



Mergers & Acquisitions

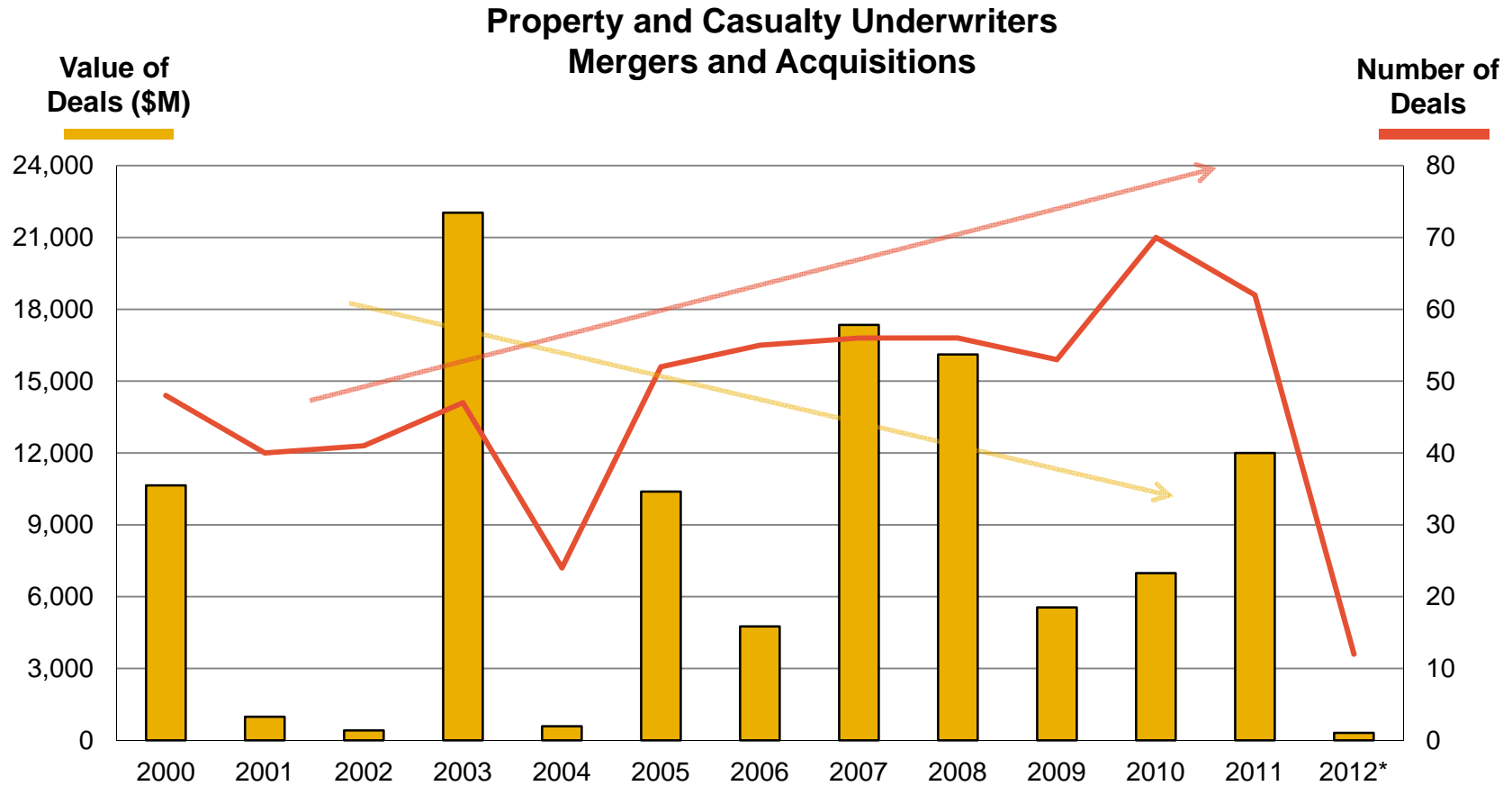
CAS Seminar on Reinsurance

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June 4, 2012

Industry M&A Overview

While the number of mergers and acquisitions has increased since 2001, the value of the deals has decreased



*2012 is through May 16, 2012

Source: SNL Financial, Towers Watson

2011 Property & Casualty Insurance M&A over \$100M

Acquirer	Target	Amount (\$M)
Alleghany Corporation	Transatlantic Holdings, Inc.	\$3,534.6
Allstate Corporation	Esurance	\$1,000.0
Nationwide Mutual Insurance Company	Harleysville Group Inc.	\$815.8
QBE Insurance Group Limited	Balboa insurance business	\$700.0
Berkshire Hathaway Inc.	Wesco Financial Corporation	\$547.6
CNA Financial Corporation	CNA Surety Corporation	\$476.5
Doctors Company, An Interinsurance Exchange	FPIC Insurance Group, Inc.	\$360.6
AmTrust Financial Services, Inc.	International Credit Mutual Reinsurance	\$315.1
Cowen Group, Inc.	Bel Re S.A.	\$293.0
Investor group	QUINN Insurance Limited	\$292.9
WRM America Holding Company, LLC	Flood insurance business	\$197.5
Tokio Marine Holdings, Inc.	First Insurance Company of Hawaii, Ltd.	\$167.8
WT Holdings, Inc.	Personal Lines Business	\$119.5
Syndicate Holding Corporation	HSBC Insurance (UK) Limited	\$109.9
ACE Limited	Penn Millers Holding Corporation	\$105.0
Tawa Plc	Regional legacy liability reserves	\$100.0

Source: SNL Financial, Towers Watson

M&As announced in 2012 (through May 16) with an announced deal value

Acquirer	Target	Amount (\$M)
Canopus Group Limited	Omega Insurance Holdings Limited (Bermuda)	\$264.2
CNA Group	Hardy Underwriting Bermuda Limited	\$227.1
Undisclosed buyer	Clal U.S. Holdings, Inc.	\$218.0
Assured Guaranty Ltd.	Municipal and Infrastructure Assurance Corporation	\$91.0
BF&M Limited*	Island Heritage Holdings Limited	\$68.0
USA Underwriters, LLC	Southern Michigan Insurance Company	\$5.0
Ten other deals were announced without deal values		N/A

*Closed on April 5, 2012

Source: SNL Financial, Towers Watson

Drivers of M&A (or lack thereof)

- Constituencies
 - Customers
 - Bigger is better
 - Lots of choice is good
 - Company Management
 - Always a voluntary buyer but rarely a voluntary seller
 - Insurance and Reinsurance Brokers
 - Smaller insurers give brokers more negotiating leverage
 - More insurers give brokers more choice
 - Rating Agencies
 - Bigger is better – more capital and diversified risk
 - Company Owners/Investors
 - This is often cited as a driver.....Let's look into this one further

Institutional Investors

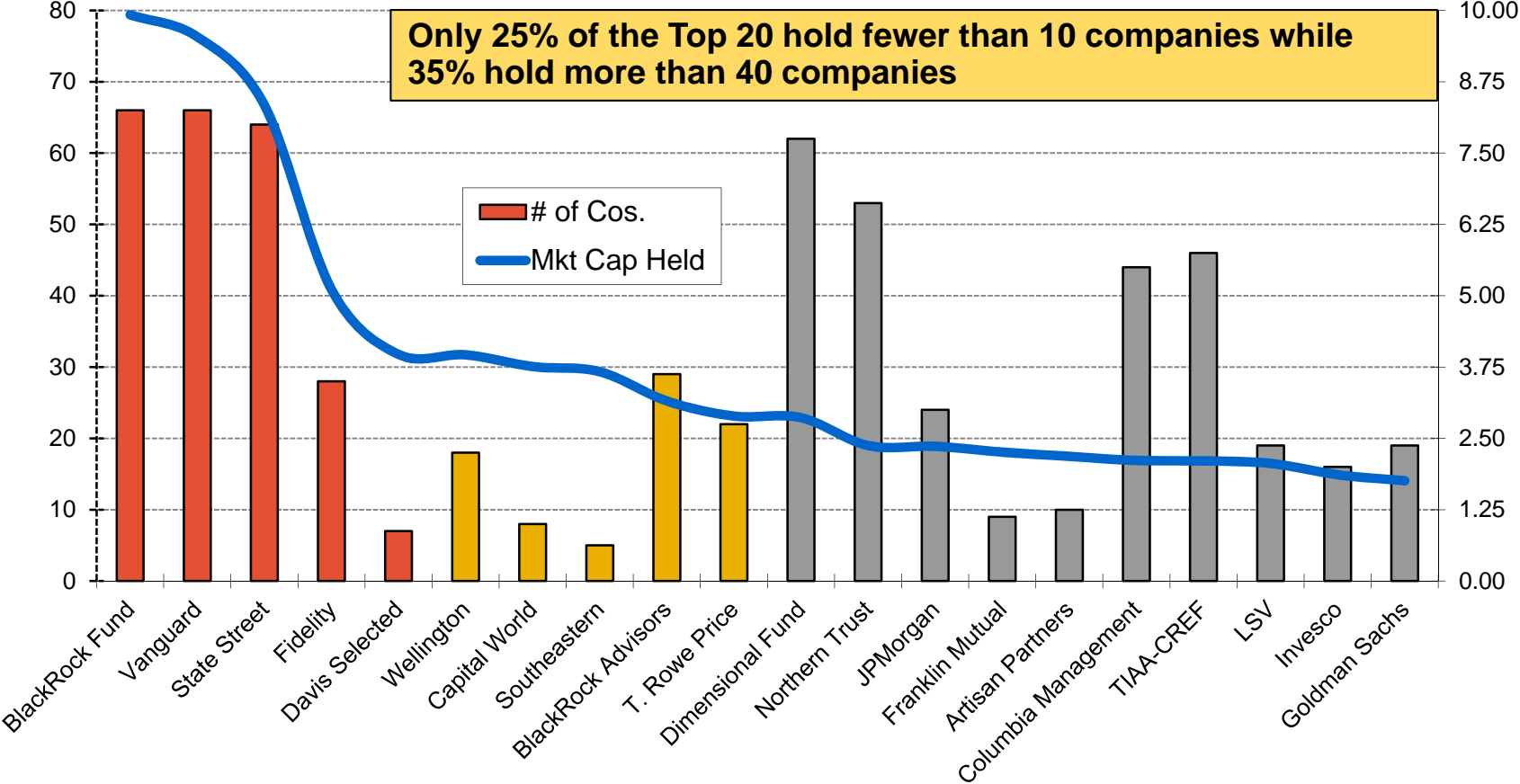
Let's look at the industry....

- Consider 76 publicly traded insurers that trade on the US stock exchanges
- There are 221 investors that show up as Top 30 institutional investors with more than \$10 million invested in the industry
 - Largest individual holding totals \$1.9B of market capital
 - Total holdings constitute \$123.9B of industry market capital (49.8%)
- Are these investors pushing for consolidation?

Most of the largest institutional investors are broadly diversified across the 81 publicly-traded companies

of Companies

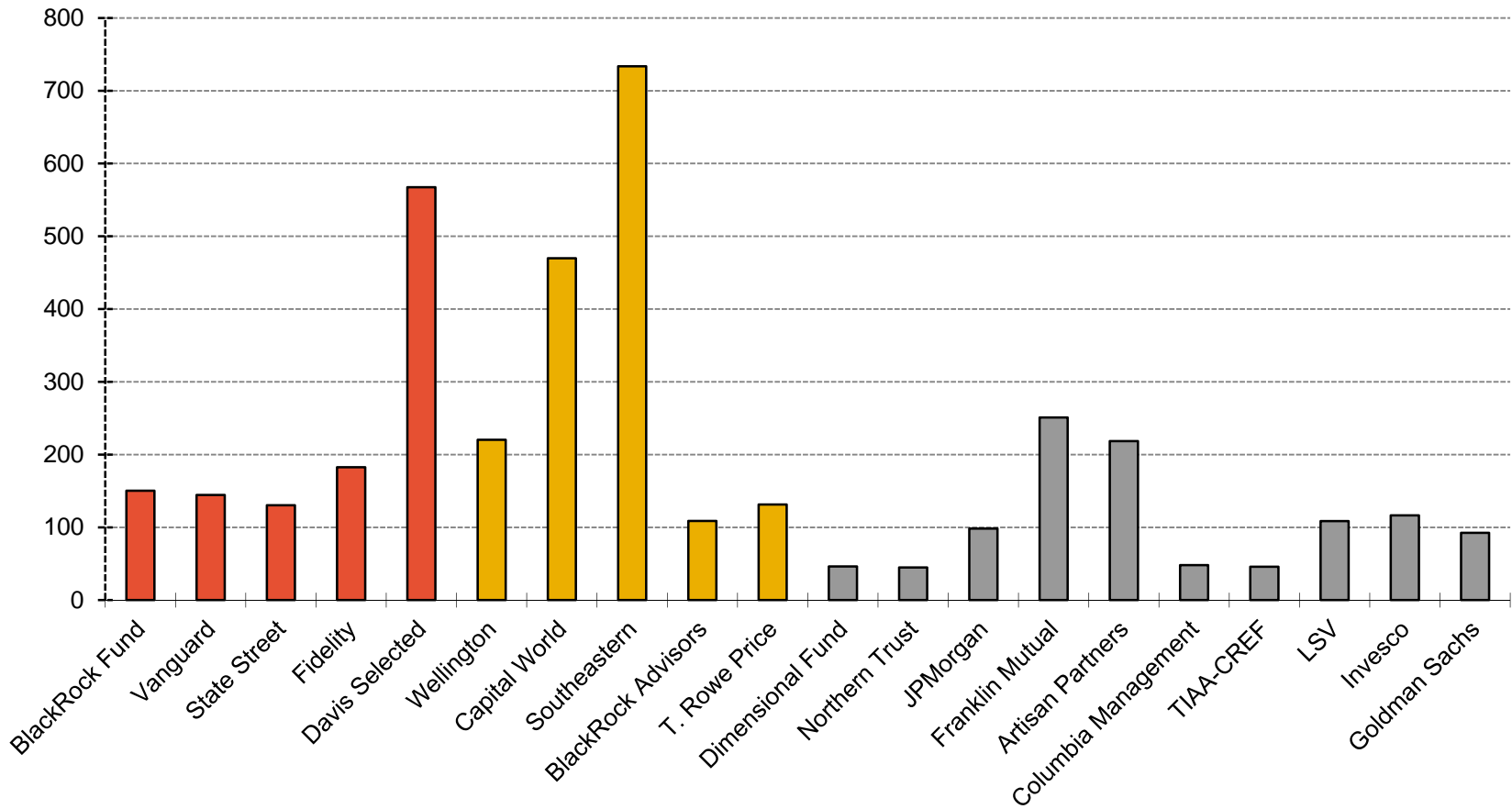
Mkt. Cap Held – \$Bn



Source: SNL Financial, Towers Watson

Only 6 investors have an average investments that exceeds \$200 million

Average Investment - \$Mn



Source: SNL Financial, Towers Watson

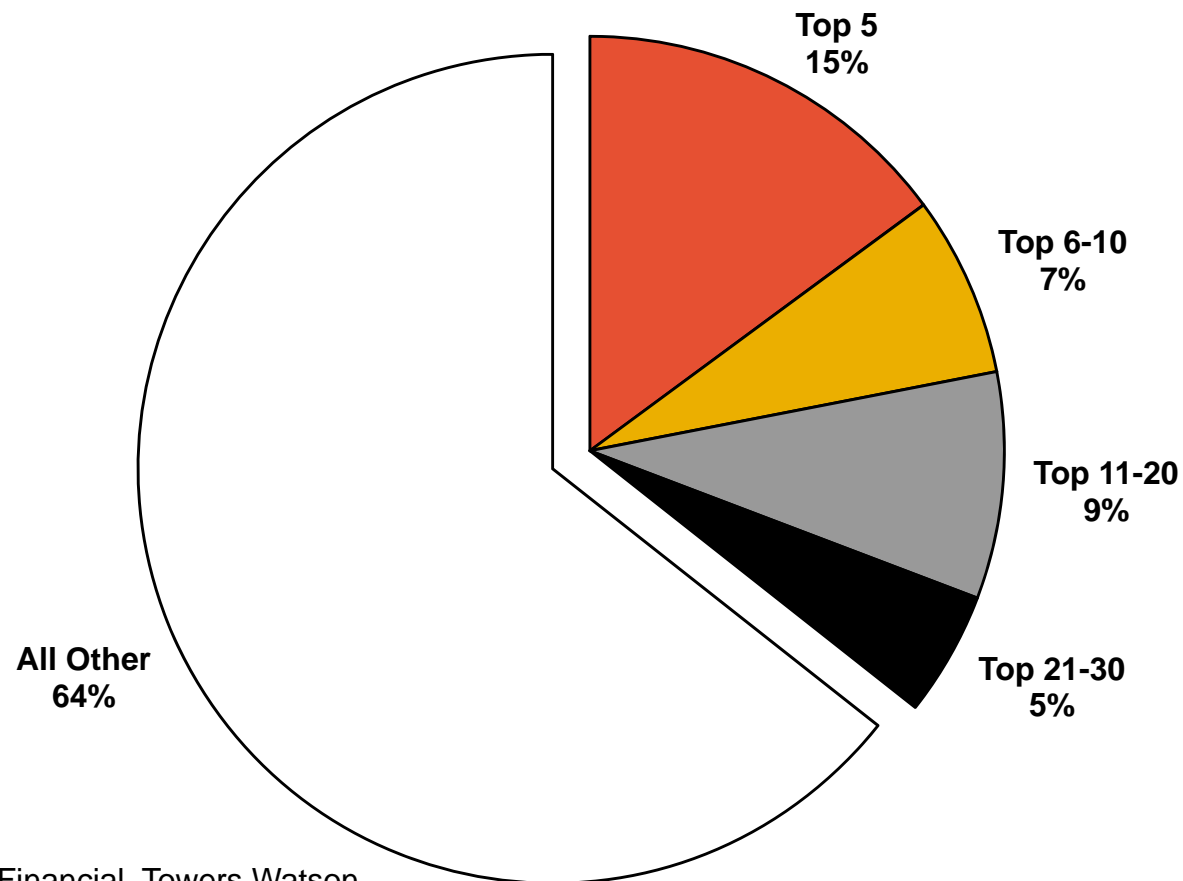
There are only 10 individual holdings in excess of \$1 billion

Investor	Insurance Company	Value of Holding
Capital World Investors	ACE Limited	1,903,180,752
Wellington Management Co. LLP	ACE Limited	1,585,361,048
State Street Global Advisors Inc.	Travelers Companies, Inc.	1,432,242,290
Davis Selected Advisers LP	Progressive Corporation	1,397,939,551
Southeastern Asset Management Inc.	Travelers Companies, Inc.	1,145,184,618
BlackRock Fund Advisors	Travelers Companies, Inc.	1,144,710,294
Southeastern Asset Management Inc.	Fairfax Financial Holdings Limited	1,076,757,237
BlackRock Fund Advisors	ACE Limited	1,047,133,138
Vanguard Group Inc.	ACE Limited	1,019,871,654
Vanguard Group Inc.	Travelers Companies, Inc.	1,019,677,545

Source: SNL Financial, Towers Watson

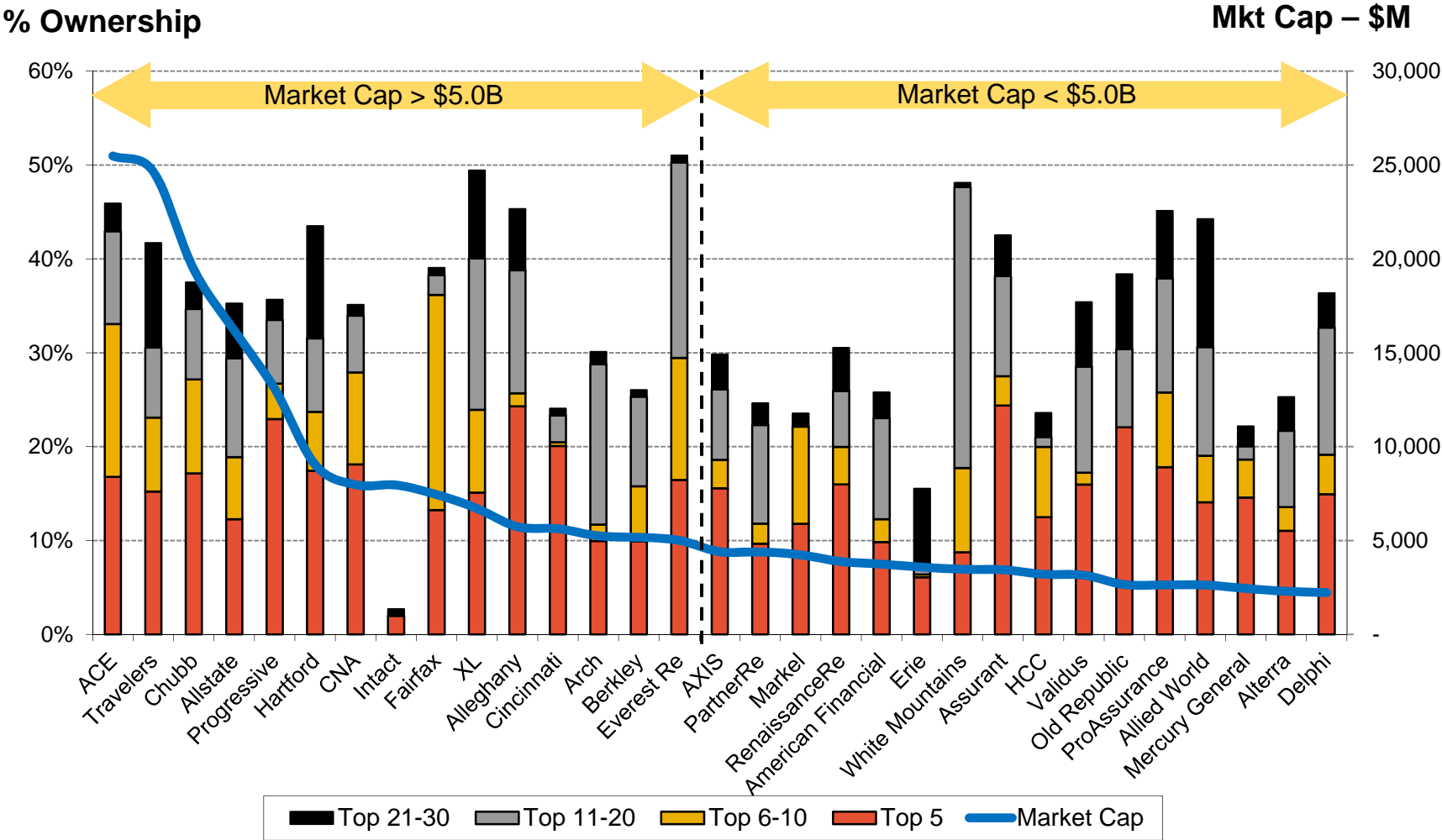
In aggregate, 36% of industry capital is provided by the Top 30 institutional investors

Share of industry held by institutional investors



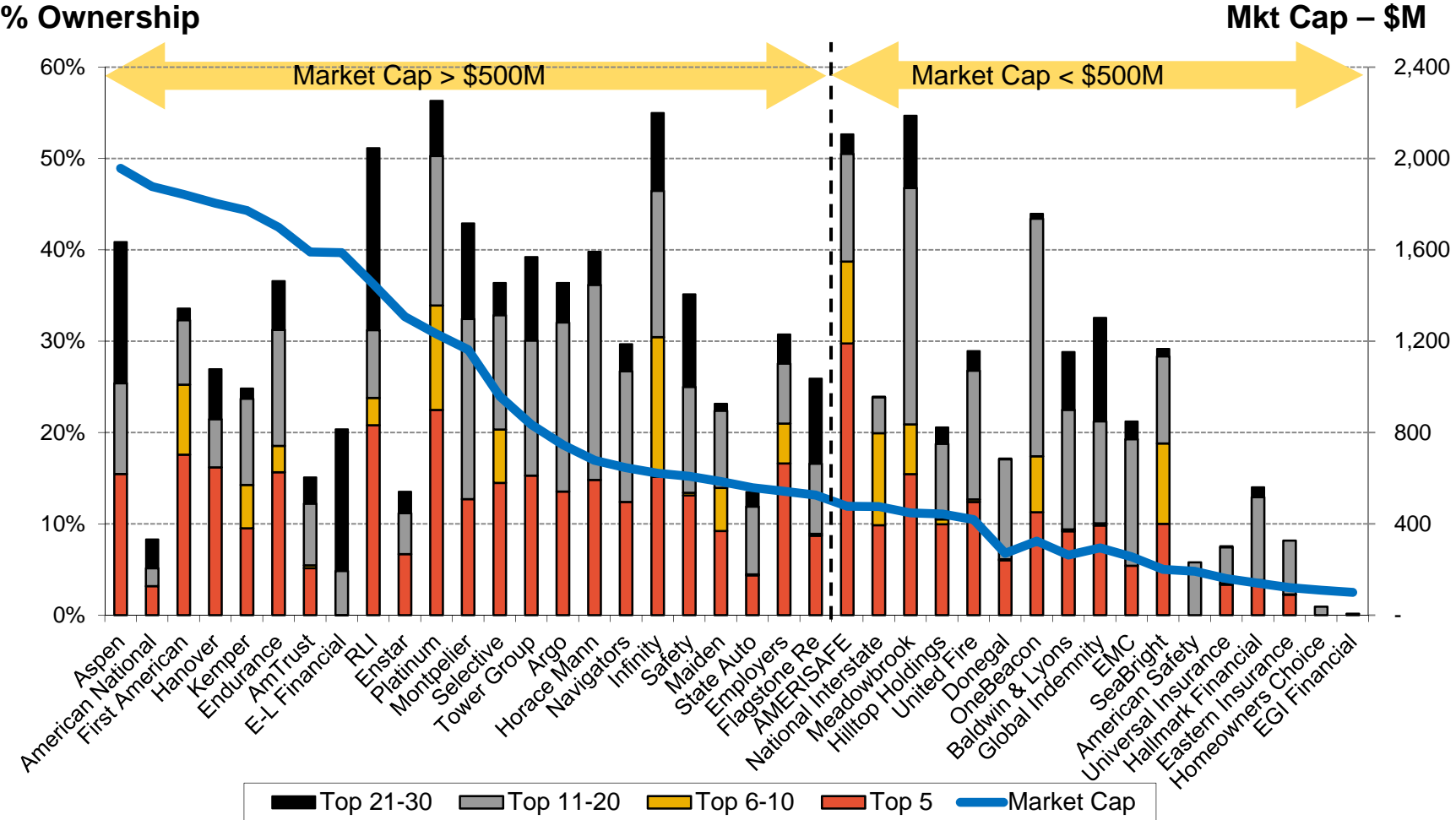
Source: SNL Financial, Towers Watson

The Top 30 investors control from 2% to 51% of each company. What incentive do they have to concentrate their holdings?



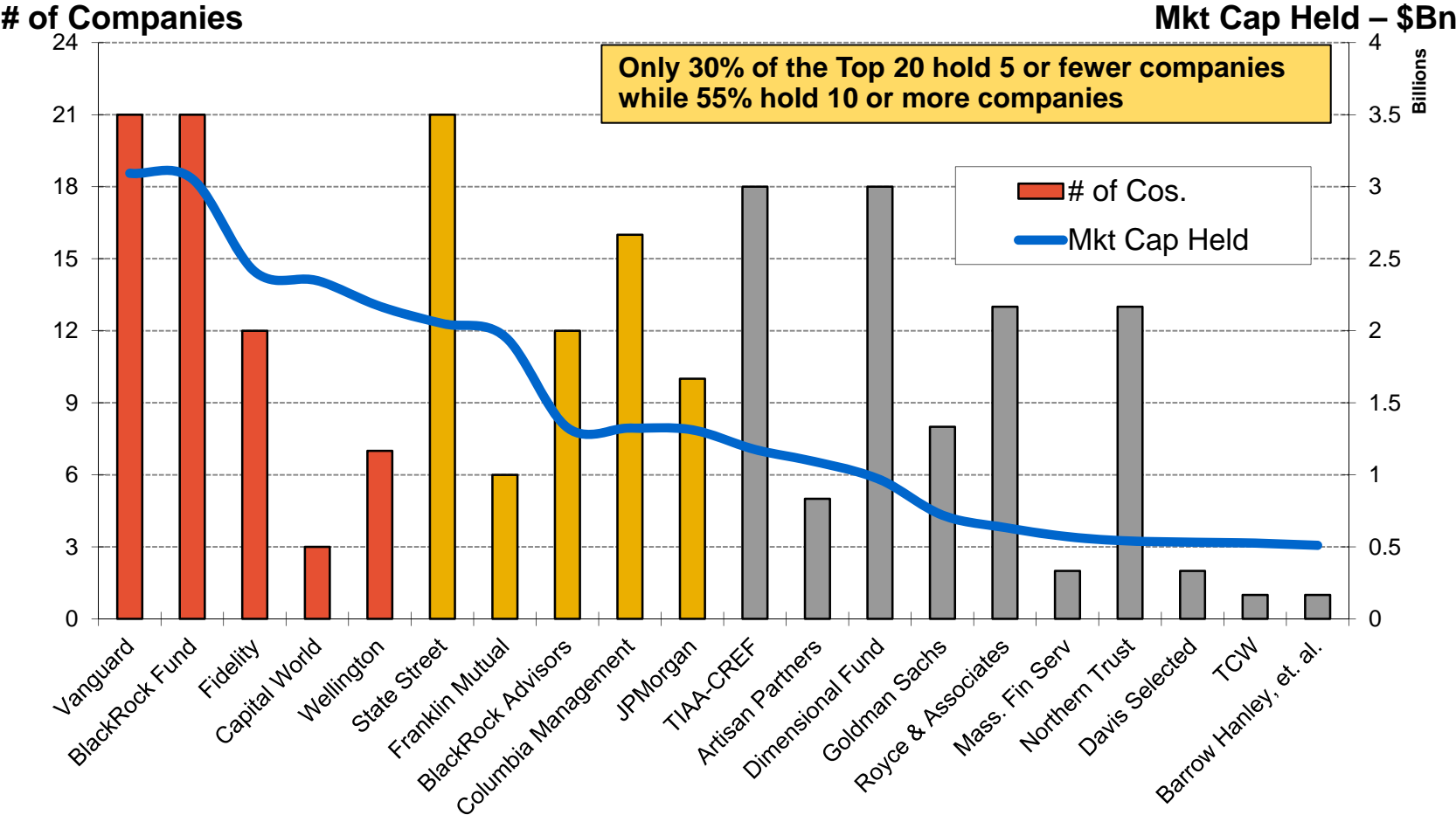
Source: SNL Financial, Towers Watson

Only the smallest of the publicly traded companies are not controlled by the large institutional investors



Source: SNL Financial, Towers Watson

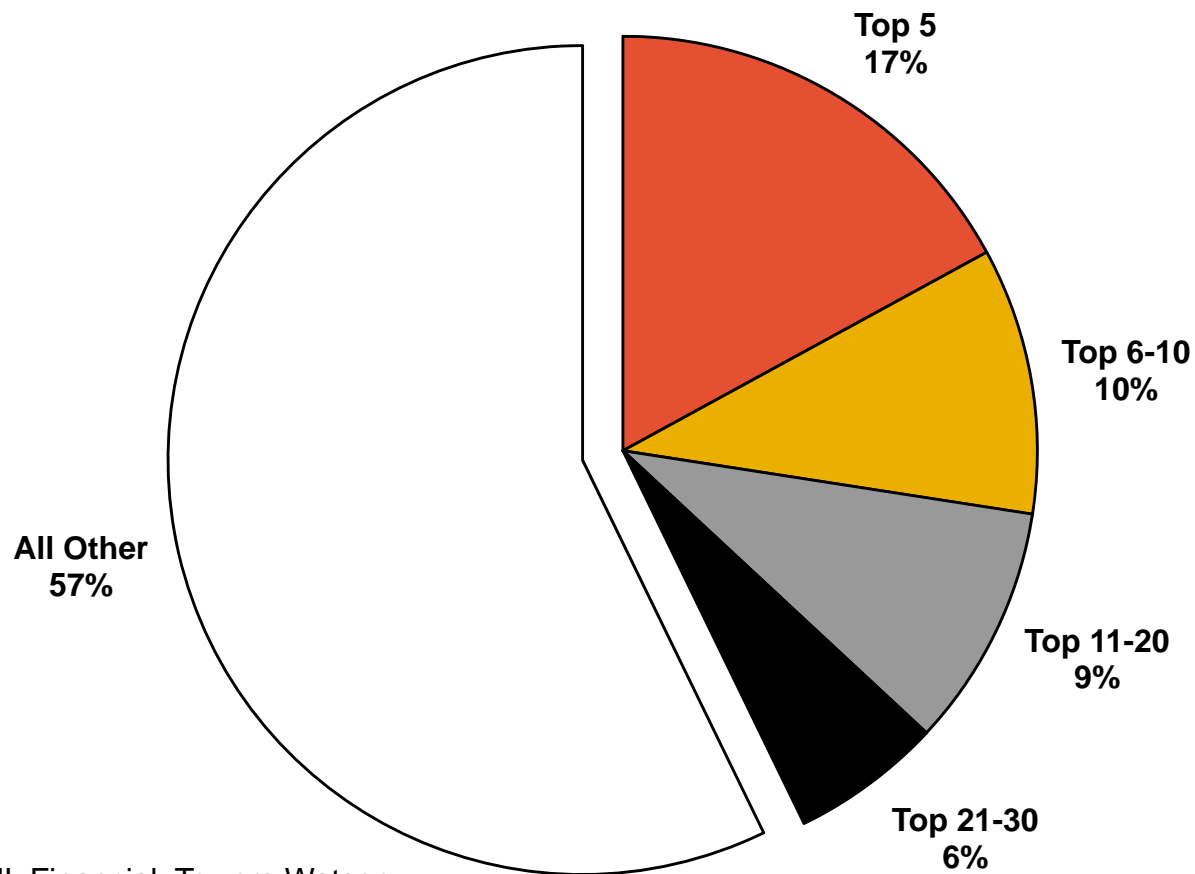
Among the “Bermuda” companies, the largest institutional investors hold even a larger stake and are more diversified



Source: SNL Financial, Towers Watson

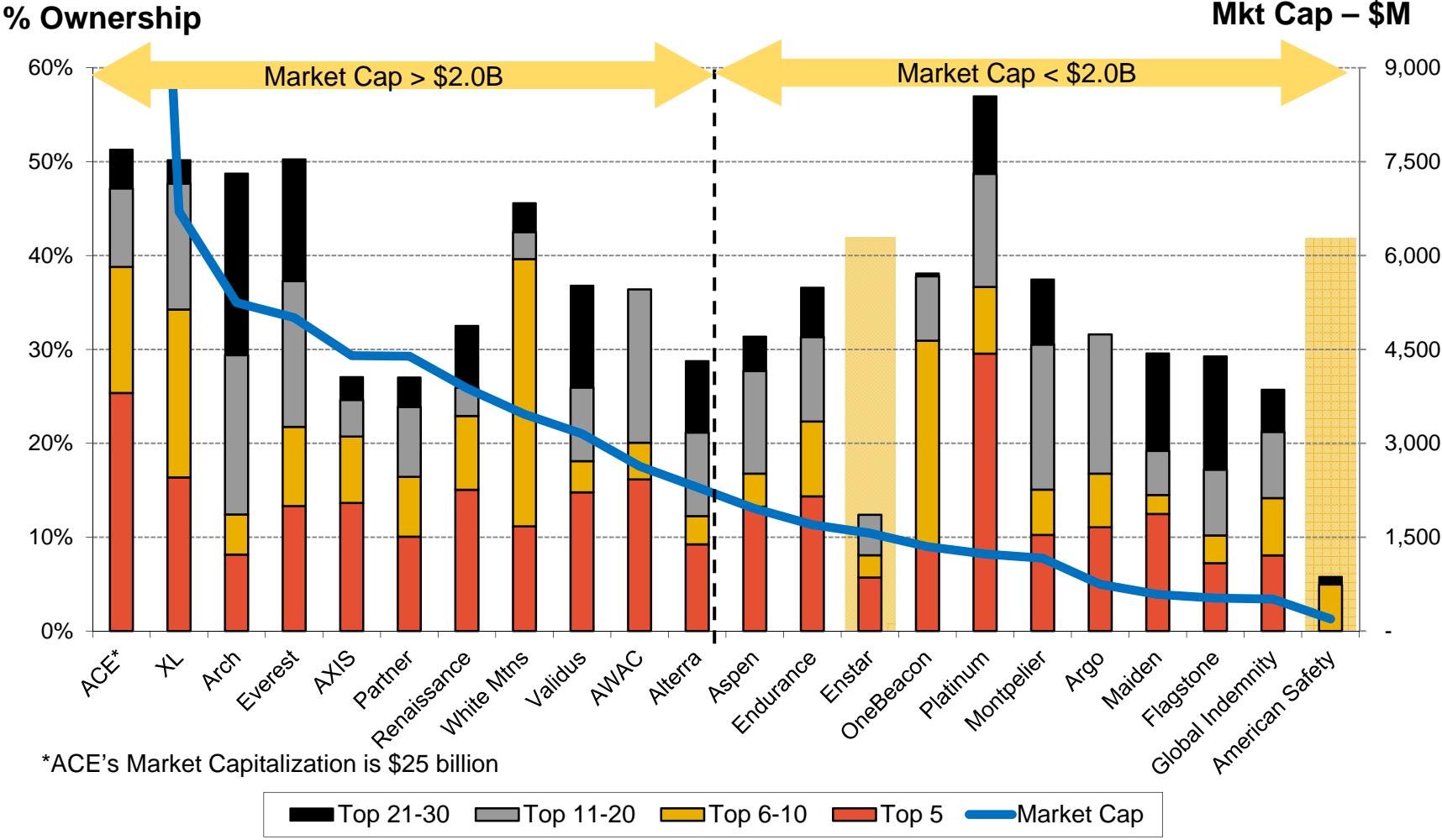
In aggregate, 43% of “Bermuda” capital is provided by the Top 30 institutional investors

Share of industry held by institutional investors



Source: SNL Financial, Towers Watson

With the exception of 2 specialists, the Top 30 investors control at least 20% and as much as 57% of each company



Source: SNL Financial, Towers Watson

Conclusions

- It doesn't appear that the institutional investors have a strong incentive to drive companies to merge or sell.
- In fact, institutional investors would see the opportunity to invest in more companies as a diversification opportunity
- Next...we will have a bit of a debate on some of the other drivers both for and against more M&A

Conflicting Perspectives

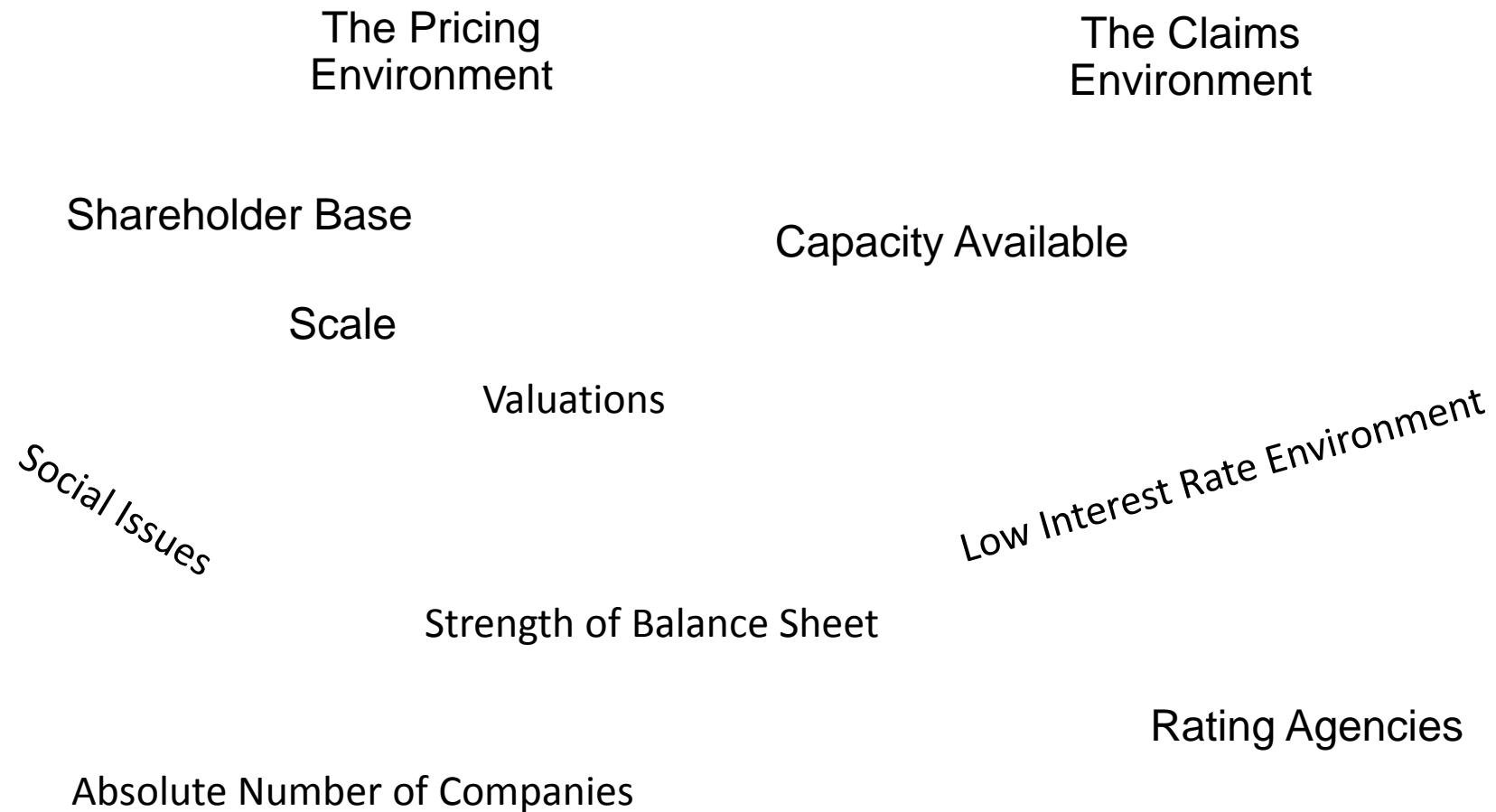
Conflicting Perspectives

Are the conditions for increased M&A activity present in today's insurance marketplace?

Yes.....

and No!

Issues / Trends in M&A – The Company Perspective



We are at the point of the market cycle when M&A needs to happen to change the dynamics in the industry.

**Two ways there will be more M&A:
No way, and....no other way**

Reason 1. There are too Many Companies

- Diversification, largely driven by rating agency models, has increased the absolute number of markets competing for each segment of the business

As an example, according to Advisen, there are currently 82 markets for private and non-profit companies to meet they're management liability insurance needs



Publicly traded Bermuda companies (by market capitalization)

Company Name	Market Cap (\$m)	Company Name	Market Cap (\$m)
ACE Limited	25,481.3	Aspen Insurance Holdings Limited	1,956.9
XL Group plc	6,705.7	Endurance Specialty Holdings Ltd.	1,699.1
Arch Capital Group Ltd.	5,246.3	Enstar Group Limited	1,307.1
Everest Re Group, Ltd.	5,007.1	Platinum Underwriters Holdings, Ltd.	1,231.2
AXIS Capital Holdings Limited	4,400.4	Montpelier Re Holdings Ltd.	1,163.0
PartnerRe Ltd.	4,392.9	Argo Group International Holdings	746.2
RenaissanceRe Holdings Ltd.	3,879.7	Maiden Holdings, Ltd.	585.1
White Mountains Insurance Group	3,464.9	Flagstone Reinsurance Holdings	525.9
Validus Holdings, Ltd.	3,153.2	OneBeacon Insurance Group, Ltd.	323.9
Allied World Assurance Company	2,629.8	Global Indemnity plc	294.8
Alterra Capital Holdings Limited	2,298.1	American Safety Insurance Holdings	192.3

Publicly traded U.S. and Canadian companies by market capitalization

Company Name	Market Cap (\$m)	Company Name	Market Cap (\$m)
Travelers Companies, Inc.	24,654.8	Assurant, Inc.	3,443.6
Chubb Corporation	19,436.9	HCC Insurance Holdings, Inc.	3,203.4
Allstate Corporation	16,190.2	Old Republic International Corporation	2,653.0
Progressive Corporation	13,084.9	ProAssurance Corporation	2,636.3
Hartford Financial Services Group, Inc.	9,038.4	Mercury General Corporation	2,446.9
CNA Financial Corporation	7,972.8	Delphi Financial Group, Inc.	2,225.7
Intact Financial Corporation	7,953.9	American National Insurance Company	1,876.8
Fairfax Financial Holdings Limited	7,450.4	First American Financial Corporation	1,842.7
Alleghany Corporation	5,731.2	Hanover Insurance Group, Inc.	1,804.3
Cincinnati Financial Corporation	5,629.8	Kemper Corporation	1,772.2
W.R. Berkley Corporation	5,170.3	AmTrust Financial Services, Inc.	1,590.8
Markel Corporation	4,238.2	E-L Financial Corporation Limited	1,587.9
American Financial Group, Inc.	3,741.8	RLI Corp.	1,450.1
Erie Indemnity Company	3,582.3	Selective Insurance Group, Inc.	959.1

Publicly traded U.S. and Canadian companies by market capitalization

Company Name	Market Cap (\$m)	Company Name	Market Cap (\$m)
Tower Group, Inc.	835.2	Baldwin & Lyons, Inc.	263.3
Horace Mann Educators Corporation	677.8	EMC Insurance Group Inc.	255.4
Navigators Group, Inc.	645.6	SeaBright Holdings, Inc.	200.3
Infinity Property and Casualty Corporation	621.1	Universal Insurance Holdings, Inc.	160.1
Safety Insurance Group, Inc.	608.5	Hallmark Financial Services, Inc.	140.4
State Auto Financial Corporation	558.5	Eastern Insurance Holdings, Inc.	120.8
Employers Holdings, Inc.	542.6	Homeowners Choice, Inc.	109.3
AMERISAFE, Inc.	477.2	EGI Financial Holdings Inc.	100.1
National Interstate Corporation	475.6	First Acceptance Corporation	63.4
Meadowbrook Insurance Group, Inc.	448.1	Atlantic American Corporation	61.6
Hilltop Holdings Inc.	442.9	Unico American Corporation	60.0
United Fire Group, Inc.	418.6	Kingsway Financial Services Inc.	35.8
Donegal Group Inc.	270.7	21st Century Holding Company	34.9

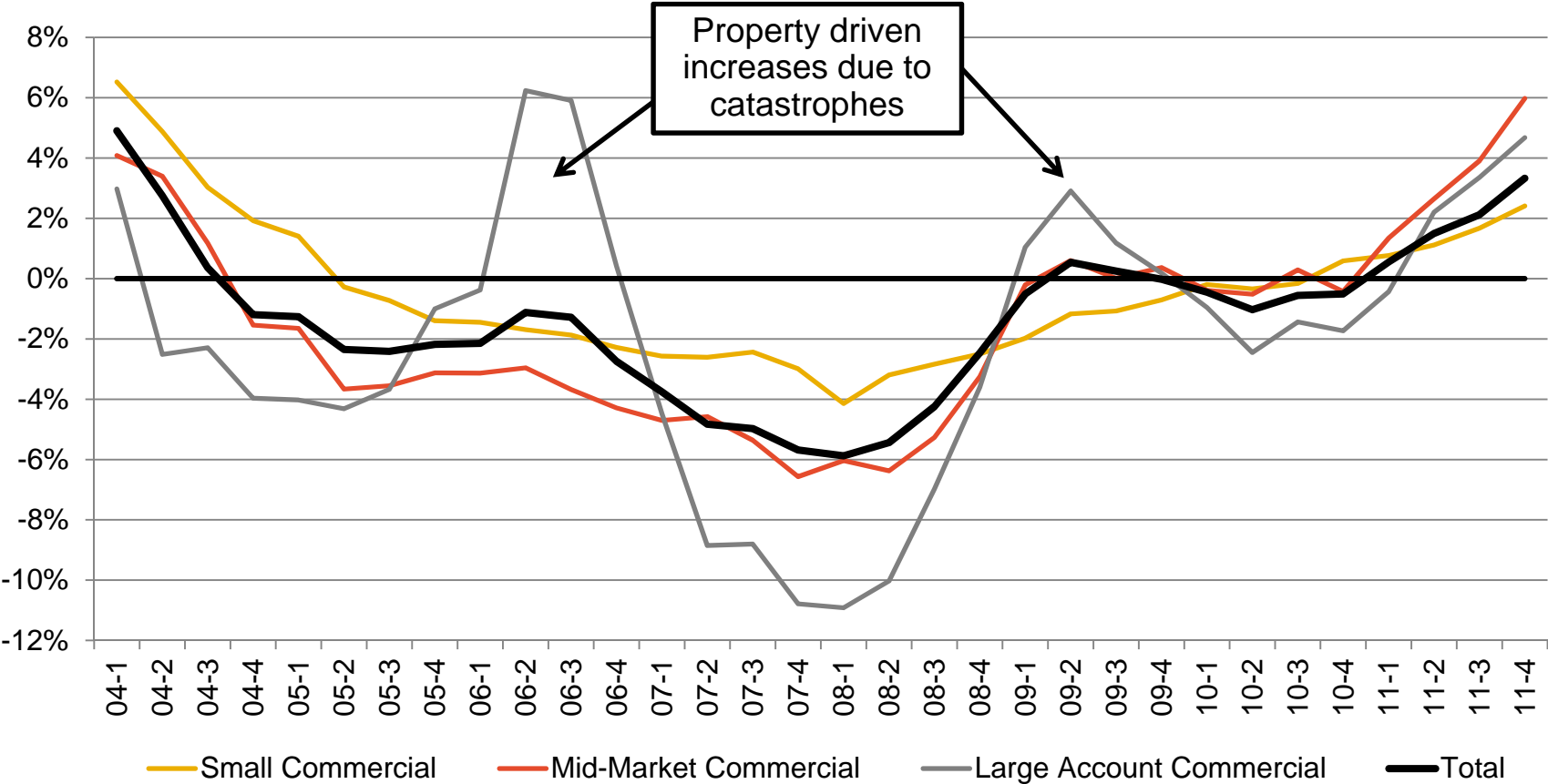
Counterpoint 1. It is Hard to do M&A

You Need to Sell the Deal 3 times!

1. Internal Management
2. The Other Party
3. Shareholders

Reason 2. Extended Soft Pricing Environment

With the exception of property increases in reaction to catastrophes, pricing declined from 2005 through early 2011



Source: Towers Watson – Commercial Lines Insurance Pricing Survey

Counterpoint 2. Most Deals Fail

The basic rule of
successful M&A –
The work starts **AFTER**
you have negotiated the
deal



Reason 3. Low Interest Rate Environment for the Foreseeable Future

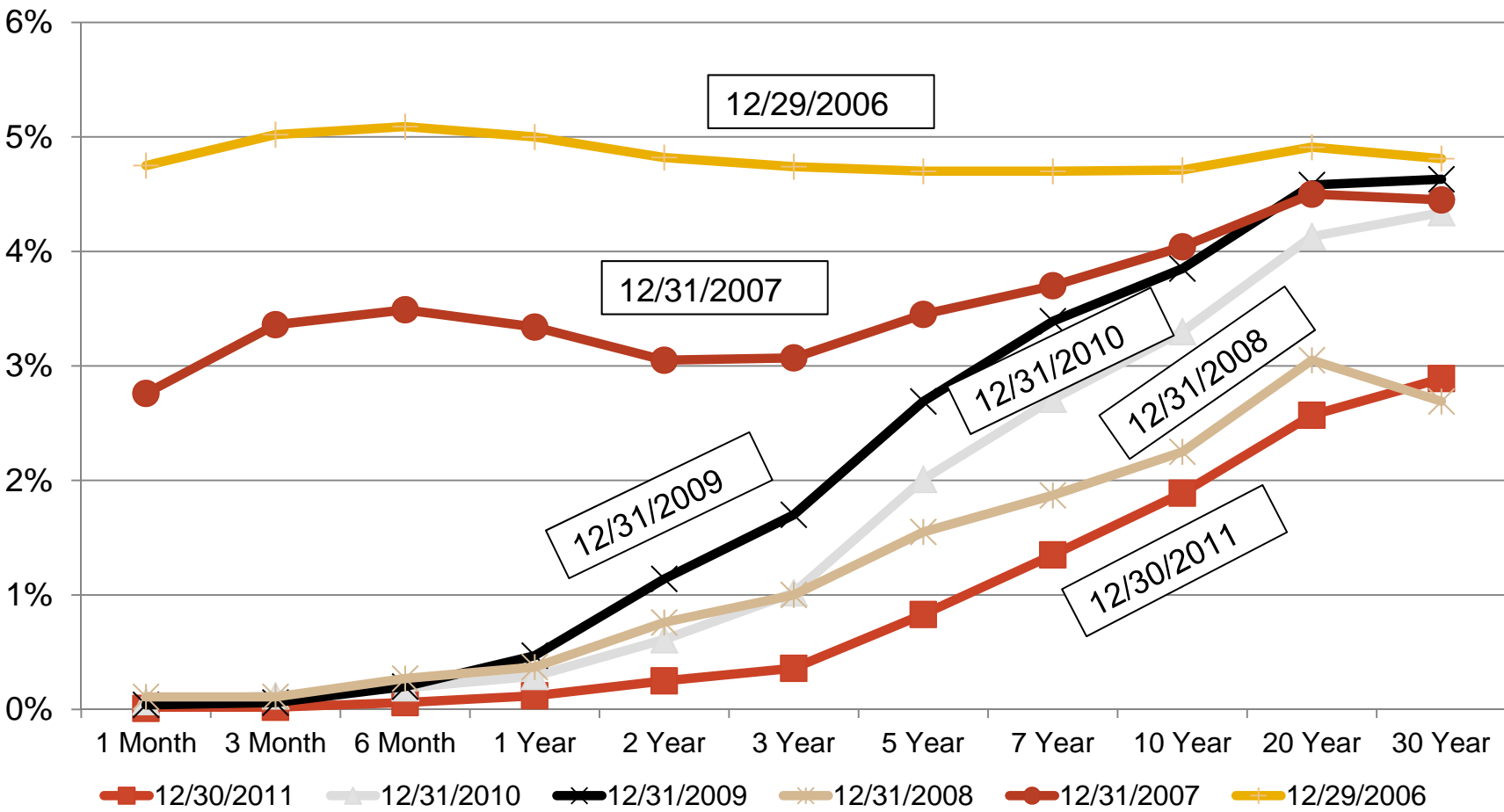
“To promote the ongoing economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent. The Committee currently anticipates that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.”

- August 9, 2011 Federal Open Market Committee meeting press release



You can't subsidize poor underwriting with yield

U.S. Treasury yields have fallen in recent years



Source: Treasury.gov

Counterpoint 3: Shareholders Value Organic Growth First....M&A Last!

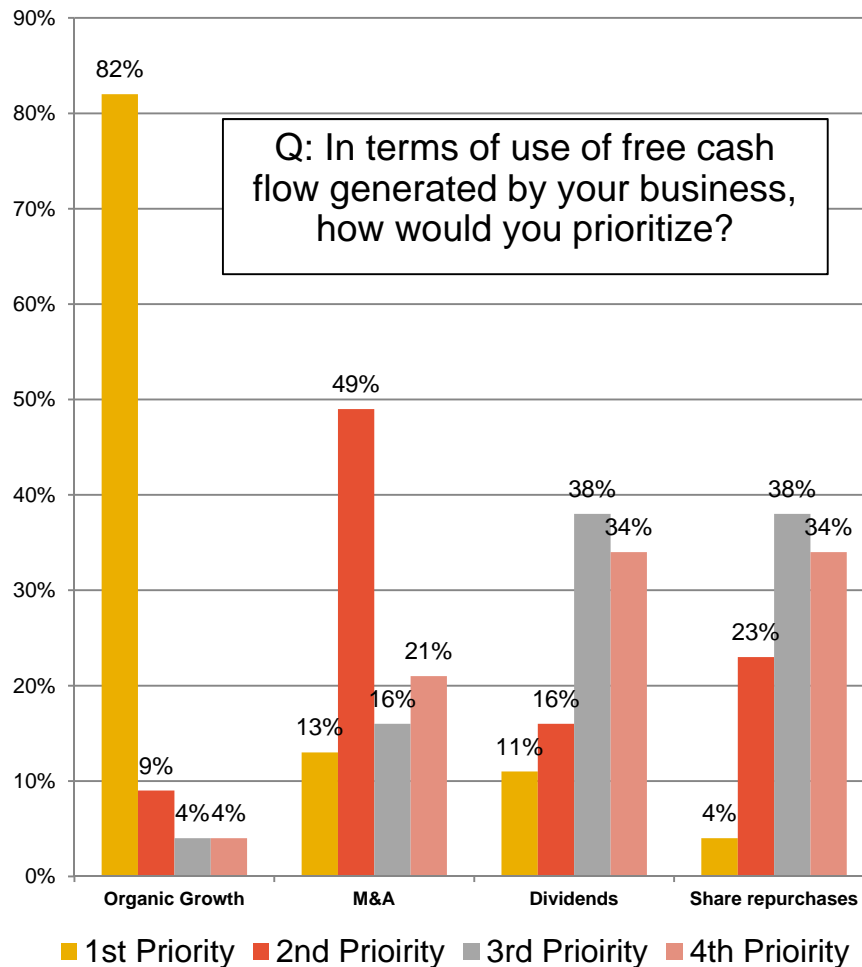
- According to the Morgan Stanley survey*, 63% of investors surveyed preferred organic growth as the first use of excess capital
 - Just 13% preferred M&A. Dividends and share repurchase fell between those extremes.
- Quick math: Return on Buying your own stock if trading at 80% of book value? $1.0/0.80 = 25\%$!



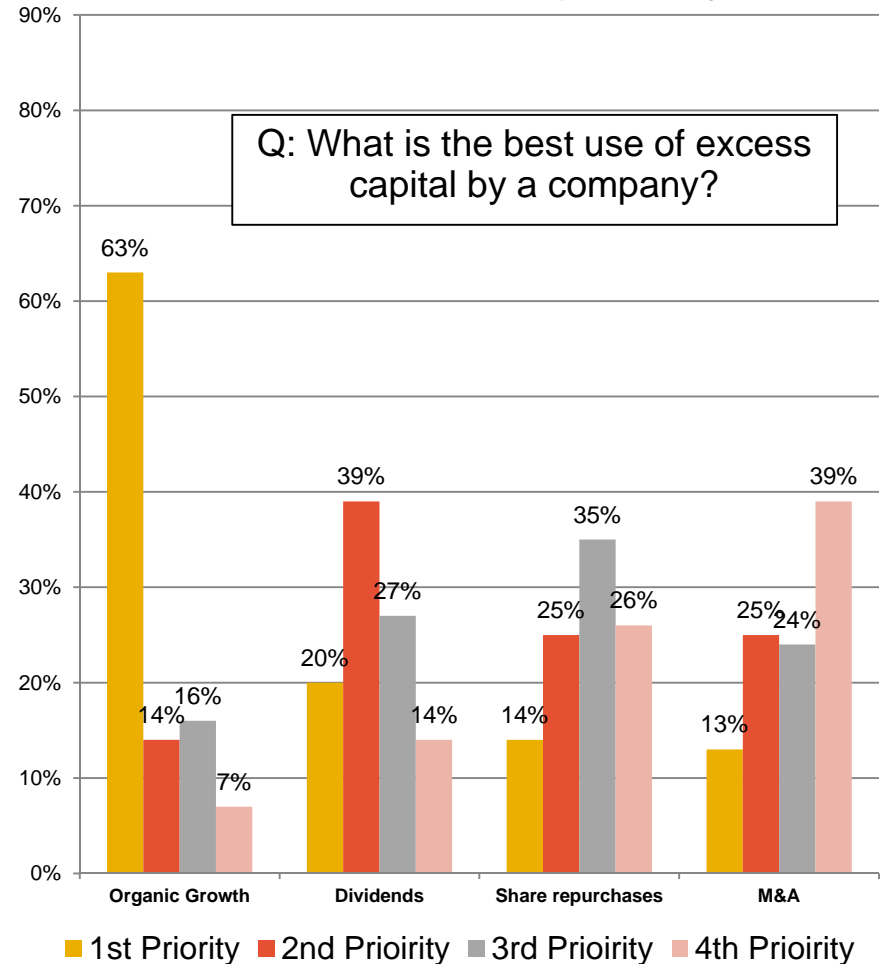
*Morgan Stanley Investor Return of Capital Survey 2012

According to Morgan Stanley, corporate managers put a much higher priority on M&A than their investors

Corporate Return of Capital Survey



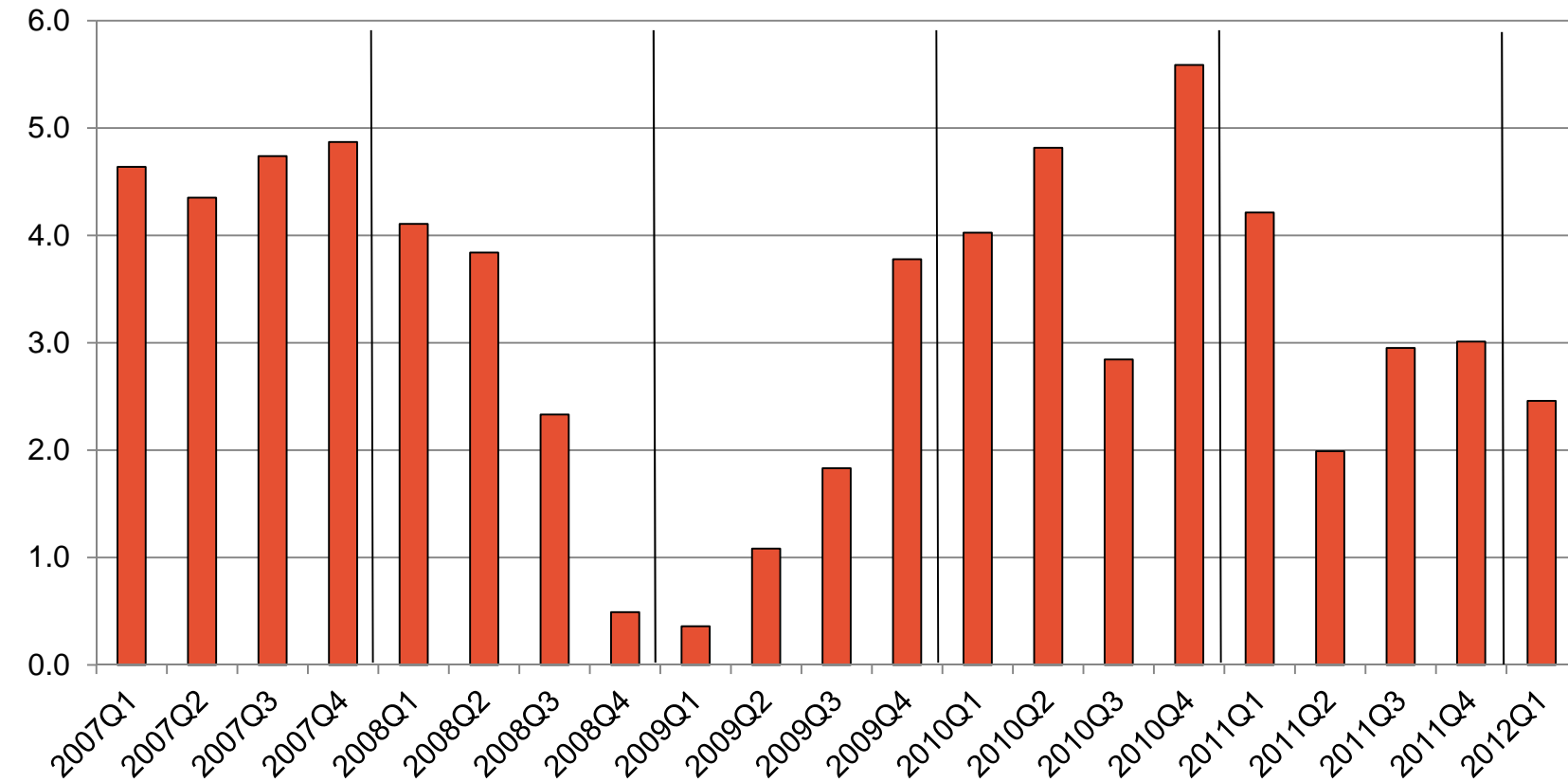
Investor Return of Capital Survey



Source: Morgan Stanley Surveys

Stock repurchases rebounded in 2009 and 2010 after the financial crisis but have begun to decline again in 2011 and 2012

Amount Repurchased (\$B)



Source: SNL Financial

Reason 4. Long-term Compensation Will be Negatively Impacted by the Previous Two Items

According to Farient and Equilar, at least 50% of insurance companies use growth in book value and return on equity as a primary measure of incentive compensation programs.



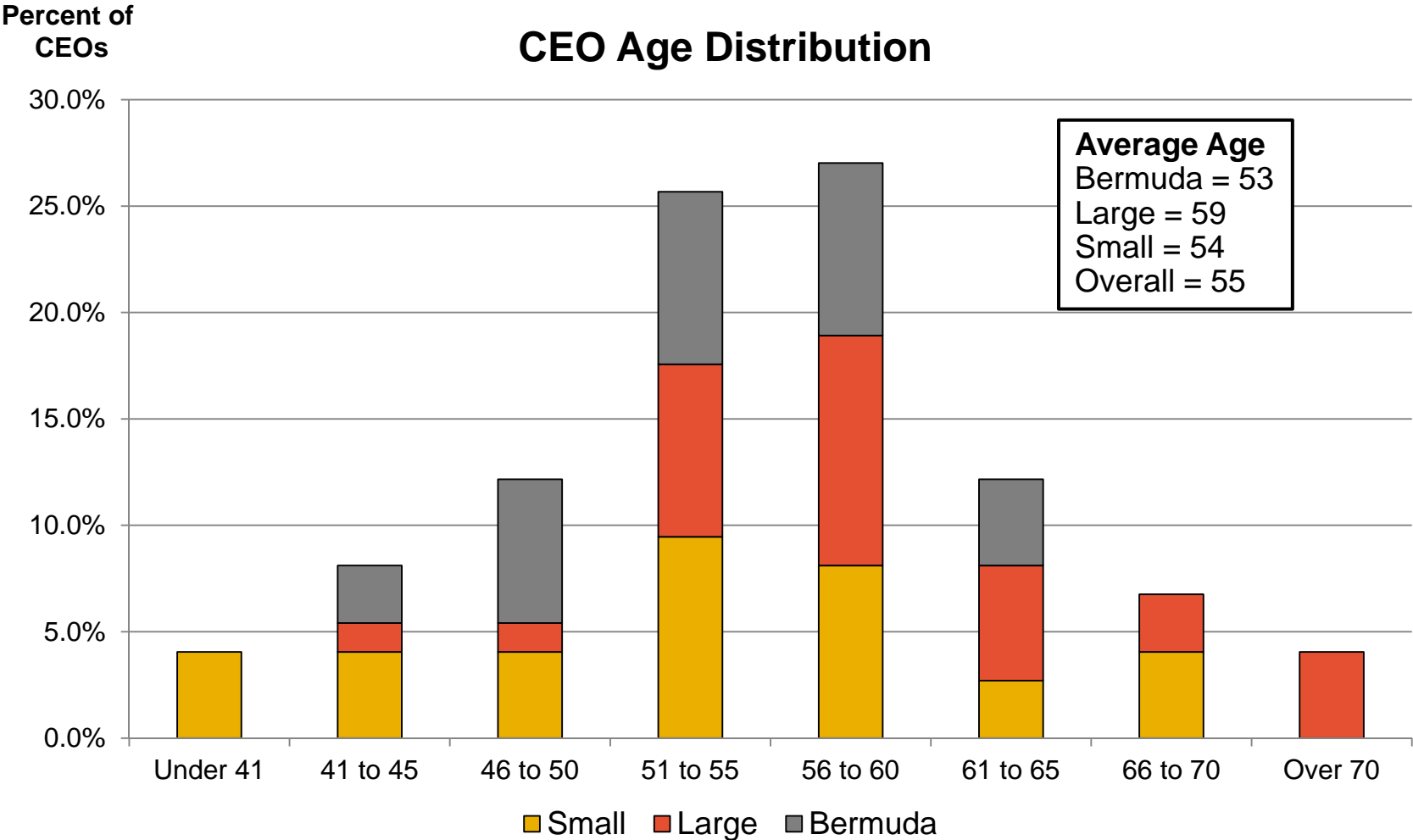
Counterpoint 4. Social Issues for senior executives are an issue

“Being an insurance executive has been a pretty good gig for the last several years. My average compensation was \$10 million in 2011. My target ROE for incentive compensation was 10%.”*



*UBS Investment Research: *What's the Incentive?* May 23, 2012
Compensation taken from an average of 18 publically traded insurers.

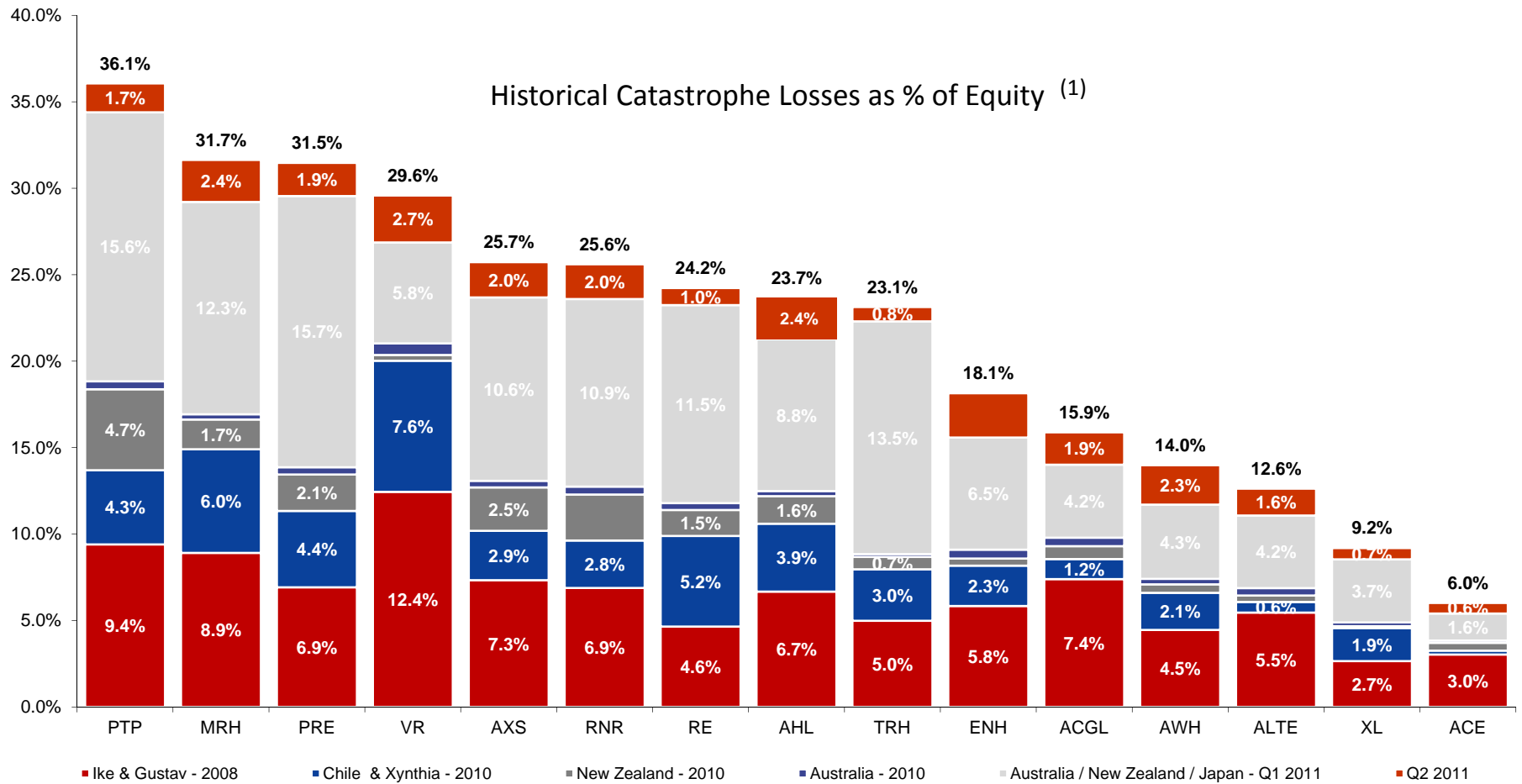
CEO ages show an evenly distributed group with over 75% of the CEOs 60 years or younger.



Source: SNL Financial

Reason 5. You Can't Shrink to Greatness

Smaller companies without scale risk a severe adverse surprise



(1) Based on ending Total Shareholders' Equity for the period prior to occurrence.

Source: SNL Financial, Company filings

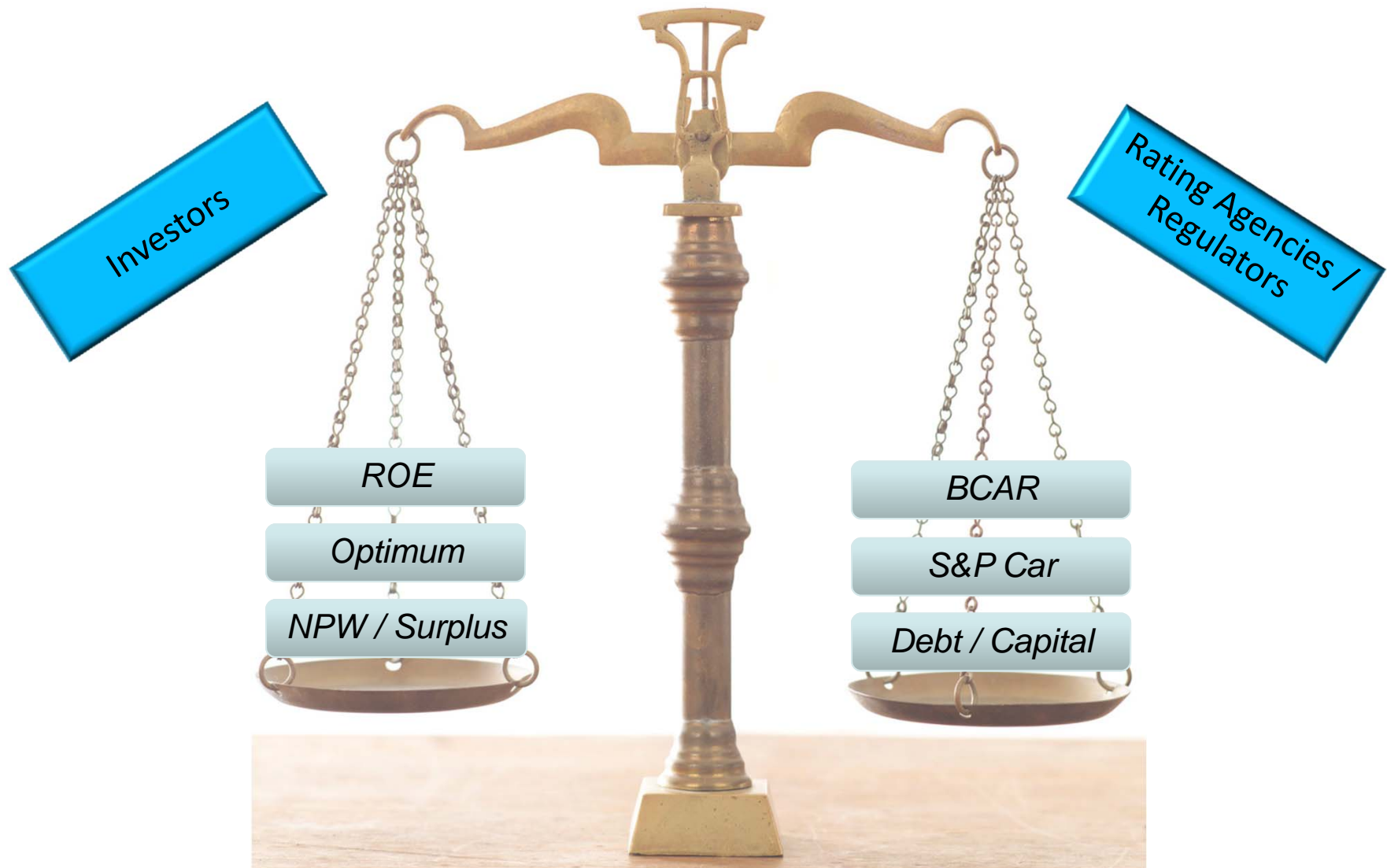
Counterpoint 5. P&L's Don't Show Opportunity cost

Very Few People get
into Trouble for NOT
Doing a Deal*



*According to UBS Research, minimum ROE thresholds to receive incentive Compensation are in the 5-7% range! (*What's the Incentive?* May, 2012)

Reason 6. Companies can more easily optimize their capital base with more size and diversification

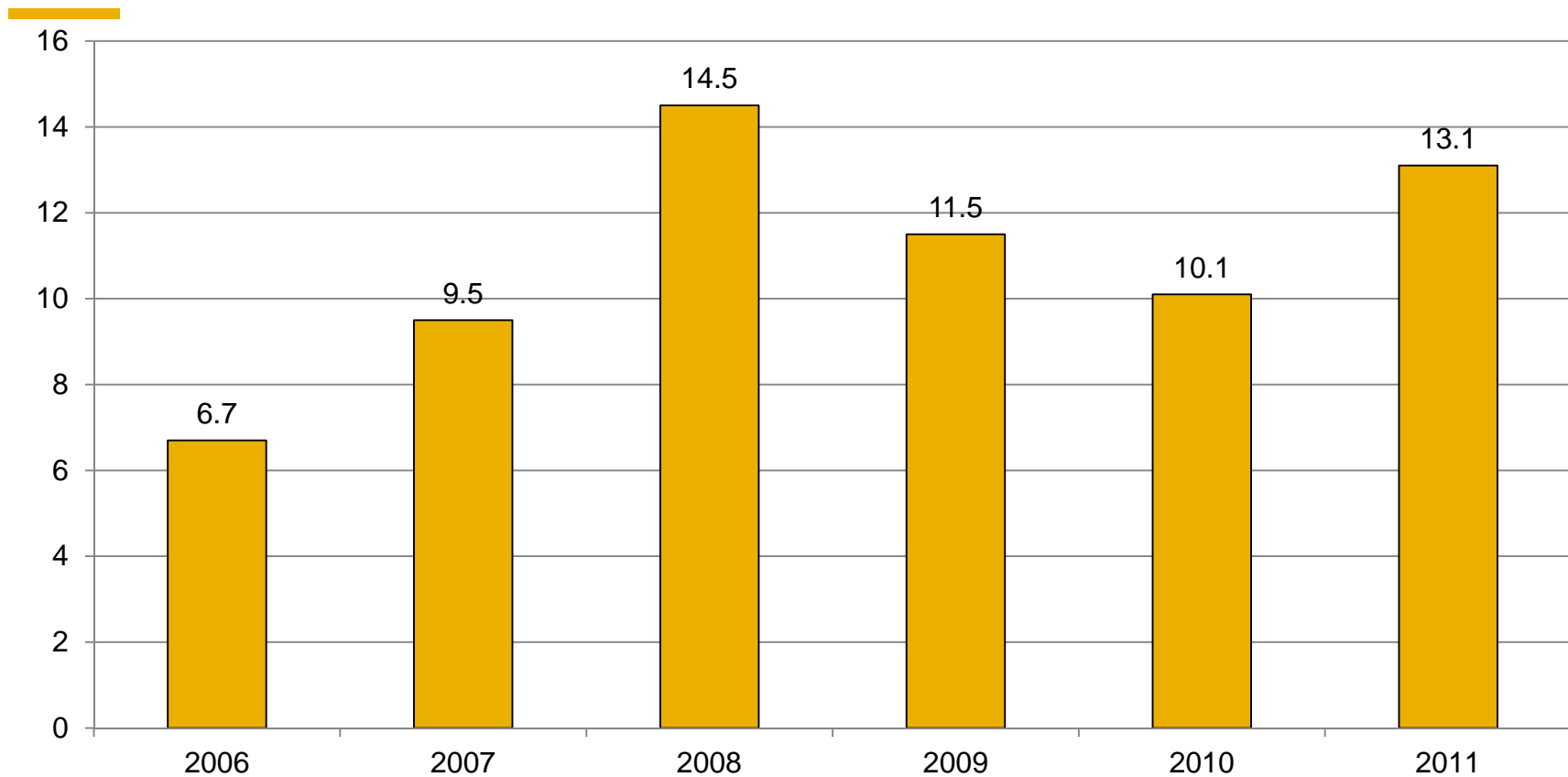


Counterpoint 6. Teams of People are Available and they can be Much Cheaper than Deals



Reason 7. Reserve releases have increased during the most recent years of the soft market - Maybe time to do a deal before they run out.

Reserve Releases (\$B)



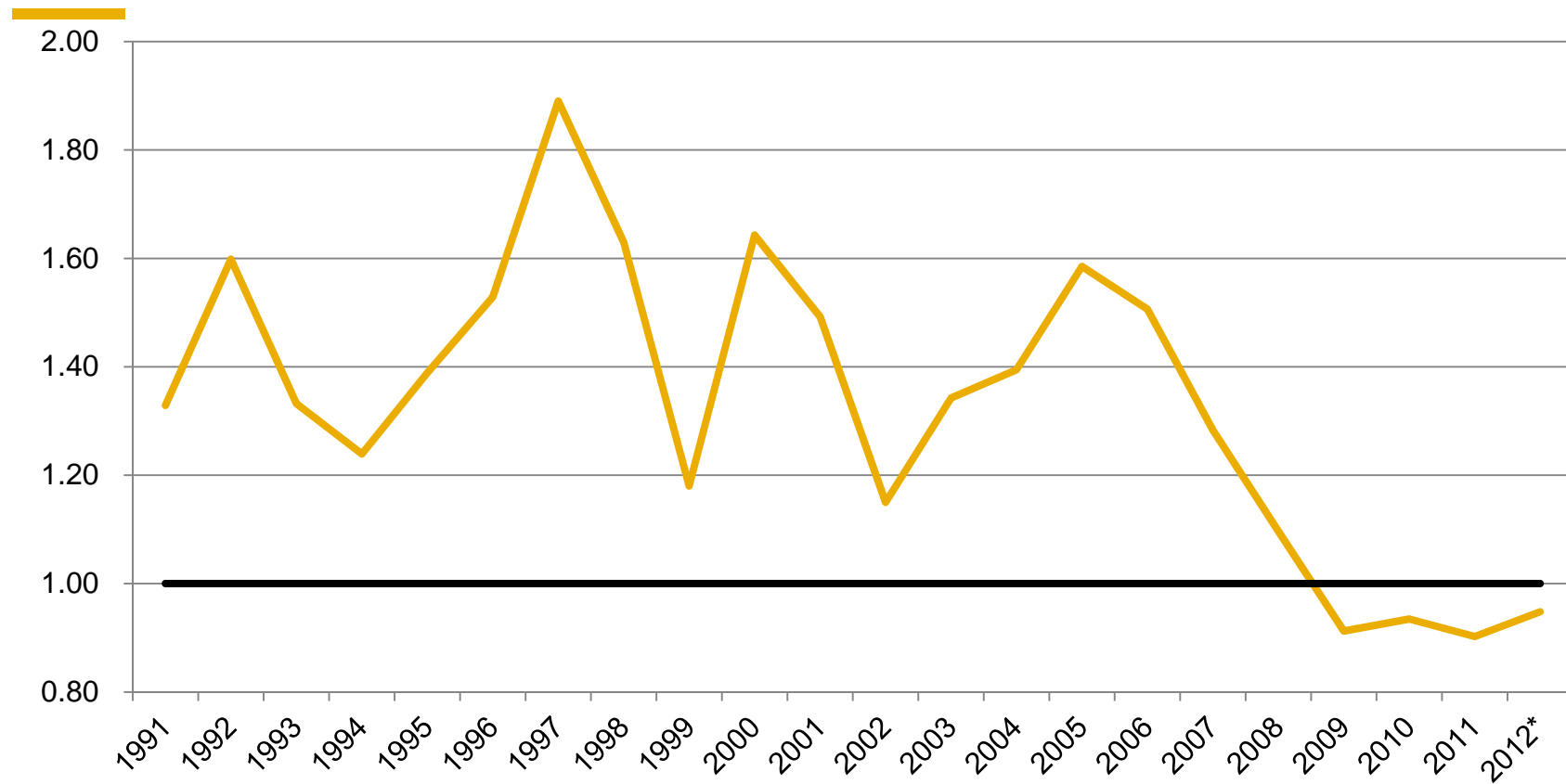
Source: SNL Financial (excluding Mortgage and Financial Guaranty lines)

Counterpoint 7. Balance Sheets Likely Have More “Gas in the Tank”

- Yes, releases have to begin decreasing at some point (conventional wisdom), but...
- ...those shouting ‘the end is near’ have been proven premature
- Across the KBW universe of 55 non-life companies, reserve releases in 1Q12 were 4.8% of premiums, down slightly from 5.3% one year ago.
 - Nearly two-thirds of companies beat earnings estimates, producing annualized ROEs of around 10%

Reason 8. Since 2008, market value has been below book value for the industry.

Price to
Book Value



*1st Quarter 2012

Source: SNL Financial

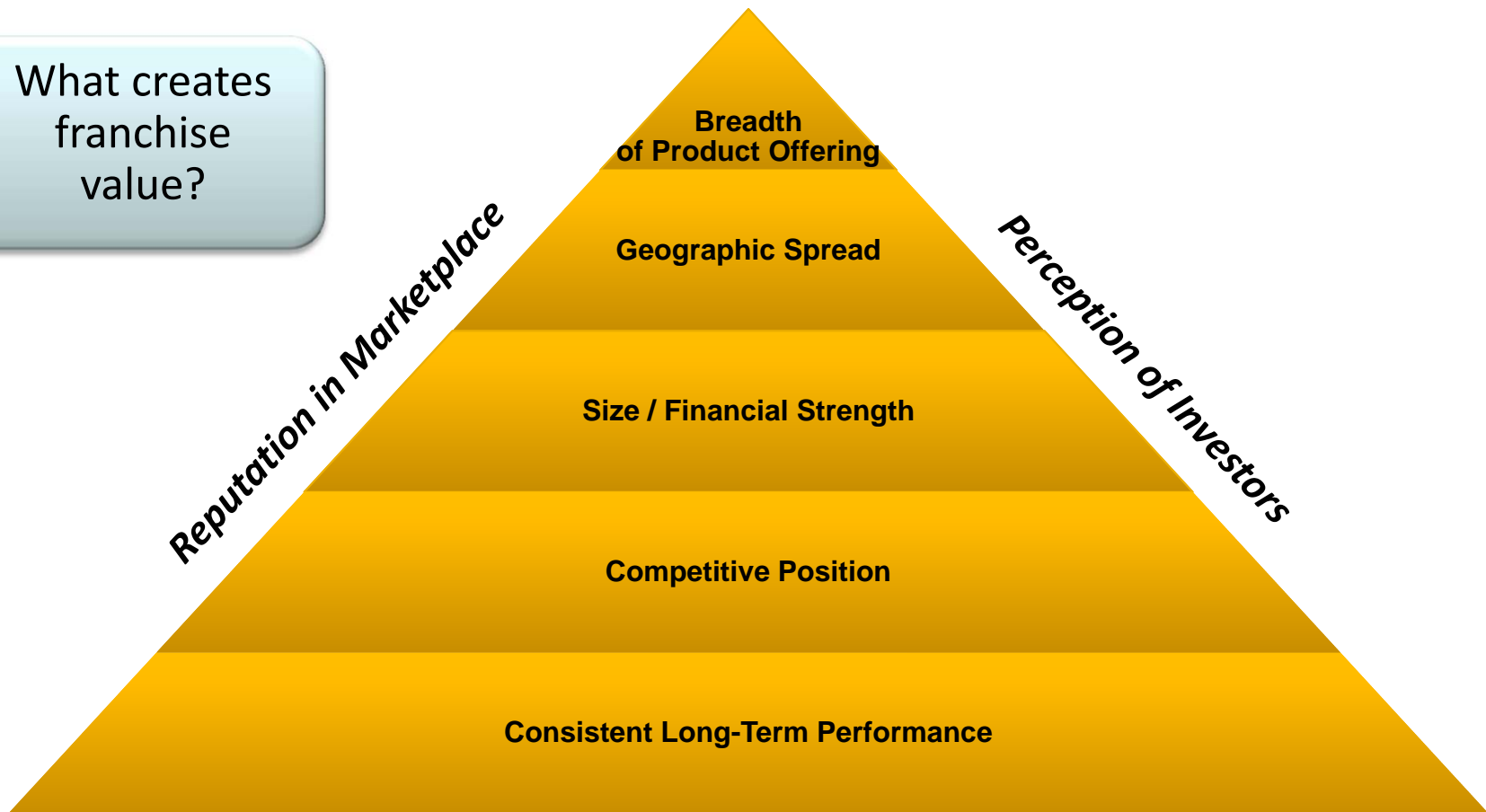
Counterpoint 8. Announcing a Deal Potentially “Puts Both Parties in Play”

Bankers... start your engines!



Reason 9. Too Many commodity companies not enough franchises.

What creates franchise value?



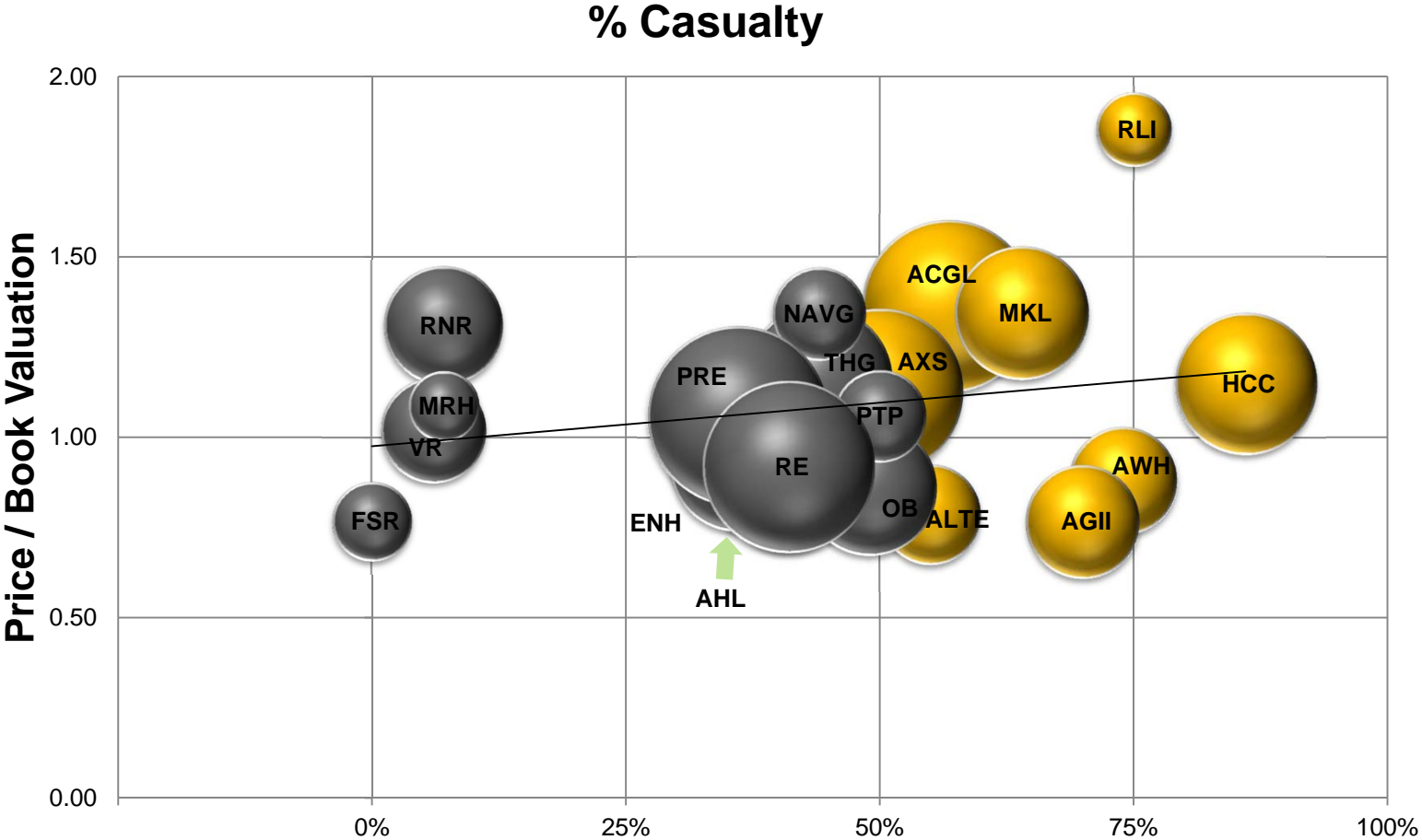
Counterpoint 9. People Fear Change More than their Current Prospects

Until results worsen, or shareholders get angry, There is likely not much pressure for deal flow to increase.

Investing is like dating, M&A is like a marriage!

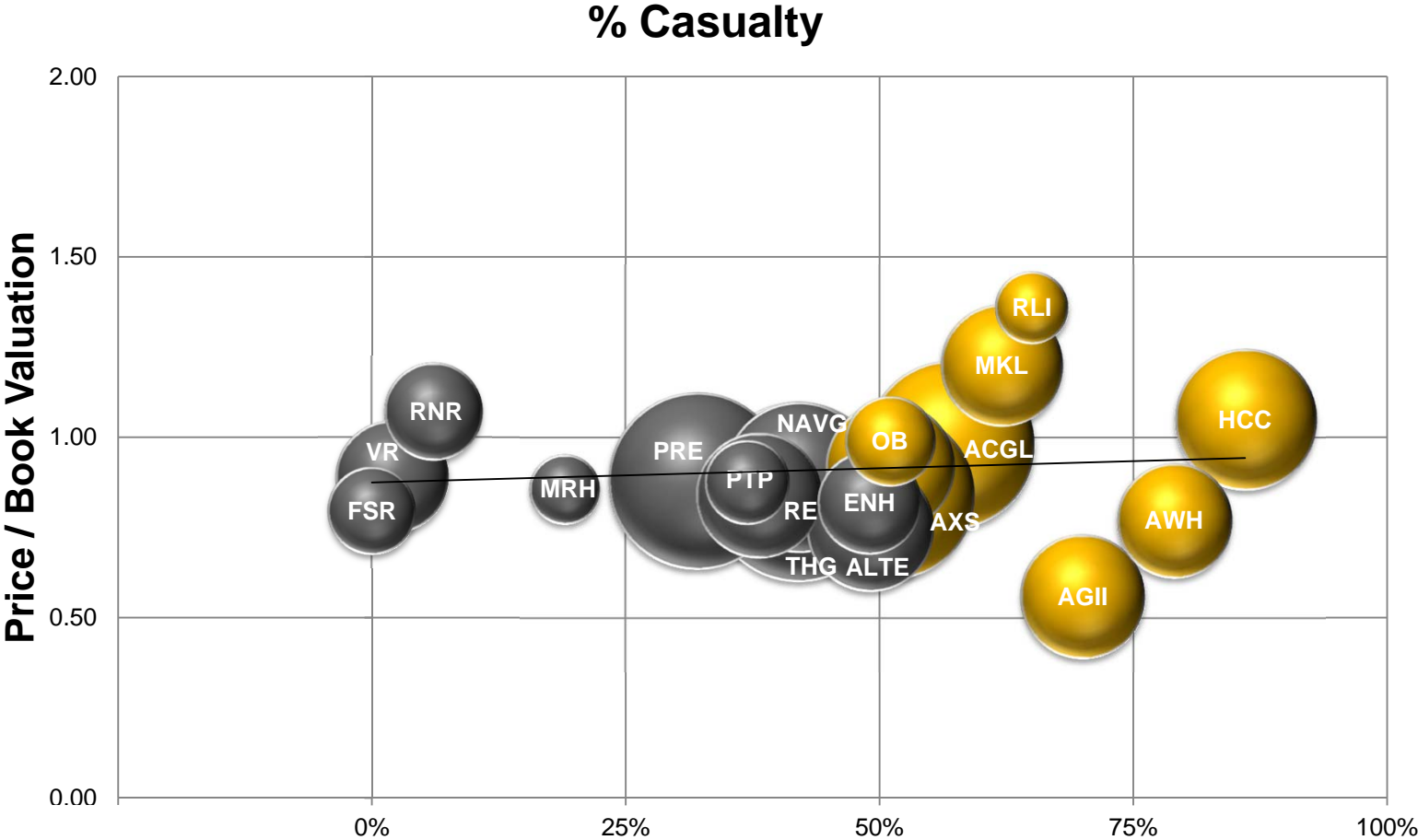


Reason 10. Relative Valuations are Good Property vs. Casualty and Valuation - 2008



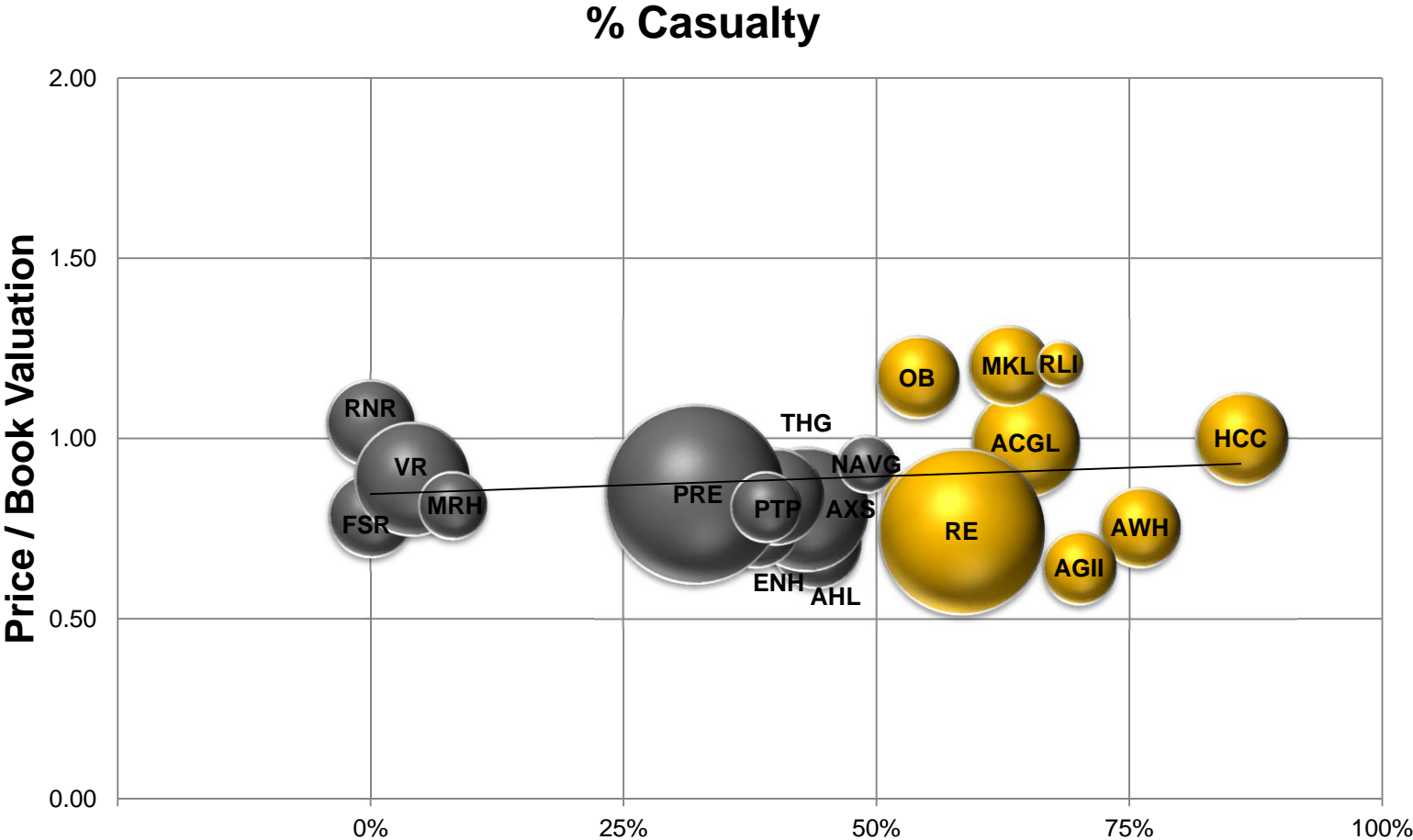
Size of bubbles based on GPW

Reason 10. Relative Valuations are Good Property vs. Casualty and Valuation - 2009



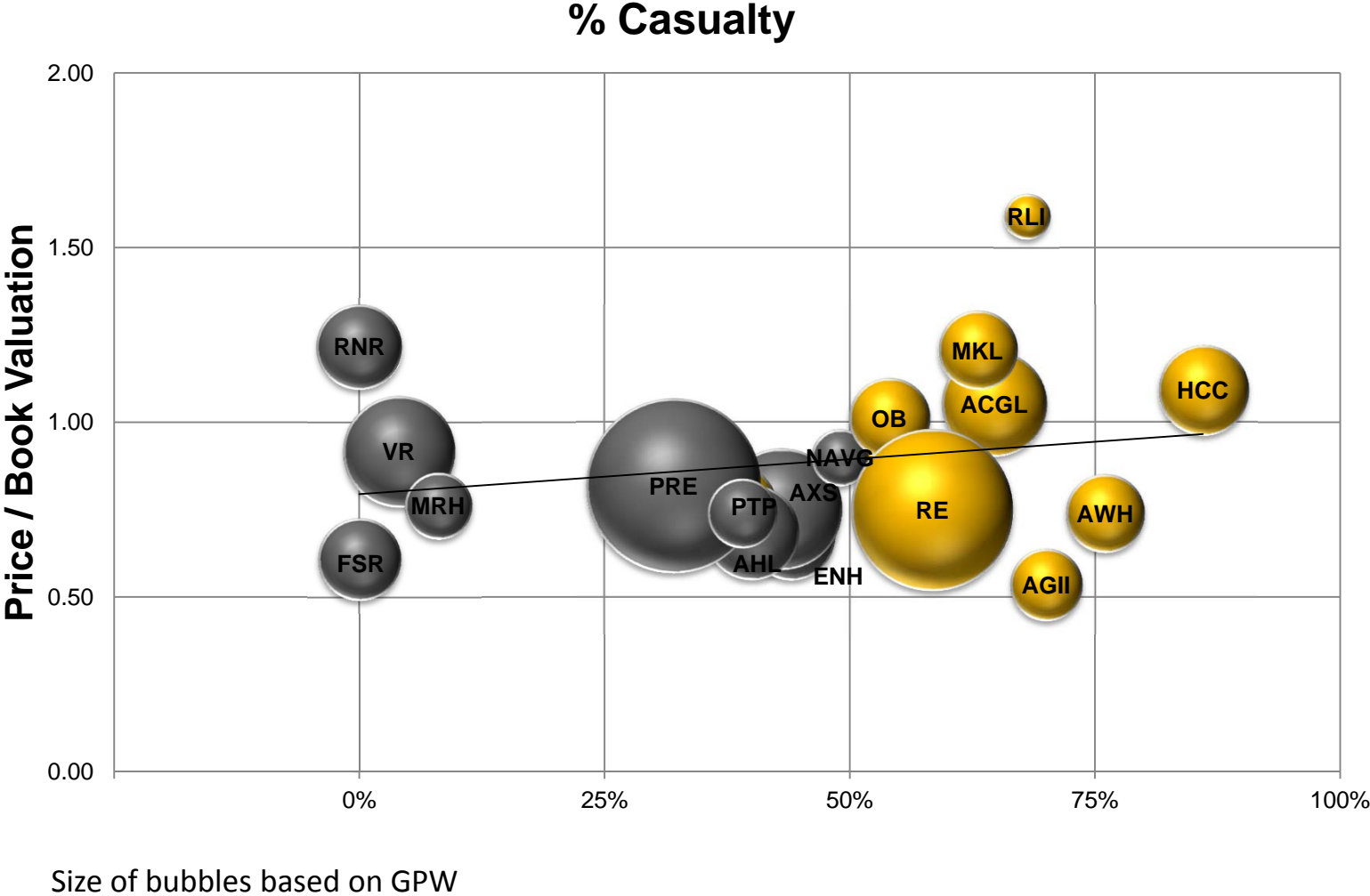
Size of bubbles based on GPW

Reason 10. Relative Valuations are Good Property vs. Casualty and Valuation - 2010

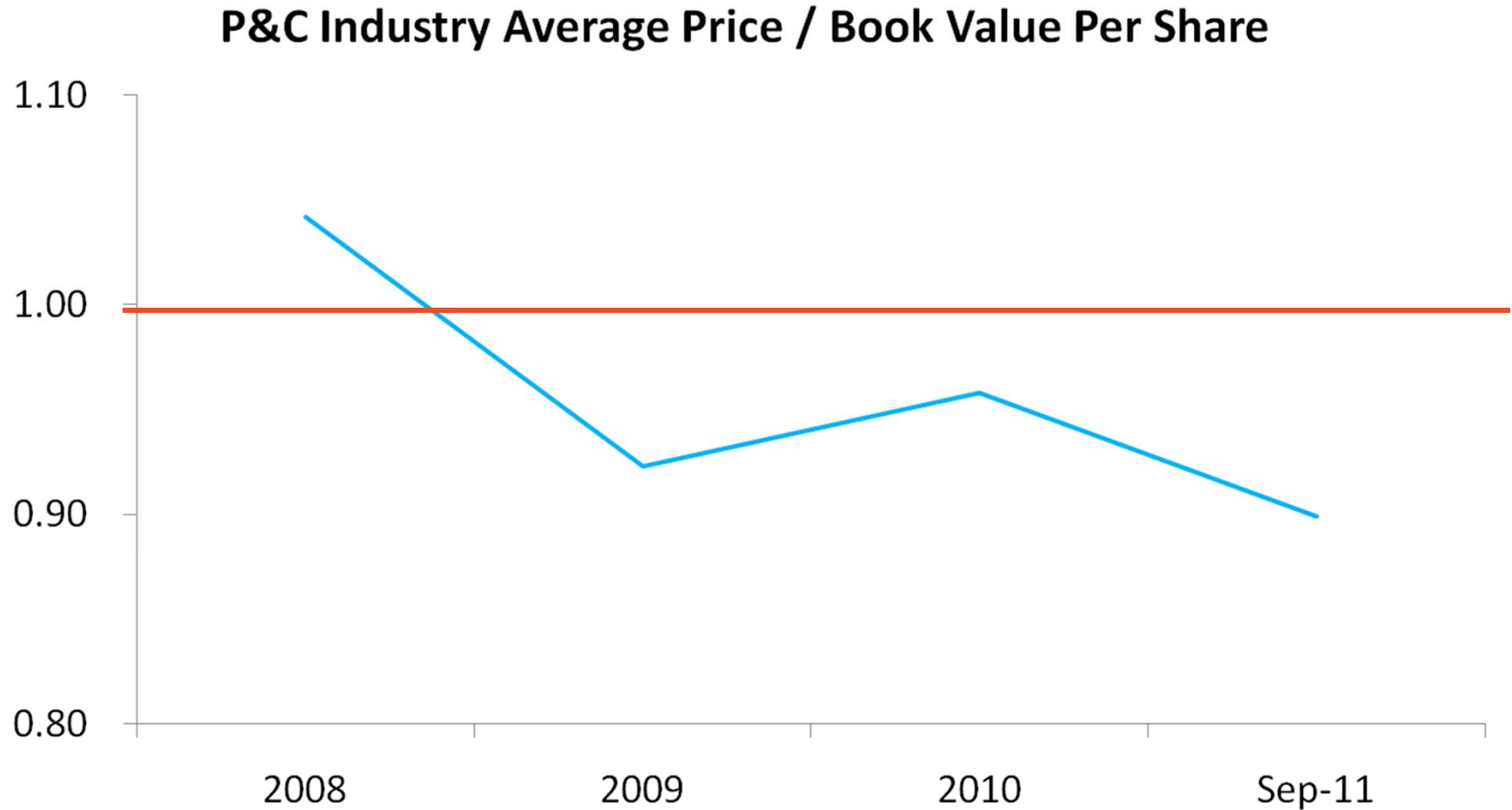


Size of bubbles based on GPW

Reason 10. Relative Valuations are Good Property vs. Casualty and Valuation – June 2011



Counterpoint 10. Although Valuations have Been Below Book for 3 Years - Not Sure you can do a MOE Below Book Value



So What Does it All Mean?

Maybe the bears have a point...

In the end it is primarily up to the shareholders to decide what happens to these companies. There has been little pressure to date.

Despite an extended soft market companies seem to remain healthy. We could be in for more of the same.

Maybe the bulls have a point...

If pricing momentum fails to lift all boats and valuations begin to diverge (winners and losers become clearer)....maybe, just maybe...

Companies positioned well vis a vis pockets of the economy poised to grow (domestic energy, health care) may be attractive targets