HK	Ping An		1	HKD	50,796	49.75	83.00	1.0	0.9	-0.6	-2.6	1.6	1.4	11.0	9.3	1.7	2.0	16.1	16.0
1299.HK	AIA Grp		1	HKD	49,865	32.10	39.00	1.4	1.3	10.1	6.3	1.7	1.5	15.7	13.9	1.3	1.5	11.3	11.6
GELA.SI	Great Eastern		2	SGD	6,443	17.31	17.90	1.0	0.9	-0.7	-1.4	1.6	1.5	16.4	15.8	2.3	2.4	10.1	9.9
005830.KS	Dongbu Ins		2	KRW	3,010	48,250.00	43,200.00	0.6	0.6	-4.7	-6.1	1.1	1.0	8.2	6.8	2.7	3.1	14.1	15.3
088350.KS	Hanwha Life		2	KRW	4,943	6,460.00	8,300.00	0.6	0.6	-6.6	-9.0	0.8	0.7	9.5	8.0	3.9	4.6	8.4	9.5
001450.KS	Hyundai Mar & Fire		3	KRW	2,410	30,600.00	27,000.00	0.6	0.5	-4.9	-5.9	1.1	1.0	7.5	6.3	3.3	3.9	15.5	16.1
003690.KS	Korean Re		1	KRW	1,134	10,900.00	14,500.00	na	na	na	na	0.7	0.7	6.8	6.5	2.8	2.9	11.6	11.1
002550.KS	LIG Ins		3H	KRW	1,221	23,100.00	20,000.00	0.4	0.3	-6.4	-7.8	0.8	0.7	6.7	5.5	3.5	3.9	12.2	13.3
000810.KS	Samsung Fire Ins		1	KRW	9,746	233,500.00	260,000.00	0.8	0.8	-2.1	-3.4	1.3	1.2	15.3	13.0	2.4	2.8	8.8	9.8
032830.KS	Samsung Life		1	KRW	19,031	108,000.00	118,000.00	0.7	0.7	-6.8	-9.4	1.0	1.0	21.0	16.7	2.1	2.5	5.0	6.0
082640.KS	Tong Yang Lf Ins		2	KRW	929	9,800.00	10,700.00	0.5	0.4	-6.9	-8.7	0.8	0.8	7.6	6.4	4.6	5.1	11.1	12.3
2882.TW	Cathay FHC		1	TWD	14,167	39.20	50.00	0.7	0.6	-5.4	-5.8	1.7	1.6	15.5	14.8	1.3	1.4	12.0	11.3
2881.TW	Fubon		3	TWD	11,750	37.05	38.00	na	na	na	na	1.3	1.1	12.1	10.7	2.5	2.8	10.8	11.2
2888.TW	Shin Kong Finanl		3	TWD	3,022	10.00	8.00	0.4	0.4	-13.4	-12.9	0.8	0.7	8.1	7.7	0.0	0.0	11.5	9.9
BLA.BK	Bangkok Life		1	THB	2,560	65.50	77.00	1.8	1.5	16.1	10.6	3.3	2.8	16.5	13.1	1.5	1.9	22.0	23.3
CSG.OQ	CNinsure		NR	USD	300	6.00	na	na	na	na	na	0.6	0.6	na	na	0.0	0.9	5.6	5.9
Average								1.0	0.9	1.5	-0.5	1.5	1.3	13.9	12.0	1.9	2.2	12.3	12.4
Australia/NZ																			
AMP.AX	AMP Ltd		2	AUD	11,393	4.23	4.65	na	na	na	na	1.6	1.6	13.7	12.7	5.6	6.0	12.0	12.9
IAG.AX	Insur Aust Grp		2	AUD	10,383	5.46	5.60	na	na	na	na	2.3	2.2	9.6	12.3	5.7	5.1	25.6	18.7
NIF.AX	NIB Hld		2	AUD	859	2.14	2.20	na	na	na	na	2.9	2.7	13.4	12.7	4.7	4.7	22.4	21.9
QBE.AX	QBE Ins		2	AUD	17,577	15.74	16.00	na	na	na	na	1.6	1.5	14.3	11.6	3.2	3.9	11.4	13.4
SUN.AX	Suncorp Grp		1	AUD	13,793	11.72	13.75	na	na	na	na	1.1	1.1	21.4	11.6	5.7	7.3	5.0	9.4
TWR.NZ	Tower Ltd		2	NZD	326	2.03	1.90	na	na	na	na	0.9	0.9	10.2	14.4	5.9	3.9	10.0	6.4
Average								1.6	1.6	15.0	12.0	4.8	5.4	12.8	13.4				
Japan																			
8750.T	Dai-ichi Life		1	JPY	14,968	152,000.00	166,000.00	na	na	na	na	1.1	1.1	26.1	22.0	1.3	1.3	3.8	5.0
8725.T	MS&AD HD		1	JPY	16,638	2,694.00	3,100.00	na	na	na	na	0.8	0.8	14.9	15.1	2.0	2.0	4.7	4.5
8630.T	NKJSJ Hld		1	JPY	10,052	2,438.00	3,200.00	na	na	na	na	0.8	0.8	45.8	29.5	2.5	2.5	2.7	3.7
8729.T	Sony Fin		1	JPY	7,029	1,626.00	2,000.00	na	na	na	na	1.6	1.6	16.6	16.0	1.8	2.2	9.7	10.0
8795.T	T&D Hld		1	JPY	9,245	1,384.00	1,400.00	na	na	na	na	1.1	1.2	21.4	19.6	1.7	1.7	5.0	5.9
8766.T	Tokio Marine		1	JPY	25,840	3,390.00	3,900.00	na	na	na	na	1.1	1.1	20.1	16.0	1.8	1.9	3.8	4.7
Average								1.1	1.0	23.1	18.9	1.8	1.9	4.5	5.2				
Europe																			
AGES.BR	Ageas		2H	EUR	8,575	27.18	20.10	0.5	0.5	na	na	0.6	0.6	11.2	10.5	3.8	4.0	5.6	5.8
SAMAS.HE	Sampo		2	EUR	22,161	30.49	19.00	2.1	2.0	na	na	1.9	1.8	13.6	12.8	4.6	4.8	14.0	14.2
AXAF.PA	AXA		1	EUR	46,628	15.02	18.50	0.8	0.7	na	na	0.7	0.7	7.3	6.5	5.3	5.9	10.2	10.6
SCOR.PA	SCOR		1	EUR	5,751	23.08	26.70	0.8	0.8	na	na	0.8	0.8	7.6	8.0	5.6	6.1	11.1	9.9
ALLVG.DE	Allianz		1	EUR	64,800	109.50	145.00	1.0	0.9	na	na	0.9	0.8	7.8	7.6	4.6	4.8	11.7	11.2
HNRGN.DE	Hannover Re		2	EUR	8,513	54.39	62.80	1.0	0.9	na	na	1.0	0.9	7.9	8.0	5.0	5.1	13.2	12.1
MUVGN.DE	Munich Re		2	EUR	32,099	137.90	152.90	0.8	0.8	na	na	0.8	0.8	8.0	8.2	5.4	5.7	10.8	9.8
GASIMI	Generali		3	EUR	27,340	13.53	13.05	1.0	0.8	na	na	1.0	1.0	9.6	9.0	3.7	4.1	10.9	11.2
AEGNAS	Aegon		2H	EUR	14,723	5.37	4.33	1.5	na	na	na	0.5	na	8.3	7.7	4.5	4.9	6.4	13.6
DLLAS	Delta Lloyd		1	EUR	3,719	15.53	19.00	0.6	0.6	na	na	1.1	1.0	13.8	6.2	6.8	7.0	8.4	17.3
PZU.WA	PZU		1	PLN	10,939	423.90	441.00	1.4	1.4	na	na	2.6	2.6	14.4	14.1	7.1	7.1	17.9	18.2
MAPMC	Mapfre		3	EUR	10,284	2.57	2.30	2.6	2.5	na	na	0.9	0.9	8.5	8.2	5.4	5.8	11.5	11.2
SRENH.VX	Swiss Re		2	CHF	27,337	70.10	78.00	0.7	0.7	na	na	0.7	0.7	7.6	8.5	5.3	5.7	10.0	8.5
ZURN.VX	Zurich Ins Grp		2	CHF	38,312	247.10	270.00	1.1	1.0	na	na	1.1	1.0	8.9	8.5	6.9	6.9	12.4	12.3
ADMILL	Admiral Grp		2	GBP	5,500	13.25	12.15	8.8	8.0	na	na	7.2	6.6	12.8	12.0	7.5	7.9	58.4	57.2
AMILL	Amlin		2	GBP	3,030	4.00	3.90	1.2	1.2	na	na	1.2	1.2	8.4	8.9	6.4	6.7	15.2	13.4
AV.L	Aviva		1	GBP	15,295	3.43	4.32	0.8	0.7	na	na	1.0	0.9	7.2	6.9	4.5	4.7	15.3	13.8
DLGDL	Direct Line		2	GBP	5,174	2.28	2.00	na	na	na	na	1.2	1.1	9.9	8.5	5.2	5.5	12.2	13.8
HSXL	Hiscox		2	GBP	3,078	5.75	5.12	1.4	1.3	na	na	1.4	1.3	11.9	12.5	3.4	3.7	12.7	11.1
LGEN.L	Legal & General		2	GBP	15,831	1.77	1.81	1.1	1.0	na	na	1.8	1.6	11.0	10.3	4.8	5.2	16.5	16.3
PRJ.L	Prudential		1	GBP	42,236	10.89	12.86	1.2	1.0	na	na	2.3	2.1	12.8	12.2	2.8	3.0	19.4	17.9
RSL.L	Resolution		2H	GBP	6,219	2.89	2.61	0.7	0.7	na	na	0.8	0.8	14.6	12.8	7.5	7.6	5.2	6.0
RSA.L	RSA Ins		2	GBP	6,632	1.20	1.24	1.0	1.0	na	na	1.1	1.0	9.5	9.3	5.2	5.4	12.1	11.7
SL.L	Standard Life		2	GBP	12,741	3.54	3.87	1.0	0.9	na	na	1.8	1.7	14.5	13.3	4.4	4.7	12.8	13.2
TLXGN.DE	Talanx		1	EUR	7,476	22.80	26.10	na	na	na	na	0.7	0.7	8.1	7.2	5.2	5.8	9.3	9.8
Average								1.1	1.0	9.6	9.1	1.2	1.1	9.6	9.1	4.9	5.2	12.9	12.8
North America																			
AFL.N	Aflac		1	USD	26,388	56.60	64.00	na	na	na	na	1.6	1.4	9.1	8.6	2.5	2.7	20.5	19.3
AMP.N	Ameriprise		1	USD	16,348	81.12	83.00	na	na	na	na	1.7	1.7	12.1	10.7	2.5	2.9	19.0	21.3
HIG.N	Hartford Financial		1	USD	13,809	30.29	35.00	na	na	na	na	0.7	0.6	9.2	8.6	1.4	1.5	8.2	8.3
VOYA.N	ING U.S.		2	USD	7,573	27.99	30.00	na	na	na	na	0.4	0.4	10.4	10.0	0.0	0.0	6.5	6.9
LNC.N	Lincoln National		2	USD	9,928	36.98	36.00	na	na	na	na	0.6	0.6	8.2	7.3	1.4	1.7	10.8	11.0
MET.N	Metlife		2	USD	50,666	46.27	45.00	na	na	na	na	0.8	0.7	8.4	8.1	2.2	2.6	11.4	11.2
PF.N	Principal Financial		2	USD	10,848	36.97	34.00	na	na	na	na	1.0	1.0	11.0	9.8	2.4	3.0	11.4	12.1
FRJ.N	Prudential Financial		1	USD	34,409	73.84	83.00	na	na	na	na	0.9	0.8	8.9	8.3	2.2	2.5	14.3	14.4
RGA.N	RGA		2	USD	4,954	68.33	65.00	na	na	na	na	0.7	0.6	9.2	8.5	1.5	1.7	11.0	10.9
TMC.N	Torchmark		2	USD	6,088	65.83	60.00	na	na	na	na	1.3	1.2	11.					

Figure 41. European insurance valuation table

					2013E	2014E	2013E	2012-15E	2013E	2014E									Market
	Recommendation	RIC	Price 03-Jul-13	Price Target	2013E ETR	P/E IFRS	P/E IFRS	Div Yield	Dividend Growth PA	Price/ EV	Price/ EV	2013E RoEV	2014E RoEV	2013E P/BVPS	2014E P/BVPS	2013E ROE	2014E ROE	Cap US\$m	
Benelux (EUR)																			
Aegon	Neutral High Risk	AEGN.AS	5.37	4.33	-15.3%	8.3	7.7	4.5%	NA	152%	NA	14.4%	0.0%	52.2%	NA	6.4%	13.6%	14,921	
Ageas	Neutral High Risk	AGES.BR	27.18	20.10	-22.5%	11.0	10.3	3.8%	NA	52%	53%	21.1%	1.5%	60.8%	58.9%	5.6%	5.8%	8,675	
Delta Lloyd	Buy	DLL.AS	15.53	19.00	29.2%	13.8	6.2	6.8%	3.0%	61%	58%	23.9%	10.4%	112.8%	102.4%	8.4%	17.3%	3,754	
ING	Buy	ING.AS	6.98	9.60	37.6%	NA	NA	0.0%	NA	NA	NA	NA	NA	48.1%	45.5%	NA	NA	36,549	
France (EUR)																			
AXA	Buy	AXAF.PA	15.02	18.50	28.5%	7.3	6.5	5.3%	10.6%	81%	70%	23.1%	19.0%	72.0%	67.4%	10.2%	10.6%	48,802	
Germany (EUR)																			
Allianz	Buy	ALVG.DE	109.50	145.00	36.8%	7.8	7.5	4.6%	7.3%	98%	89%	19.5%	17.2%	90.9%	79.9%	11.7%	11.2%	67,122	
Talanx	Buy	TLXGn.DE	22.80	26.10	19.7%	8.1	7.2	5.2%	10.4%	NA	NA	NA	NA	72.7%	68.4%	9.3%	9.8%	7,560	
Italy (EUR)																			
Generali	Sell	GASI.MI	13.53	13.05	0.1%	9.6	9.0	3.7%	42.0%	96%	85%	21.1%	14.9%	103.1%	97.9%	10.9%	11.2%	28,046	
Nordic (Local Ccy)																			
Sampo	Neutral	SAMAS.HE	30.49	19.00	-33.6%	13.6	12.8	4.6%	NA	211%	198%	16.4%	16.3%	186.8%	177.0%	14.0%	14.2%	22,247	
Reinsurers (Local Ccy)																			
Hannover Re	Neutral	HNRGn.DE	54.39	62.80	20.4%	7.9	8.0	5.0%	-1.1%	100%	93%	NA	NA	100.3%	93.2%	13.2%	12.1%	8,609	
Munich Re	Neutral	MUVGn.DE	137.90	152.90	16.3%	8.0	8.2	5.4%	5.4%	83%	78%	NA	NA	82.9%	78.5%	10.8%	9.8%	32,608	
SCOR	Buy	SCOR.PA	23.08	26.70	21.3%	7.6	8.0	5.6%	7.7%	81%	77%	NA	NA	81.1%	76.8%	11.1%	9.9%	5,785	
Swiss Re	Neutral	SRENH.VX	70.10	78.00	16.6%	8.4	9.4	5.3%	-17.2%	75%	69%	NA	NA	74.5%	69.3%	10.0%	8.5%	27,496	
Spain (EUR)																			
Mapfre	Sell	MAP.MC	2.57	2.30	-5.2%	8.5	8.2	5.4%	13.3%	262%	250%	NA	NA	94.7%	89.2%	11.5%	11.2%	10,582	
Switzerland (SFr)																			
Zurich Ins Grp	Neutral	ZURN.VX	247.10	270.00	16.1%	8.9	8.5	6.9%	0.0%	112%	102%	20.9%	17.3%	107.4%	102.2%	12.4%	12.3%	38,813	
UK Life (p)																			
Aviva	Buy	AV.L	342.50	432.00	30.6%	10.0	7.8	4.5%	-4.0%	82%	75%	6.1%	5.9%	99.2%	91.0%	11.0%	12.2%	15,730	
Legal & General	Neutral	LGEN.L	176.60	181.00	7.3%	11.2	10.5	4.8%	10.0%	111%	104%	6.3%	6.9%	176.3%	162.7%	16.5%	16.3%	16,192	
Prudential	Buy	PRU.L	1089.00	1286.00	20.9%	12.7	12.2	2.8%	5.0%	117%	104%	16.5%	15.8%	232.6%	206.9%	19.6%	17.9%	43,511	
Resolution	Neutral High Risk	RSL.L	289.40	261.00	-2.3%	18.0	17.2	7.5%	2.0%	70%	70%	5.2%	6.1%	76.8%	77.1%	4.7%	5.1%	6,372	
Standard Life	Neutral	SL.L	353.80	387.00	13.8%	15.6	13.8	4.4%	6.5%	100%	94%	NA	NA	181.9%	171.5%	12.0%	12.8%	13,241	
UK P&C (p)																			
Admiral Grp	Neutral	ADML.L	1325.00	1215.00	-0.8%	12.9	12.1	7.5%	6.0%	NM	NM	NA	NA	716.5%	661.2%	58.4%	57.2%	5,565	
Amlin	Neutral	AML.L	399.70	390.00	3.9%	8.4	8.9	6.4%	NA	123%	116%	NA	NA	123.3%	116.5%	15.2%	13.4%	3,091	
Catlin Grp	Buy	CGL.L	506.00	569.00	18.6%	8.6	8.3	6.4%	NA	73%	46%	NA	NA	87.6%	82.9%	10.5%	10.3%	2,847	
Direct Line	Neutral	DLGD.L	227.60	200.00	-6.9%	14.8	9.5	5.2%	21.3%	NA	NA	NA	NA	120.4%	113.2%	8.2%	12.3%	5,135	
Hiscox	Neutral	HSX.L	574.50	512.00	-7.4%	11.9	12.5	3.4%	NA	144%	134%	NA	NA	144.0%	133.8%	12.7%	11.1%	3,144	
Lancashire	Buy	LRE.L	810.00	901.00	19.5%	9.9	10.0	8.6%	NA	190%	119%	NA	NA	192.6%	182.5%	17.2%	17.5%	2,006	
RSA Ins	Neutral	RSAL	119.70	124.00	8.9%	9.6	9.4	5.2%	-2.5%	105%	99%	NA	NA	111.3%	105.0%	12.1%	11.7%	6,757	
Average/Total						8.9	8.4	5.1%		96%	84%	11.8%	9.4%	108.9%	99.1%	11.1%	11%	485,162	

Source: Datacentral, Citi Research estimates

Figure 42. US life insurance valuation sheet – pricing at July 5, 2013

\$ in millions, except per share amounts

Company Name	Ticker	Rating	Price Target	Market Price	Cap	Perf YTD	Div Yield	Operating EPS			Operating EPS Growth			P/E Ratio			Book Value (ex. AOCI)		Total Book Value		Price / BV		ROE (ex. AOCI)	
								2012	2013E	2014E	2012	2013E	2014E	2012	2013E	2014E	12/31/12	3/31/13	12/31/12	3/31/13	ex. AOCI	Total BV	TTM	2013E
AFLAC Inc.	AFL	1	64.00	57.13	26,635	7.5%	2.5%	6.60	6.20	6.56	5.3%	-6.0%	5.7%	8.7	9.2	8.7	28.34	29.79	34.16	33.34	1.92	1.71	24.0%	20.8%
American Equity Life	AEL			15.79	1,011	29.3%	1.0%	1.69	1.91	2.20	-20.3%	13.2%	15.1%	9.3	8.3	7.2	16.49	16.84	27.46	27.27	0.94	0.58	10.6%	11.4%
American Intl Group	AIG			45.19	66,716	28.0%	0.0%	3.93			NM			11.5			57.87	59.40	66.38	67.41	0.76	0.67	6.1%	
Ameriprise Financial	AMP	1	90.00	83.10	16,747	32.7%	2.6%	5.59	6.72	7.60	8.1%	20.2%	13.1%	14.9	12.4	10.9	36.13	36.37	41.95	41.73	2.28	1.99	16.1%	18.5%
Assurant Inc.	AIZ			50.95	4,369	46.8%	2.0%	5.27	5.49	5.77	17.6%	4.2%	5.2%	9.7	9.3	8.8	53.87	54.90	64.14	64.54	0.93	0.79	9.1%	10.0%
CNO Financial Group	CNO			13.51	3,002	44.9%	0.9%	0.69	1.02	1.19	13.1%	47.3%	17.5%	19.6	13.3	11.3	17.39	17.26	22.80	22.50	0.78	0.60	4.6%	5.9%
Genworth Financial	GNW			12.32	6,075	64.0%	0.0%	0.81	1.20	1.40	NM	48.6%	16.6%	15.2	10.2	8.8	22.95	23.11	33.53	32.90	0.53	0.37	4.6%	5.2%
Hartford Financial	HIG	1	35.00	31.36	14,297	39.8%	1.3%	2.88	3.31	3.52	28.6%	14.9%	6.5%	10.9	9.5	8.9	40.00	39.09	45.80	42.43	0.80	0.74	7.3%	8.5%
ING U.S., Inc.	VOYA	2	30.00	27.79	7,247	N/A	0.0%	2.60	2.70	2.81	-16.1%	3.8%	4.2%	10.7	10.3	9.9	44.19	43.21	60.33	58.22	0.64	0.48	6.2%	6.2%
Lincoln National	LNC	2	41.00	38.98	10,465	50.5%	1.3%	4.47	4.56	5.10	13.5%	2.0%	11.8%	8.7	8.6	7.6	41.11	42.00	55.13	55.33	0.93	0.70	11.0%	10.9%
Manulife Financial	MFC			16.38	30,025	20.5%	3.1%	0.90	1.19	1.42	NM	32.0%	19.6%	18.2	13.8	11.5	12.87	12.76	12.21	12.28	1.28	1.33	10.2%	9.3%
MetLife Inc.	MET	2	51.00	47.52	52,035	44.3%	2.4%	5.28	5.50	5.73	20.5%	4.2%	4.2%	9.0	8.6	8.3	46.73	47.36	57.17	57.03	1.00	0.83	11.4%	11.6%
Principal Financial	PFG	2	37.00	37.91	11,124	32.9%	2.5%	2.69	3.33	3.74	1.1%	23.7%	12.4%	14.1	11.4	10.1	29.20	29.19	31.35	31.30	1.30	1.21	9.7%	11.4%
Protective Life	PL			39.98	3,136	39.9%	2.1%	3.78	3.89	4.67	15.2%	2.9%	20.0%	10.6	10.3	8.6	36.84	37.50	59.06	57.89	1.07	0.69	9.7%	10.4%
Prudential Financial	PRU	1	85.00	75.60	35,230	41.8%	2.2%	6.27	8.34	8.98	7.6%	33.1%	7.7%	12.1	9.1	8.4	57.86	55.94	79.19	81.96	1.35	0.92	11.9%	14.9%
Reinsurance Group	RGA	2	73.00	69.62	5,047	30.1%	1.4%	6.96	7.45	8.05	6.3%	7.1%	8.1%	10.0	9.3	8.6	64.95	67.37	93.47	94.34	1.03	0.74	11.3%	11.1%
Stancorp Financial	SFG			51.07	2,261	39.2%	1.9%	3.24	4.02	4.39	3.2%	24.0%	9.2%	15.8	12.7	11.6	41.87	42.90	48.83	49.36	1.19	1.03	8.5%	9.4%
Sun Life Financial	SLF			29.90	18,030	12.9%	4.6%	2.83	2.54	2.62	NM	-10.3%	3.1%	10.6	11.8	11.4	23.08	23.35	23.39	23.76	1.28	1.26	11.1%	10.9%
Symetra Financial	SYA			16.72	1,987	28.8%	2.0%	1.34	1.41	1.51	-2.9%	5.5%	6.8%	12.5	11.8	11.1	17.94	18.32	27.87	27.68	0.91	0.60	7.2%	7.7%
Torchmark Corp.	TMK	2	68.00	67.08	6,204	29.8%	1.0%	5.18	5.65	6.10	15.1%	9.1%	7.8%	12.9	11.9	11.0	32.70	35.98	38.19	45.88	1.86	1.46	15.5%	15.7%
Unum Group	UNM	2	33.00	30.48	8,136	46.4%	1.8%	3.15	3.27	3.56	NM	3.9%	8.9%	9.7	9.3	8.6	29.55	30.24	31.87	32.06	1.01	0.95	11.2%	10.8%
Group Average						35.5%	1.7%				7.2%	14.2%	10.2%	12.1	10.5	9.6					1.13	0.94	10.3%	11.0%
Group Median						36.1%	1.9%				7.8%	8.1%	8.5%	10.9	10.3	8.9					1.01	0.79	10.2%	10.8%

Source: FactSet, Company data, Citi Research estimates

Note: Using consensus estimates for companies not under Citi coverage

# Appendix A-1

## Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Torchmark Corp

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