European insurance – an analyst’s view

September 2018

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Many investors see insurance as a black box
European insurance – an analyst’s view

Premiums + capital → Insurer → ?
Presentation overview
European insurance – an analyst’s view

- Equity markets – what you need to know
- Sector themes – opportunities and challenges
- Case studies
- Conclusions
The traditional view of the market has limitations
Equity markets – all you need to know

Equity value = NPV of cash flows

The traditional view...
Cash flows based on consensus EPS/DPS expectations
Risks are reflected in the cost of equity

...has some practical limitations
IFRS EPS and book value metrics are not “economic”
The market does not wait around for changes in consensus estimates
The market moves faster than accounting profits
Equity markets – all you need to know

Indexed 12-month forward consensus net income

- Allianz
- AXA
- Generali
- Zurich

Share price volatility

- Trailing SXIP 90-day standard deviation
- Average standard deviation for the period

Source: Datastream, Goldman Sachs Global Investment Research
An economic view of equity value

Equity markets – all you need to know

Economic net asset value

Economic profits
- Expected surplus
- Cost of risk
- Return in excess of the cost of risk
- Recognised on expectation

Risk spread
- Return on risk held
- Cost of liabilities on balance sheet
- Return commensurate with the cost of risk
- Recognised on emergence

IFRS earnings are a mix of economic profits and risk spreads -> not all IFRS profits are the same

Source: Goldman Sachs Global Investment Research
Key themes in European insurance

Key sector themes - challenges & opportunities

Macro themes

- Low growth
- Low interest rates
- Shifting demographics
- Political uncertainty

Micro themes

- New technology
- M&A/simplification
- Regulation
- Capital returns

In summary...
...the market environment is seen as challenging but with some potential opportunities
How will new technology affect the industry?

Key sector themes – new technology

<table>
<thead>
<tr>
<th>Clear conclusions</th>
<th>Uncertainties</th>
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<tr>
<td>Potential for operational improvements</td>
<td>Is there risk of disruption?</td>
</tr>
<tr>
<td>Risk exposures will change</td>
<td>How will legacy issues be resolved?</td>
</tr>
<tr>
<td>Insurers that do not adapt will fail</td>
<td>Who will be the main beneficiaries?</td>
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</table>
Re-modelling the insurance value chain
Key sector themes – new technology

Technology will place high demands on insurers…

…specially in process heavy areas

Insurance value chain

Traditional

Sales → UW → Admin → Claims → AM → Risk

Disaggregated

Sales → UW → Admin → Claims → AM → Risk

eg. PCW
eg. Guidewire
eg. Reins/ILS
eg. Blackrock

Compressed

Sales → Claims → Admin

MGA

UW → Risk → Risk

Reinsurer

A narrower focus may be helpful

The main beneficiaries may not be insurers

Source: Goldman Sachs Global Investment Research
UK motor insurance distribution is dominated by price comparison websites.

The insurer makes money at a low price point due to operational and capital efficiency.

Hence, the insurer is able to deliver economic profitability in a competitive market.

Source: Goldman Sachs Global Investment Research
Rising life expectancy and lower birth rates have transformed developed world demographics

New solutions are needed across the protection and savings landscape...

...and legacy liabilities need to be managed

Source: INED, Mercer, Goldman Sachs Global Investment Research
Defined benefit pension obligations weigh on corporate balance sheet, particularly in the UK.

The bulk annuity writer assumes liabilities against an upfront payment.

However, what is discounted in pricing? What drives capital generation?

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Source: Rothesay Life, Goldman Sachs Investment Research
Profits create value, not investment themes

European insurance company valuations

European insurance: P/E ratio (x, 2019 Y/E, GS estimates)

High proportion economic profits

High proportion "risk spreads"

Source: Datastream, Goldman Sachs Global Investment Research
Given the lack of growth, capital returns are key to the insurance value proposition.

To understand dividend capacity we need to look beyond solvency and earnings metrics.

Capital returns alone will not deliver value for shareholders.

At year-end 2017, 20 insurers in our coverage were in or close to an excess capital position…

…but only three returned excess capital.

Source: Goldman Sachs Global Investment Research
Capital returns alone do not create value

European insurance company valuations

European insurance: P/E ratio (x, 2019e) vs. dividend yield (%, 2018e)

Source: Datastream, Goldman Sachs Global Investment Research
If the market is assessing insurers on an economic basis, surely disclosure should be economic?

IFRS17 moves economic disclosure in the right direction…

…but is it more informative than Solvency II?
Conclusions
How insurers create value for investors

Insurance is a black box for most investors but the market as a whole understands it quite well.

There are no obvious tailwinds but plenty of challenges.

To create value for investors insurers need to offer economic profits or access to underwriting risks.
Q&A
Disclosure Appendix

September 25, 2018

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Sami Taipalus: Europe-Insurance.

Goldman Sachs Investment Research global Equity coverage universe

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<th>Rating Distribution</th>
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<td>Global</td>
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| Buy                 | 35%  
| Hold                | 53%  
| Sell                | 12%  |

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