

Tokio Marine Holdings Inc to Discuss Acquisition of Privilege Underwriters Inc Conference Call

Company Participants

- Akira Harashima, Senior MD, Representative Director & Co

Presentation

Akira Harashima {BIO 18946450 <GO>}

My name is Harashima from Tokio Marine Holdings. Thank you. So much for joining us for this conference call in spite of the last-minute invitation.

I am going to explain the acquisition of Privilege Underwriters, Inc. or Pure Group. At the beginning, I'd like to explain the overall highlight using Page three and Page 4.

First, on Page 3, what we are acquiring is the nonlisted holding company for the speciality insurance group called Privilege Underwriters, Inc., which provides insurance products and services specialized in the U.S. High Net Worth insurance market and its subsidiaries. It's proven that there is no fixed definition of High Net Worth in the United States. But the Pure Group defines it to be the customer segment with house price over \$1 million in the insurance contract.

This acquisition is in line with our M&A strategy from before, which is aiming to further diversify our business portfolio and sustainable profit growth in the international insurance business. Pure Group is an excellent insurance group, which meets our acquisition criteria.

Acquisition price is \$3.1 billion or around JPY 325.5 billion at the exchange rate of JPY 105 to the dollar. Expected profit after-tax for FY 2020 for Pure Group is around \$95 million. And expected profit after-tax for FY 2023 is around \$200 million.

PER based on the profit after-tax for FY 2020 is around 33x. This level is about the similar level to those listed comparable companies with a similar business model in the United States.

We consider the acquisition price based on comprehensive factors such as asset portfolio and the business portfolio of Pure Group as well as growth potential and profitability and so on to be fair and appropriate. This acquisition will be funded by cash on hand in our group. And we will also consider external funding through issuance of subordinated bonds. We will not do equity finance. We estimate the goodwill, including intangible assets, to be around JPY 300 billion at the maximum.

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Please turn to Page 4. Let me explain characteristics and the strength of Pure Group. There are 4 main points. First, U.S. High Net Worth insurance market has been outgrowing the overall P&C insurance market in the United States driven by High Net Worth population growth. And we expected this high growth to continue in the future.

Second, Pure Group's business model is mainly based on fee income. Therefore, stable income is expected. And the business is low-capital intensity structure.

Third, services provided by Pure Group are highly rated with the top-tier customer satisfaction, which is, of course, higher than the industry average in the P&C industry as well as that of top brands in other industries. That's why their renewal ratio is at the top in the U.S. P&C market.

Lastly, fourth, Pure Group is led by very talented and highly regarded management team, headed by Mr. Ross Buchmueller, who has experience over 30 years in the High Net Worth insurance market.

By acquiring Pure Group who has these strengths, there are mainly 3 strategic rationale for us: first, we can further expand specialty primary insurance business in the United States as we have pursued over the years without so much overlap with our existing businesses; second, it will contribute to sustainable profit growth and stability and capital efficiency through further portfolio diversification; third, we can generate synergies by combining strengths of the 2 groups and customer base of Pure Group.

From the financial perspective, the acquisition of Pure Group will contribute to increase our projected adjusted ROE by 1.2 points in FY 2020. This completes the transaction summary.

Our group has been keeping our eyes on Pure Group as the best candidate for the potential acquisition in the U.S. from the past. Therefore, we are pleased that we reached agreement on this acquisition, which has a significant meaning to our growth strategy.

Now let me explain one by one using the presentation material. First, transaction structure and key terms. Please turn to Page 6.

Acquisition structure is through TMHCC. From the perspective of efficiency of consolidation of financial statement after the acquisition and other reporting needs, we judged that it was the best to utilize the existing organization and infrastructure in place as much as we can.

Consolidation and funding are as I have explained earlier. Upon the consent and approval of related regulators in the future, we are planning to close the deal from January to March in 2020. Current management of Pure Group is to stay to run the company continuously after our acquisition.

Next, let me explain the business model of Pure Group. Please turn to Page 8. First, underwriting of insurance for policyholders is done by Privilege Underwriters Reciprocal

Exchange on the left. This organization is called Reciprocal, which is similar to mutual aid system based on mutual support of the policyholders. The details of Reciprocal will be explained later. But this is something that is owned by policyholders. And it is not in the scope of the acquisition.

This Reciprocal is an unincorporated organization without substance. Therefore, it delegates operations such as insurance underwriting and loans services through a third party for which fees are paid. The operation is done by the management company, PRM, PURE Risk Management, which is a subsidiary of Privilege Underwriters, Inc. we are acquiring at this time. Capital of Reciprocal is contributed by policyholders in principal. And the maturity of risks underwritten is ceded to reinsurance market.

The entity, which we are acquiring this time, namely Privilege Underwriters and its subsidiaries or so-called Pure Group, has its main business in managing the insurance of Reciprocal by PRM. In exchange for the service they provide, they receive management fee, which is their main source of group income. Level of fee is about 20% of Reciprocal's gross written premium. In the Pure Group, they also hold a broker business, claims service provider of fine arts and an insurance company that assumes part of the reinsurance from Reciprocal.

Please turn to Page 9. On the left is the overview of Pure Group and fiscal 2018 key financials. Premiums under management, a line called premiums under management is the premium underwritten by Reciprocal with the management of PRM.

On the right is the breakdown of premium under management by lines of business. And you can see that more than half is homeowner. And the rest is auto and also inland marine. Lower right is the main distribution channels. And it's mainly broker channel. But on top of that, they have partnerships with other major insurers.

Through this channel, other major insurers, the further High Net Worth clients to Pure. And Pure provides products and services to them. To Pure Group, this leads to the expansion of sales channels and customer base and to other insurers, they receive fee income and be able to provide better products and services to their customers. So this is an initiative to build a win-win relationship with other insurers.

Please turn to Page 10. This page summarizes about Reciprocal. Please look at the bottom half of the page for the comparison chart of Reciprocal versus stock company and mutual company.

Next, I will talk about the characteristics and strengths of Pure Group based on their business model. Please turn to Page 12. There are mainly 4 points.

Please turn to Page 13. The first point is the characteristic of the business model of Pure Group, which is that first, the policyholders are the owners of the insurance business. And it's done through a Reciprocal structure, encouraging alignment between policyholders and the Reciprocal Exchange.

Another point is the majority of the income comes from the fees earned through the management of the Reciprocal Exchange. For the insurance business, external funding is done by capital contribution from policyholders and from reinsurance market.

Those are the characteristics of the business model. And as a result, they enjoy a business model with high customer loyalty and with stable fee-based profit and low capital intensity.

Please turn to Page 14. The second point is the High Net Worth market that Pure specializes in. And this is a very attractive market. As you can see on the left hand of the graph, the U.S. High Net Worth population is growing. And it's outpacing the U.S. total population growth. It is a rare, high-growth market that we see in the U.S. market. And we expect this growth to continue. As the lower-right chart shows, Pure Group is right now #3 in the market. And market share is soon to be around 3%. We believe there is room for Pure to grow, both by the entire market growing as well as the market share expansion of Pure.

On top of this growth potential, their customers expect high-quality, customized services. And the sector is not commoditized. Therefore, it is insulated from the impacts of technological advancements such as digitization. So although the products are similar to that of usual residential insurance products, its success relies on deep knowledge and expertise unique to this business to be able to provide services that match the needs and requirements and risks of High Net Worth customers.

Please turn to Page 15. Due to these characteristics of High Net Worth insurance market and also by the strength of Pure Group, Pure has been growing rapidly since it was established back in 2006. And for the past five years, Pure grew its premium under management by average of 30% per annum and is an expanding market share. As a result of various growth measures they are taking. And we expected their premium and profit growth to continue. Their premium under management has now -- is now exceeding \$1 billion.

The third characteristic is their high-quality service provision and high customer satisfaction. You can also see the renewal ratio as a result.

On Page 16, we are showing some services. There is a concierge service with a staff in charge of each policyholder to do claims handling and other consultation. There are also nonclaim-handling services, including assessing the right insurance amount, crime and disaster prevention and also loss prevention for catastrophe.

Please turn to Page 17. Through such high-quality service provisioning, they have achieved a high customer satisfaction and renewal ratio. Specifically, their Net Promoter Score, which is a way to quantify customer loyalty, Pure outperforms the insurance industry with this Net Promoter Score by far and is comparable to high-scoring companies from other industries.

As a result, renewal ratio, which is the ratio of policyholders continuing with the policy after maturity, is top tier among U.S. P&C industry.

Please go to Page 18. Fourth point is about the group management with abundant knowledge and experience leading the High Net Worth insurance business at Pure, especially Mr. Ross Buchmueller, the Founder and CEO, has worked at Chubb, a leading company in this area and went to AIG to start their High Net Worth group from scratch. After that, he founded Pure in 2006 and has over 30 years of experience in this industry and have major achievements.

Lastly, I will talk about the strategic rationale of this acquisition. We believe there are 3 rationales to this deal. First is the further expansion of specialty primary underwriting business in the U.S. market.

Please look at Page 20. Expansion of international businesses scale and profit have been identified as the growth driver of the group. And we have worked on our net organic growth as well as M&A in both developed and emerging markets.

By doing so, we have sought-after global growth opportunity and tried to build a diversified portfolio especially in developed markets, while we acquired Kiln, Philly, Delphi and HCC. And also in March this year, we have also divested our reinsurance subsidiary in order to focus more on primary underwriting business, centering around specialty insurance that has less earnings volatility. This deal is perfectly aligned with such M&A strategy.

Please turn to Page 21. On top of being consistent with M&A strategy, this deal satisfies all criteria for M&A, which is having a solid business model, having high profitability and having a cultural fit with management who can share similar corporate philosophy with us.

Please turn to Page 22. Another major advantage with this deal is that Pure's business does not overlap with our existing U.S. businesses. As you can see, by having Pure Group join Tokio Marine Group, highly complementing portfolio will be built with Philadelphia, Delphi and TMHCC. And this shows that Pure is the best fit for Tokio Marine Group.

Please turn to Page 23. The second point is about sustainable profit growth and further diversification of the portfolio, leading to improving further capital efficiency. We believe there will be a positive impact to adjusted net profit and adjusted ROE as you can see on this page.

Lastly, the third point is about synergy creation, leveraging on the strengths of both entities. Please turn to Page 24. By combining financial strengths, underwriting capability and product lineup of Tokio Marine with High Net Worth customer base in the insurance market held by Pure Group, we will be able to realize synergies as shown on this page.

That concludes my presentation. Thank you for your patience.

(Statements in English on this transcript were spoken by an interpreter present on the live call.)

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