info@twelvecapital.com
www.twelvecapital.com

For professional/qualified investors only

Twelve Capital Research Spotlight
The current opportunity in the US life insurance sector

Valuation Update

Twelve reviews the results of the Q2 2018 reporting season for US life insurers and the overall valuation of these companies. Analysis shows valuations seem to be pricing in pessimism which is neither justified by company-specific fundamentals nor the overall current macro environment.

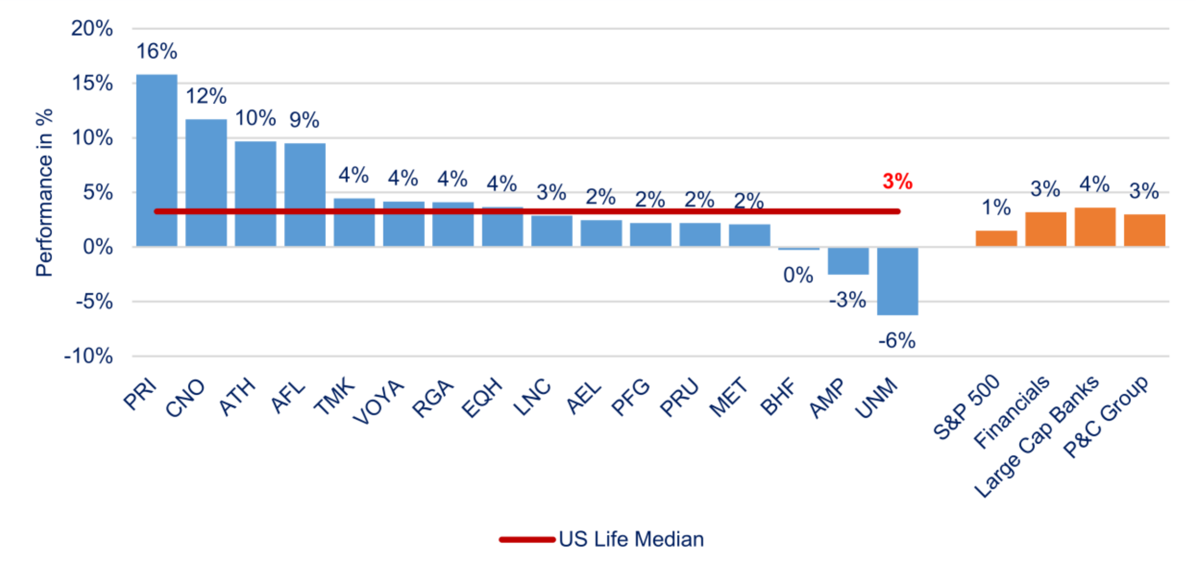
Key takeaways are:
- Operating results for Q2 were relatively benign, apart from a few names that outperformed on big earnings beats and/or positive outlook comments (Primerica, Athene, Aflac). Other companies showed substantial moves on non-earnings, company-specific considerations (CNO Financial Group, Unum).
- Overall stock performance for the group over the reporting season was in line with other financials, i.e. slightly ahead of the wider market. Results were not quite strong enough to revive investor enthusiasm for the sector, however.
- These companies' valuations are in line with historical averages, but depressed relative to elevated overall market valuations.
- US life insurers now trade at around 50% of the S&P 500 Index's P/E rather than at 60% - on a historical basis, this valuation is consistent with the US being in recession or 10-year Treasury yields below 2%, neither of which are the case.
- Merger activity in the US life insurance sector has been relatively quiet year-to-date. However, Twelve believes that conditions continue to support a pick-up in acquisition and restructuring activities.
- US life insurers' investment income is benefiting from higher yields, overall equity volatility remains navigable – all of which support the belief that valuations for the sector should improve.

A relatively neutral Q2 2018 reporting season

Performance of US life insurers during the Q2 2018 reporting season was mixed, but was essentially in line with other major financials groups slightly ahead of the S&P 500 Index[1], which was up 1%. An overview is shown in Figure 1. There were substantial movements driven by considerations around company exposures to long-term care insurance risks as we got our first look at a completed annual reserve review (Prudential), saw a meaningful reinsurance transaction (CNO Financial Group), and received interim guidance ahead of another important reserve review to be completed in Q3 (Unum).

[1] American stock market index based on the market capitalisations of 500 large companies having common stock listed on the NYSE or NASDAQ.

Figure 1: Earnings season stock performance



Source: Bloomberg, Twelve Capital. As at 14 August 2018.

Otherwise, stock movements were largely name-specific with three companies reporting results meaningfully ahead of investors' expectations (Primerica, Athene, Aflac). Overall, results were generally in line, although not sufficiently positive to outweigh broader macro fears and drive investors back to the group in a strong way.

Sector valuations look compelling relative to overall markets and the level of interest rates

At a price/earnings ratio (P/E) of 8.5 times, US life insurers[2] are trading at a valuation roughly in line with the long-term average. However, relative to a richly-valued overall market, the sector could be viewed as trading at a discount. As shown in Figure 2, at 51% of the S&P 500 Index P/E, this is historically around the lowest level at which the group has typically traded outside severely stressed macro environments. Other points in time when this valuation level have been seen post-crisis were during the first and second Eurozone crises and the early 2016 China-driven risk-off market.

[2] Represented by the S&P 500 Life sub-index. Standard and Poor's 500 Life & Health Insurance Index is a capitalisation-weighted index containing companies providing primarily life, disability, indemnity or supplemental health insurance.

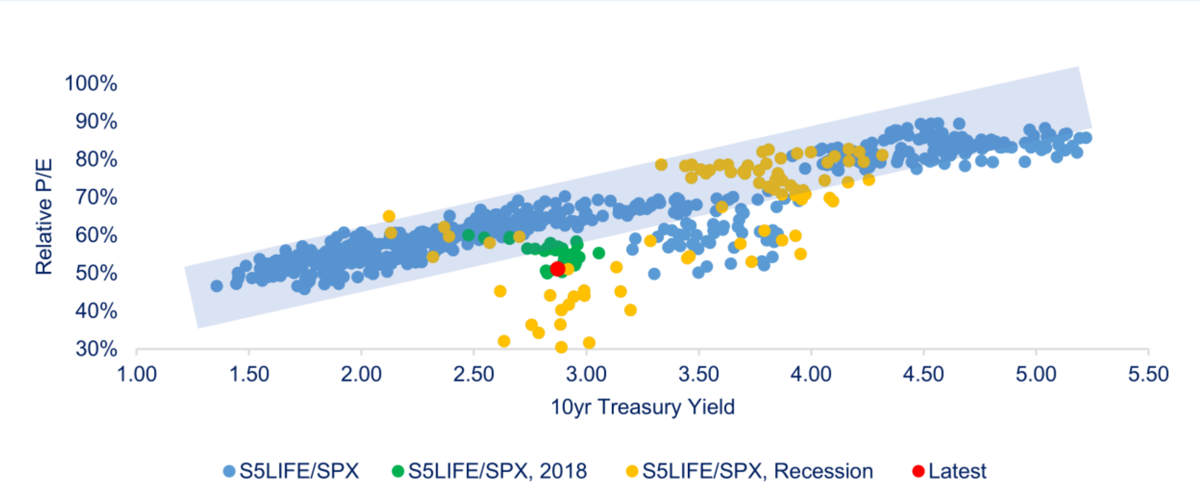
info@twelvecapital.com
www.twelvecapital.com

Figure 2: US life insurers' P/E Ratio – divergence relative to S&P 500 Index P/E

Source: Bloomberg, Twelve Capital. 31 December 2004 – 10 August 2018.
Legend: S5LIFE: S&P 500 Life & Health Insurance Index. SPX: S&P 500 Index. USGG10YR: US Generic Govt 10 Year Yield

Historically, there has been a high correlation between the yield on the US 10-year Treasury and the relative valuation of the US life insurers. This is demonstrated in Figures 2 and 3. Since 2004, this relationship only broke down during the 2007/2008 recession (as represented by the yellow points in Figure 3) and for a short period early in the post-recession recovery (shown by the few blue points below the shaded region in Figure 3).

Figure 3: US life insurance sector P/E ratio (relative to S&P 500 Index P/E) vs. US 10-year Treasury yield, since YE'2014



Source: Bloomberg, Twelve Capital. 31 December 2004 – 10 August 2018.

With the underperformance of US life insurers this year (as per the green points in Figure 3), the group now trades at a valuation consistent with the US currently being in recession, or as if the 10-year Treasury yield were still below 2%. Were the historical relationship to hold, Twelve would expect the group to trade at around 60% of the S&P 500 Index's P/E, rather than the current level of approximately 50%. This would imply an average P/E of about 10 times versus the current level of 8.5 times, or about 17% higher.

M&A and restructuring activity – currently quiet but has the potential to pick up

Merger and acquisition (M&A) activity has been quiet so far this year, but conditions support a potential pick-up. Recent items have included:

- Annuity insurer American Equity Life holding preliminary discussions regarding a potential transaction. The stock trades at a take-out valuation, though so far there has not been a reported bid.
- Annuity insurer and active acquirer Athene described their transaction pipeline as being as robust as they have ever seen it and noted a particular appetite for large, complex structured transactions and acknowledged an interest in partnering with private equity sponsor Apollo on transactions involving long-term care insurance. This further fuelled speculation that the companies are looking at General Electric's insurance business. In July, it was reported that Voya had hired Morgan Stanley to seek a buyer for their life insurance business, potentially worth in excess of USD 1 billion. It is expected that there are likely to be a number of bidders for this asset.
- Meanwhile, Reinsurance Group of America, a life reinsurer had a quiet quarter in terms of acquisitions. However, the company revealed a positive outlook for closed block deals, weighted towards the US but seeing opportunities in Europe as well, for a range of sizes and structures. The company reported USD 1.2 billion of excess capital to deploy on block acquisitions.

Summary & conclusion

Twelve does not see a justification for this valuation gap given the US life insurers' recent reported earnings due to:

- Higher yields across the yield curve are lifting pressures on these companies' investment income.
- Equity market volatility has risen from historic lows, but remain generally navigable.
- Sales trends are mixed, but the overall growth outlook for the group is relatively consistent with long-term trends for this mature business, and some areas justify optimism for improvement such as wage inflation gearing in group benefits and headwinds fading in annuities.
- While the overall balance sheet credit environment warrants some caution, there are no indicators at present to suggest recession-level credit risk concerns on the horizon.

Thus Twelve continues to see limited downside for the group from current levels in the absence of a broader macro downturn, which already appears to be partly-priced into the sector.

info@twelvecapital.com
www.twelvecapital.com

Directory of company names

Ticker	Company Name	Market Cap (USDm)	P/E Ratio	P/BVPS	Dividend Yield	EPS Growth
US Life Insurance Companies						
AEL	American Equity Investment Life Holding Co	3'392	11.2x	1.40x	0.75%	5.3%
AFL	Aflac Inc.	36'025	11.6x	1.52x	2.23%	2.3%
AMP	Ameriprise Financial Inc	20'128	9.3x	3.58x	2.50%	10.0%
ATH	Athene Holding Ltd	9'522	7.4x	1.18x	0.00%	14.9%
BHF	Brighthouse Financial Inc	5'051	4.8x	0.35x	0.00%	12.7%
CNO	CNO Financial Group Inc	3'639	10.7x	0.82x	1.76%	10.6%
EQH	AXA Equitable Holdings Inc	12'723	6.1x	0.41x	1.27%	11.4%
LNC	Lincoln National Corp	14'418	7.5x	0.95x	2.02%	10.5%
MET	MetLife Inc	46'568	8.9x	0.91x	3.54%	5.6%
PFG	Principal Financial Group Inc	16'085	9.6x	1.38x	3.72%	6.0%
PRI	Primerica Inc	5'242	16.0x	3.75x	0.83%	14.1%
PRU	Prudential Financial Inc	41'562	7.9x	0.86x	3.61%	6.3%
RGA	Reinsurance Group of America Inc	9'268	11.5x	1.08x	1.49%	17.4%
UNM	Unum Group	7'937	8.0x	0.84x	2.66%	19.7%
VOYA	Voya Financial Inc	8'138	10.4x	0.97x	0.09%	24.2%
Other stocks mentioned in this report						
GE	General Electric Co	109'768	12.1x	1.99x	3.80%	11.3%
LGEN	Legal & General Group PLC	19'589	8.9x	1.98x	6.38%	5.9%
RNR	RenaissanceRe Holdings Ltd	5'298	12.2x	1.26x	1.00%	-18.3%

Source: Bloomberg. As at 22 August 2018.

Twelve Capital AG
Dufourstrasse 101
8008 Zurich, Switzerland
Phone +41 (0)44 5000 120

Twelve Capital (UK) Ltd
Moss House, 15-16 Brook's Mews
London W1K 4DS, United Kingdom
Phone: +44 (0)203 856 6760

Twelve Capital US Inc.
1010 Northern Blvd
Great Neck, NY 10021
United States of America

info@twelvecapital.com
www.twelvecapital.com

About Twelve Capital

Twelve Capital is an independent investment manager specialising in insurance investments for institutional clients. As at 30 June 2018, the firm had approximately USD 4.5bn in assets under management. Twelve Capital's investment expertise covers the entire balance sheet of insurance companies, including Insurance Bonds, Insurance Private Debt, Catastrophe Bonds, Private Insurance-Linked Securities and Insurance Equity. The firm also structures portfolios of its Best Ideas. Twelve Capital was founded in October 2010 and has offices in Zurich, London and New York.