



Joint Regional Seminar Series 2010

Mergers and Acquisitions – Some Food for Thought

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Asia Pacific Risk Consulting Practice Leader &
Managing Director, Towers Watson, Hong Kong

- Working in the insurance industry since the 1980s and in Asia since 1989
- Before Towers Watson he was Asian Regional CEO and Executive Director Board Member of international life insurance operations of a UK-parented insurer including their joint venture in Korea
- Lead advisor of more than 200 actuarial appraisal assessments of economic value of Asian insurers and widely regarded as a leading practitioner in economic value determination and Mergers & Acquisitions of insurers in Asia
- Leader in Actuarial Expert Opinions in Prospectuses for IPOs of Asian insurance businesses
 - Actuarial advisor to China Life, Korea Life, Vietnam Life...
- Appointed Actuary for ten insurers in Hong Kong, Singapore and Vietnam
- Expert Witness testimonials and Independent Actuary for High Court sanctioned business transfers
- Memberships of numerous insurance-related, actuarial, regulatory and professional committees:
 - Regulatory Committees such as Insurance Advisory Committee, the statutory body that oversees the Insurance Authority in HK
 - CIRC and IRDA committees
 - Professional actuarial committees
- He holds both a BSC (Honours) degree and Post Graduate Certificate of Education in Mathematics from Manchester University, UK. And is a Fellow of six professional actuarial bodies.

Agenda ... Some Food for Thought

- **M&A is hot in Asia...**
- Challenges in M&A. Bigger picture.
- Actuaries, financials and price...
- Some insights into top-down pricing considerations and metrics...
- Useful metrics and benchmarks?
- Final food for thought...

Risk and Opportunity in action...

Some headlines ... Reactions ?

- “Prudential to pay US\$35.5 billion for AIA”
- “Prudential to pay US\$1 billion in advisor’s fees”
- “Met to acquire ALICo for US\$15.5 billion”
- “AXA to double the size of it’s Asian business”
- “Max NYL sheds 4% pie to Axis Bank”
- “Prudential pays S\$ 428 million for UOB Life”
- “European insurers exit Taiwan”
- “ING to dispose of its insurance unit”
- “Chinese consortium to buy AIA...”
- “AIA IPO back on...”

- In short, high activity and we will see many deals as the above headlines are the tip of the iceberg and a catalyst for action...
 - There has always been relatively high M&A activity in Asia over the last fifteen or so years but few exercises have resulted in deals...
 - A hinderance has been different perspectives and expectations of sellers and buyers...
 - And, unfortunately, not all actuaries involved have covered themselves in glory...

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Key challenges for M&A deals

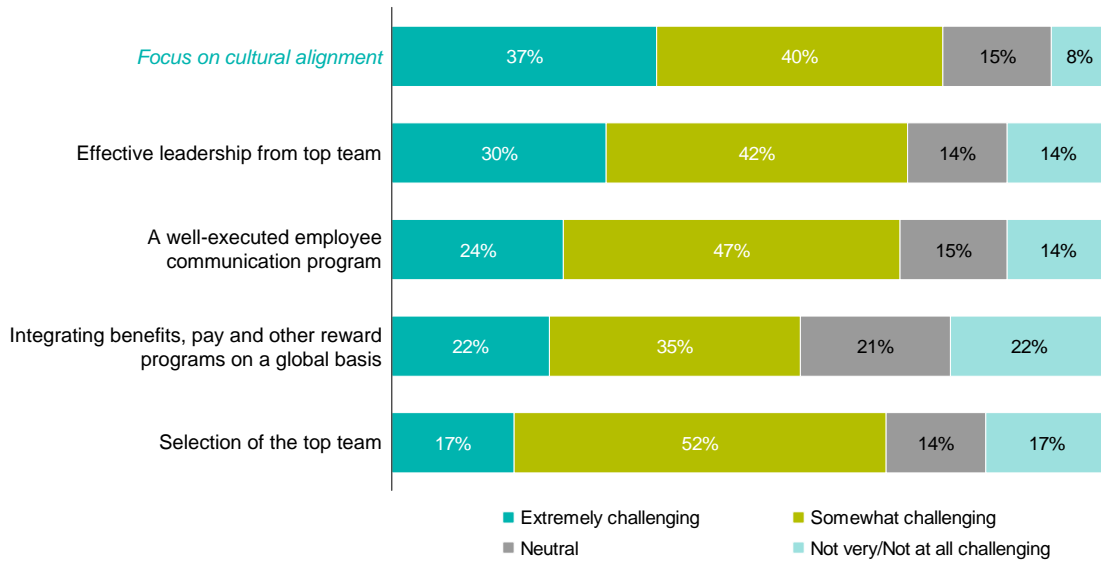
Global Deals		Negative Impact
Rank	Top 10 challenges in achieving synergies	
1	Incompatible cultures	5.60
2	Inability to manage target	5.39
3	Unable to implement change	5.34
4	Synergy non-existent or overestimated	5.22
5	Did not anticipate foreseeable events	5.14
6	Clash of management styles/egos	5.11
7	Acquirer paid too much	5.00
8	Acquired firm too unhealthy	4.58
9	Need to spin off or liquidate too much	4.05
10	Incompatible marketing systems	4.01

So execution risk is high. Note the issue about price is in 7th position. And poor financial state is in 8th. These are often the areas focused on in due diligence but clearly there are even more pertinent factors to consider than financials of the deal

Note: Survey of Forbes 500 CFOs Assessed on a scale of 1 to 7, where 7 is high.

Culture is ranked as the most challenging people issue in M&A

Most Challenging People Issues in M&A Deals

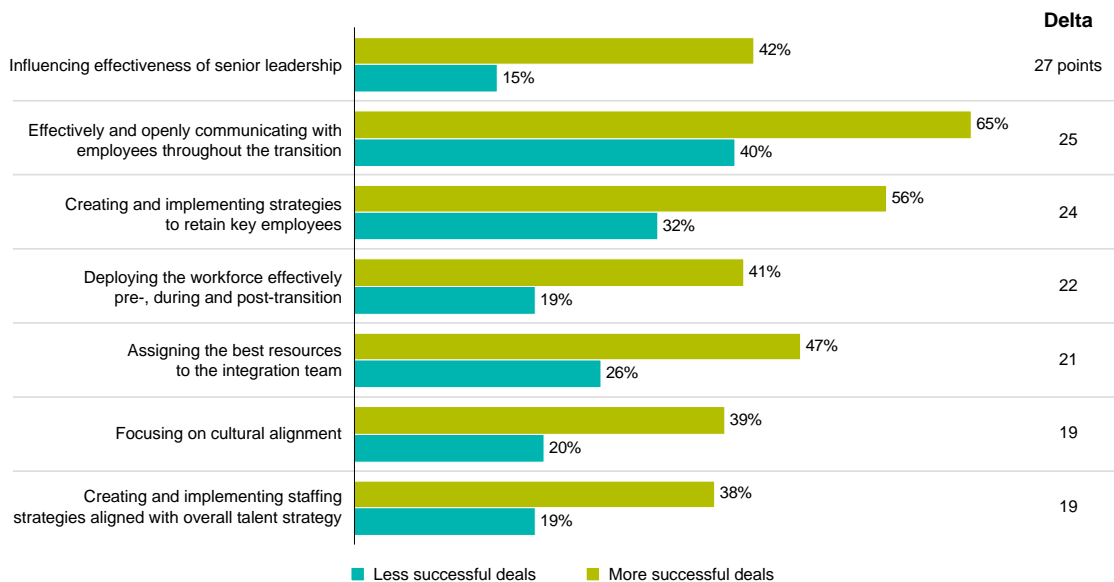


Source: Towers Perrin TP Track Survey 2004. Percentages reflect the answers of those respondents who have completed at least one deal in the past three years.

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...and, as a deal is struck, the challenges of Post Merger/Acquisition Integration are often underestimated...



Source: 2009 Global Pulse Survey.

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Agenda ... Some Food for Thought

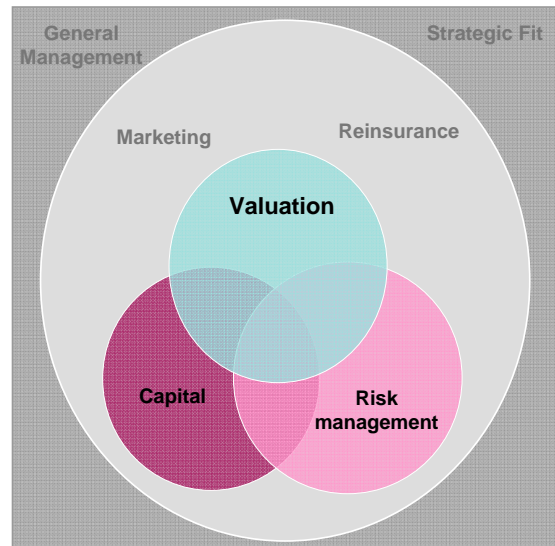
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OK so execution and people issues are massive but, for now, let's get back to the financials...

Actuarial & financial analysis for M&A

- **Financial valuation**
- Reserve adequacy
- Projected earnings
- Product profitability analysis
- Reinsurance evaluation and optimisation
- Capital management
- Asset-liability analysis and options
- Supporting synergy analysis
- Regulatory analysis and approval
- Representations and warranties
- Risk mitigation strategies
- Distribution capabilities
- Market analysis
- Underwriting & claims handling reviews
- Management meetings
- Deal structuring



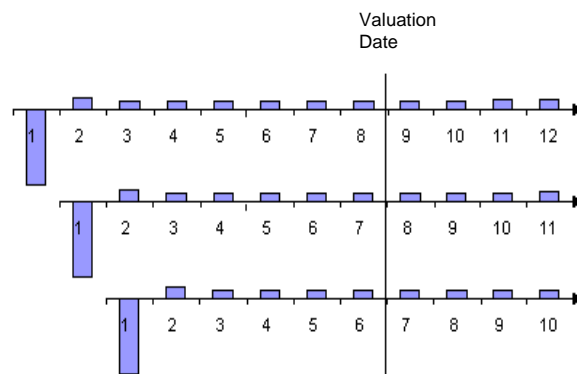
Much more than just number crunching!!

So achieving a successful M&A is easier to get wrong than get right... There is clearly strategic and execution risk ...

- ... and all can be exacerbated by not getting the price of the deal right... so let's focus on a key component of M&A in this presentation;
 - The **PRICE**... and so the deal pricing risk...
- What is the right price?...
 - Assess the risk/opportunity and the earnings stream to be realised
 - Determine the commensurate right price
- Actuaries play a critical and vital role in helping inform parties in pricing of the deal
 - Present different perspectives/scenarios/sensitivity tests/"what ifs"...
 - Help understanding of the drivers of value
- But please don't bring credibility into question by just producing numbers based on assumptions, approach or methodology that no-one (including you!) believes in...
 - "Here are the results of some calculations based on a set of assumptions that may or may not be correct but that's all we're doing for you...good luck!"
 - This is a disappointing practice and reflects badly on the actuaries involved and our profession

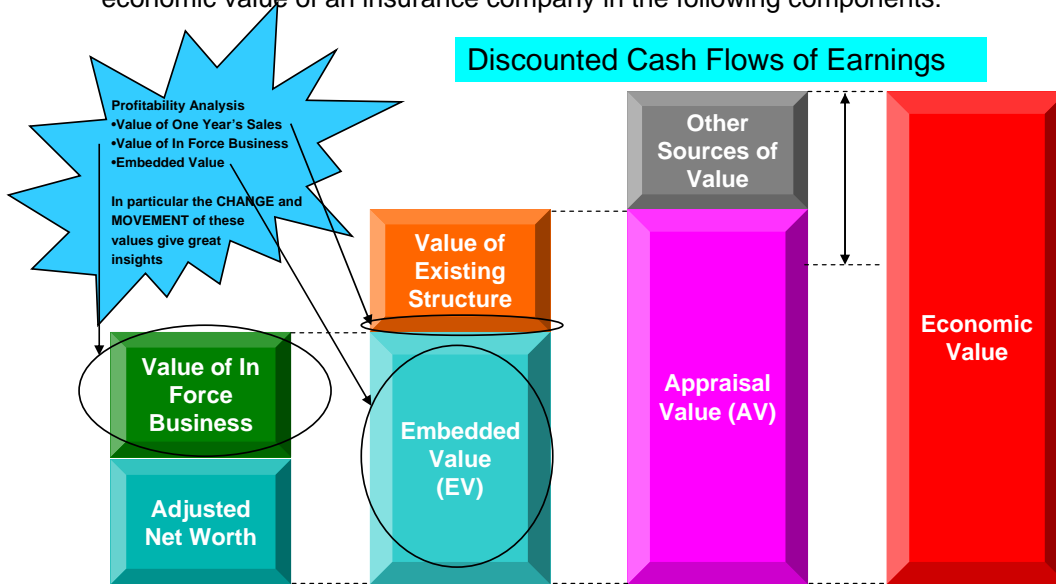
Present Value of Future Profits

- Best estimates of projected future cashflows
- Determination of earnings distributable to shareholders
- Discounted at an appropriate risk discount rate

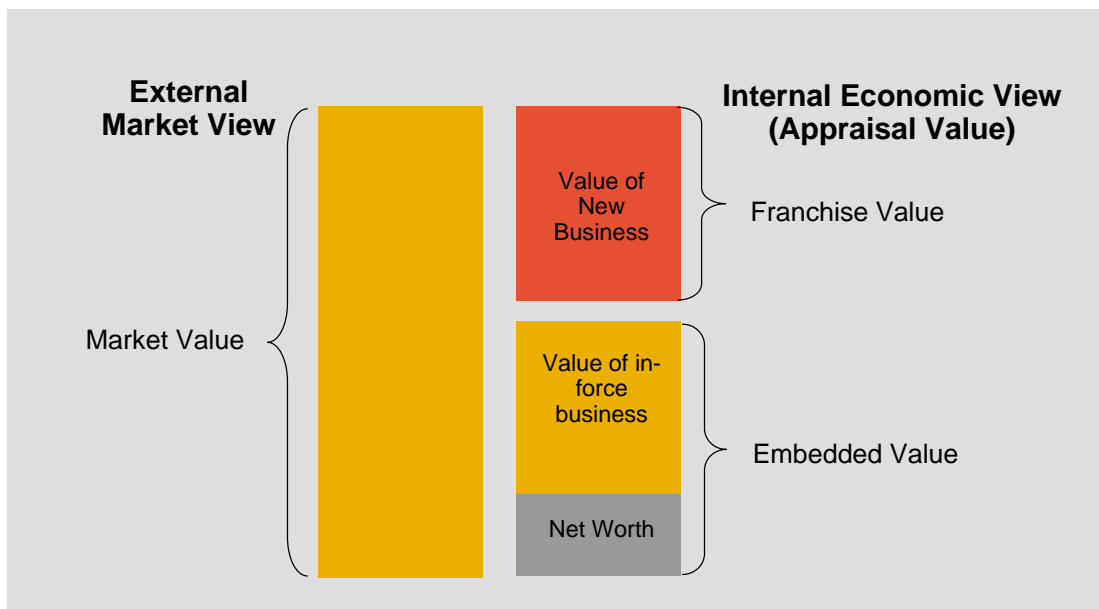


Components of a traditional assessment of Economic Value

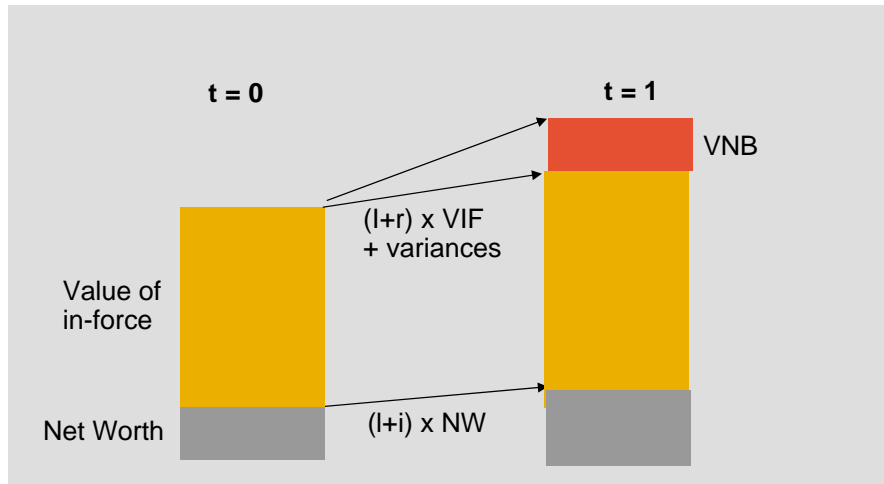
A traditional actuarial appraisal approach valuation typically develops the economic value of an insurance company in the following components:



Market value versus appraisal value



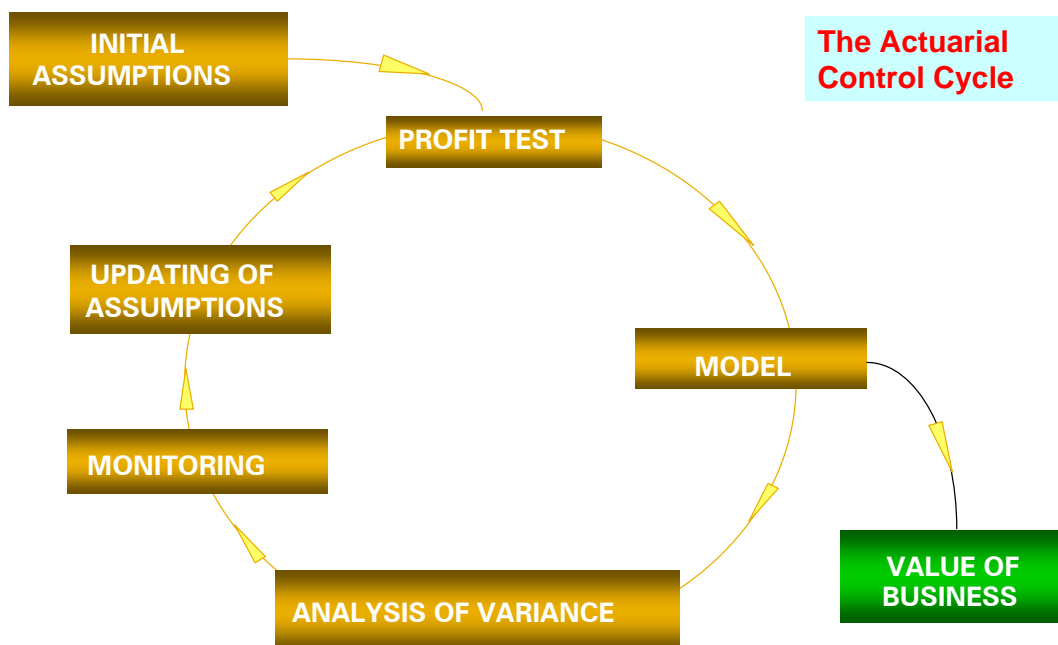
Movement in EV



Simplistic representation of $AV = EV + NB \text{ multiple} \times VNB$

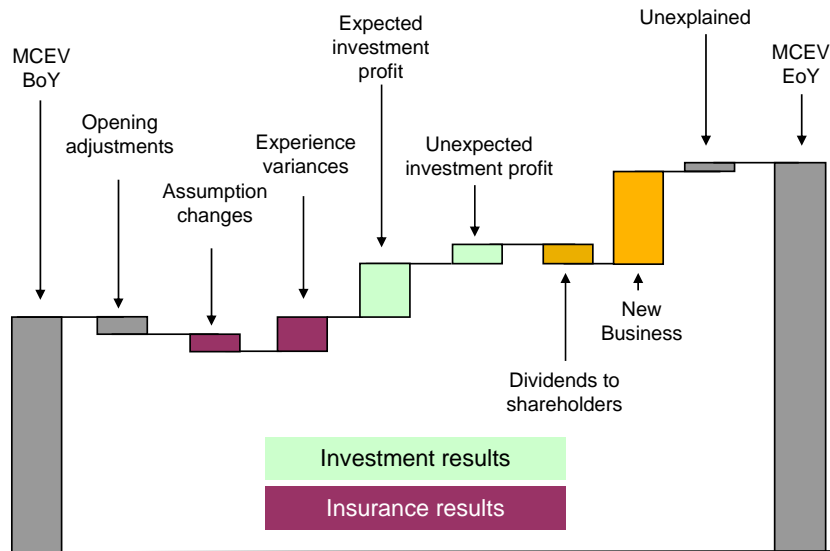
But most insights can be gained by detailed analysis of movement of EV

The Control Cycle



EV analysis of movement is the key to effective performance monitoring

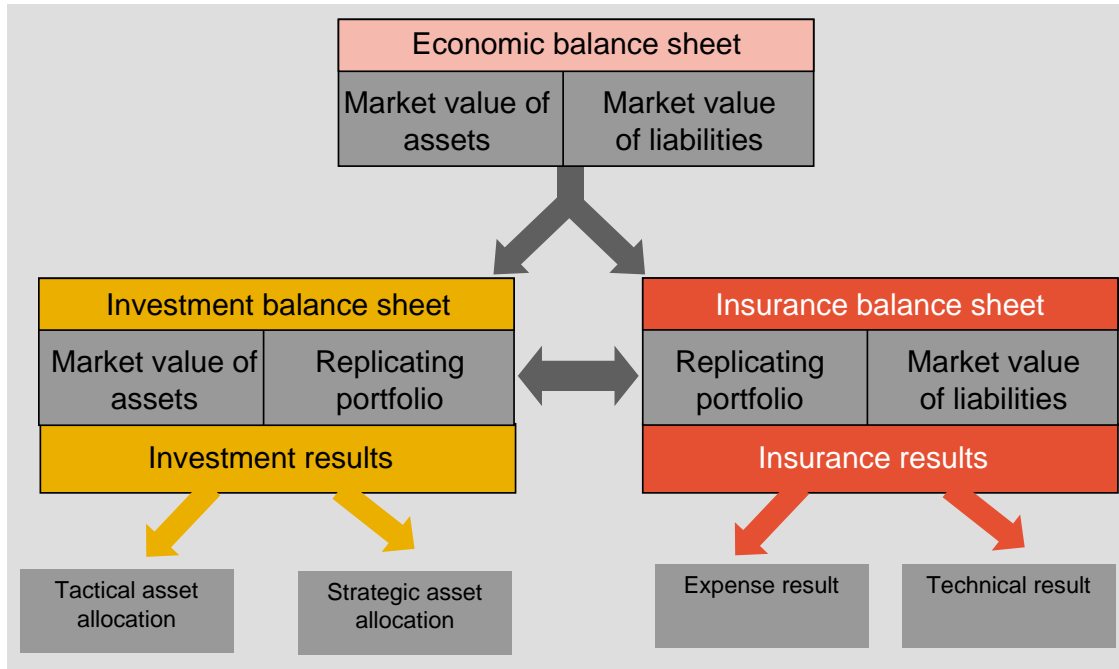
Analysis of Movement in MCEV



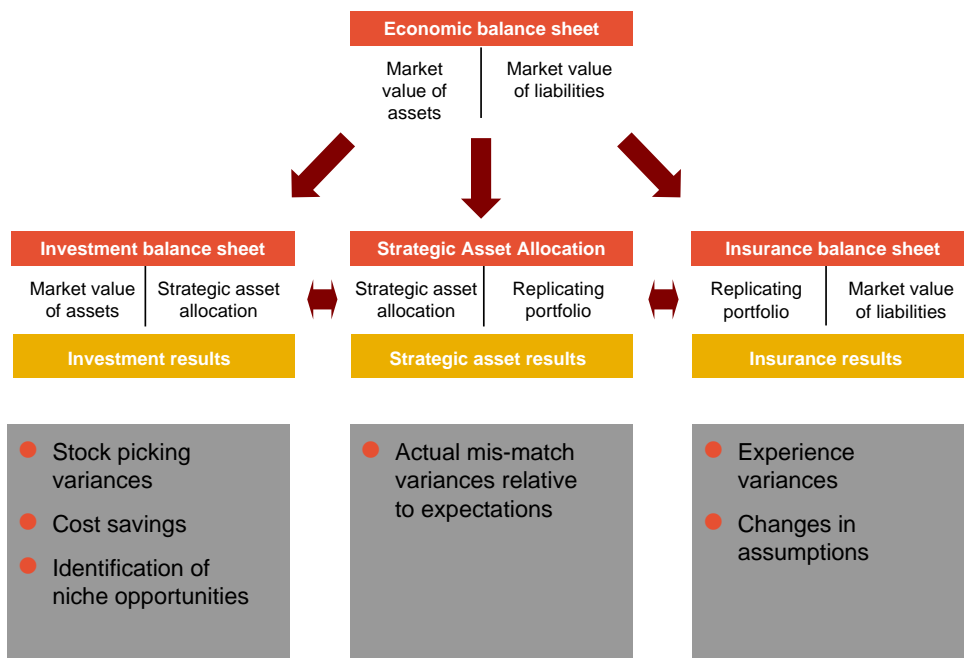
Presentation of MCEV analysis of earnings

	Earnings on MCEV analysis			
	Free Surplus	Required Capital	VIF	MCEV
Opening MCEV				
Opening adjustments				
Adjusted opening MCEV				
New business contribution				
Existing business contribution (reference rate)				
Existing business contribution (in excess of reference rate)				
Transfers from VIF and required capital to free surplus				
Experience variances				
Assumptions changes				
Other operating variance				
Operating MCEV earnings				
Economic variances				
Other non operating variance				
Total MCEV earnings				
Closing Adjustments				
Closing MCEV				

MCEV framework for understanding and managing risk



Equivalently but splitting out more explicitly strategic and tactical investment results... To measure performance, insurers need to understand insurance and investment results



Agenda ... Some Food for Thought

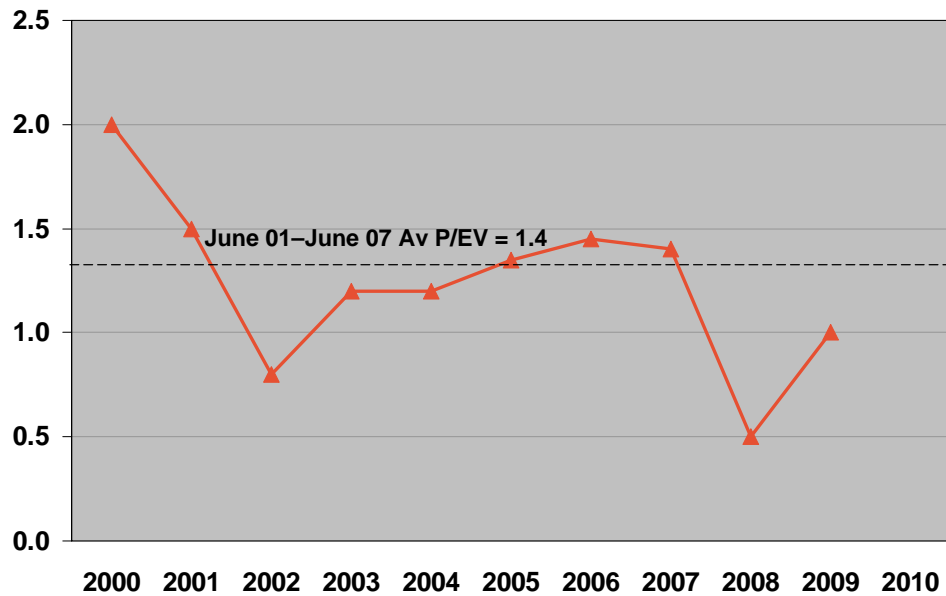
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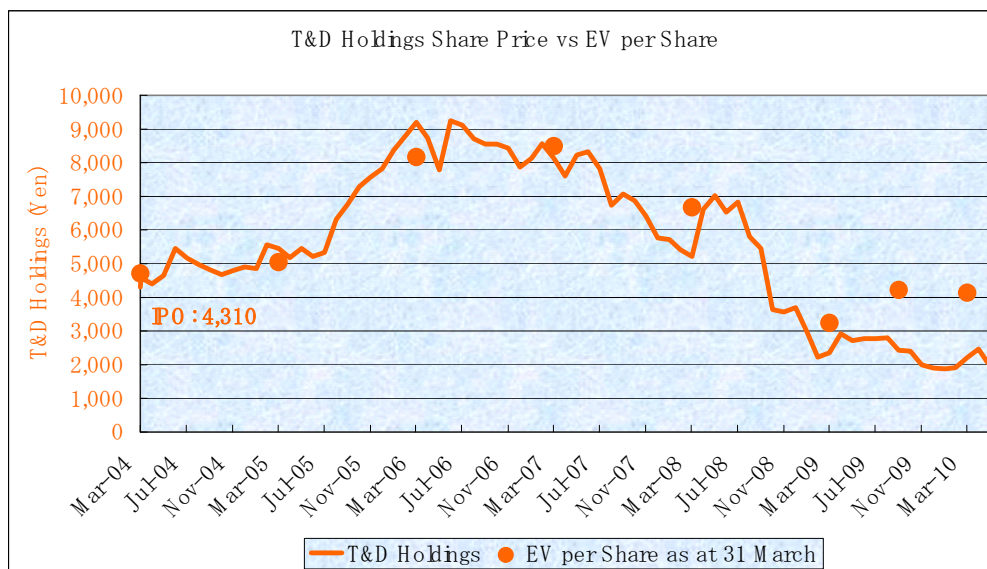
Common valuation metrics for life insurers

Primary	Valuation metric	Supplementary
IFRS P/E	Price/earnings ratio	P/EV earnings
P/ IFRS NAV	Price/book	P/EV
Dividend yield Earnings yield	Yields	-
RoE	Return on equity	RoEV

Price/EV – European Life Companies

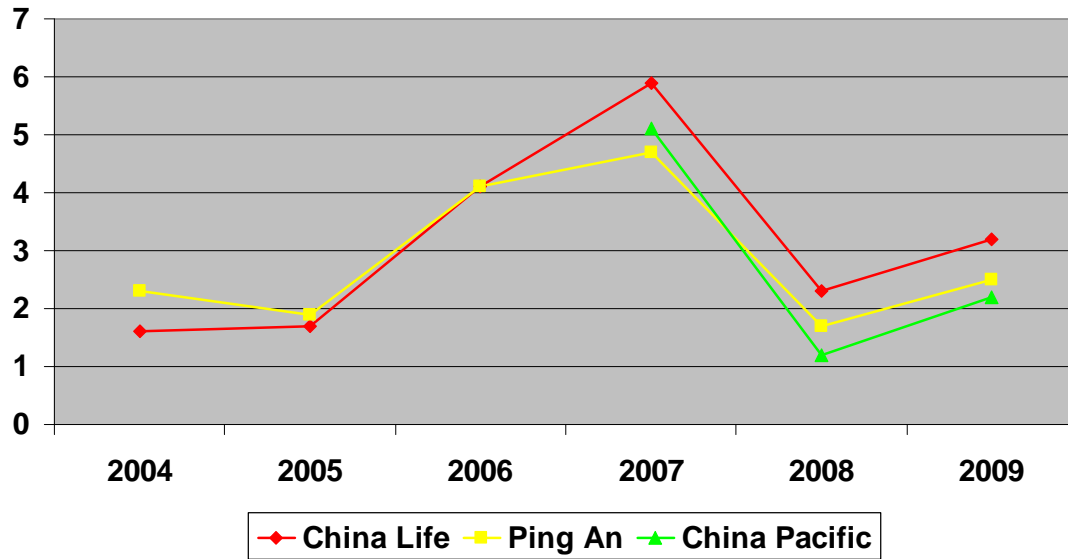


T&D Holdings Share Price since April 1, 2004

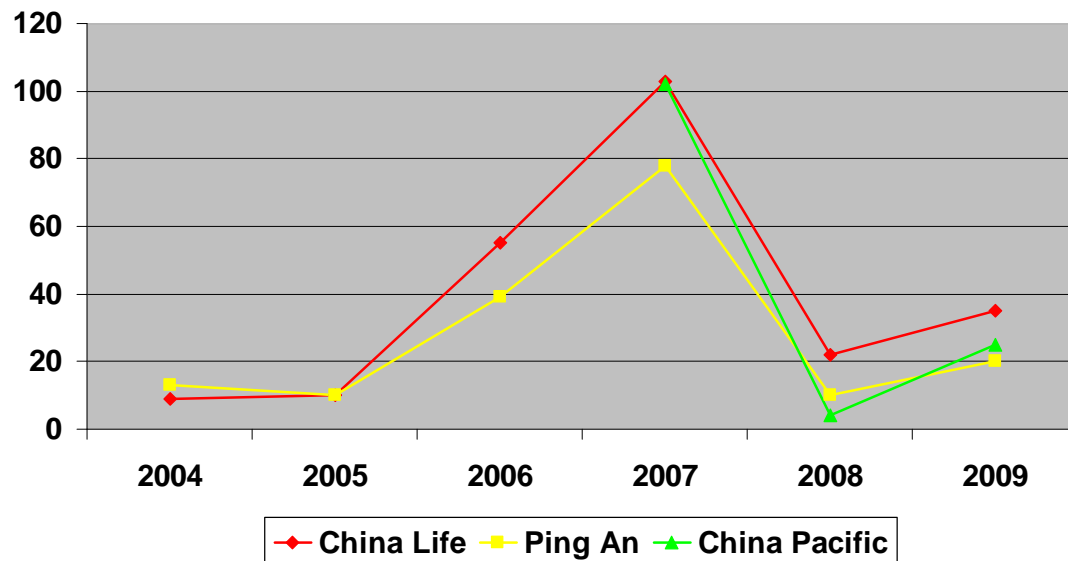


Book value per share of non-covered business of T&D Holdings included in the EV per share.

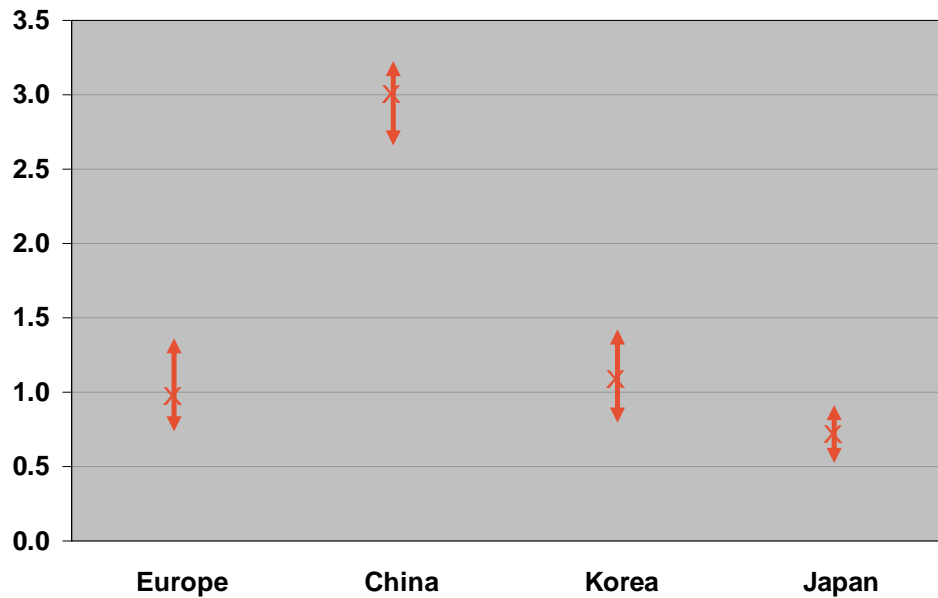
Price/EV for major Chinese Life Companies



Implied NB multiples for major Chinese Life Companies



Price/EV – Europe and Asia



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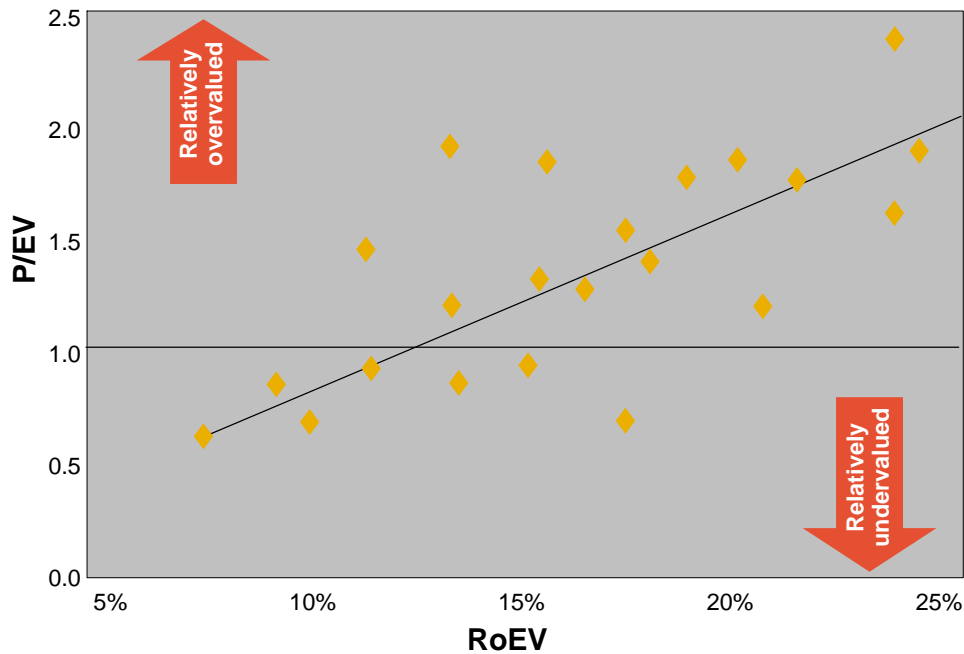
**Current ranking ...
which metric gives you the best insight to market price?**

	Assets	Premiums	EV	VOYS	Mkt Cap
China Life	2	1	1	1	?
Dai-ichi Life	1	2	2	2	?
Samsung Life	3	3	3	3	?

**Current ranking...
Hmmm...**

	Assets	Premiums	EV	VOYS	Mkt Cap
China Life	2	1	1	1	1
Dai-ichi Life	1	2	2	2	3
Samsung Life	3	3	3	3	2

Life Sector Regression: P/EV vs RoEV



Benchmarks? Help or hinder?

	AIA Australia	AIA China	AIA HK	AIA Indonesia (US\$ denominated)	AIA Indonesia (Rupiahs denominated)	AIA Korea	AIA Malaysia
Risk discount rate	9.00%	10.00%	8.00%	12.50%	17.00%	10.00%	9.00%
Expected long term rate of inflation	2.50%	2.00%	2.00%	6.00%	6.00%	3.50%	3.00%
10 year Government bond yield	5.75%	3.74%	3.83%	6.92%	11.00%	5.16%	4.46%
	AIA New Zealand	Philam Life	AIA Singapore & Brunei	AIA Taiwan	AIA Thailand	AIA Vietnam	
Risk discount rate	9.00%	14.00%	7.50%	8.00%	10.00%	16.00%	
Expected long term rate of inflation	2.00%	4.50%	2.00%	1.00%	2.00%	5.0%	
10 year Government bond yield	6.30%	7.47%	2.93%	1.73%	4.16%	9.25%	

**Useful ... but beware ... Many moving parts, components, and considerations
Any measure in isolation is dangerous...**

In addition to what is here, what is not here?!?

Case Study: So what was the right price?

- If you were P's shareholders?
- If you were A's Board?
- If you were considering it as a standalone entity?
- If you were investor C?
- **What is the correct economic value of your company?**
 - **To who?!?**
 - ...are you sure?!?...

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So need Top Down as well as Bottom Up assessments...

1. Do the bottom up determination
 - Together with range of perspectives/scenarios/sensitivities/'what ifs'...
 - And detailed analysis of movement in values and sources of earnings
 2. Apply deep knowledge and expertise from all available benchmarks and comparatives
 - Use a matrix of metrics in your assessment ...
 3. Don't lose sight of common sense
 - Eg. How much additional value needs to be created in order to justify the price?
 - Profits/synergies/expenses/improvements/effectiveness/distribution/products(mix)/... "we'll do things better...." ...but don't forget the execution risk post acquisition...
 - "What growth in VOYS is required per annum compound over the next ten years to realise an IRR of x% in our investment in the franchise value?"
- **Seasoned actuaries are THE professionals best placed to determine and inform other parties about economic values of insurers...**

And finally... We live in interesting and exciting times ...
Grasp the opportunity...

Success and Fortune



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