KPMG
cutting through complexity

Insurance Briefing
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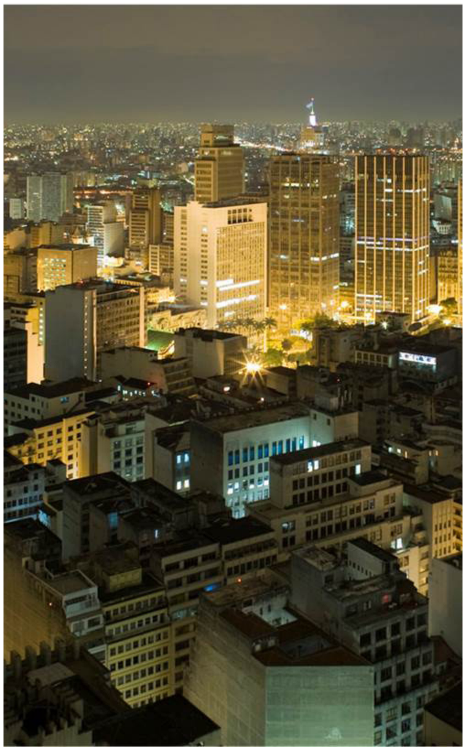


Consider Latin America markets as a growth engine

Opportunities and risks abound in a complex environment

One look at the data and demographics and it is no wonder the idea of competing for more business in Central and South America (Latin American – LatAm) countries remains a high priority for discussion among boards and management teams at so many of the world's largest insurance companies.

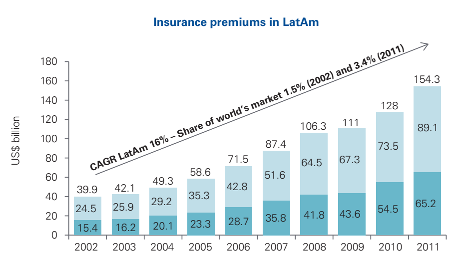
Consider:

- LatAm comprises 33 countries with population of approximately 590 million
- Collectively, the compound annual growth rate (CAGR) of insurance premiums of the countries in the past 10 years is 16 percent, reaching about $160 billion in 2013
- LatAm's CAGR of the combined gross domestic product (GDP) is 14.4 percent over that same period

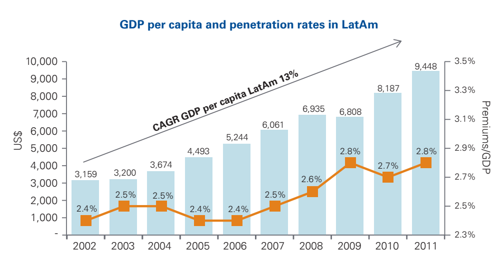
Combine those statistics with a low total insurance penetration rate of 2.8 percent, and the argument for expansion through a strategy of mergers and acquisitions (M&A) begins to get more interesting, especially when viewed against the backdrop of U.S. and European markets beset by flagging growth, thin margins, and continued regulatory demands and uncertainty.

With all scenarios rife with opportunity, huge risks are attached. Insurers seeking to benefit from the need for insurance and investment products accompanying the rising wealth of LatAm's population will need to identify, analyze, and manage the complexities that are routinely shifting in the region. As many executives across industry lines can attest, even a small misstep in a program of cross-border expansion in the LatAm region can mean the difference between growth and a wasted investment.

33 countries	591 million population (8.5% of world's)	GDP per capita of US$9.5k
US$5.5 trillion GDP (8% of world's)	CAGR GDP of 14.4% between 2002 and 2011	Total insurance penetration of 2.8%
Total premiums of US$154 billion	Life US$65 billion and Non-Life US$89 billion	Insurance spent per capita of US$260
Local insurers remained stable during global crisis	Dynamic regulatory environment	Huge growth potential



Source: Sigma reports, CIA Fact book; various



Source: Sigma reports, CIA Fact book; various

Positive long-term prospects

Many LatAm countries have penetration rates of below 2.9 percent of the total GDP, with the exception of Chile, Panama, and Brazil (4.2 percent, 3.4 percent, and 3.2 percent, respectively).

Premiums per capita (density) in the key market participants are still relatively low in LatAm. Aside from Chile (density rate of nearly US$560), the density rates of the remaining eight countries are all below US$400, with Peru having the lowest premiums per capita of approximately US$90.

Brazil, Mexico, and Argentina are the largest insurance markets in LatAm, each with total premium volumes in excess of US$10 billion in 2011 (US$78 billion, US$22 billion, and US$13 billion, respectively). Costa Rica and Uruguay are the smallest of the key market participants, each with total premium volumes lower than US$1 billion (US$0.9 billion and US$0.8 billion).

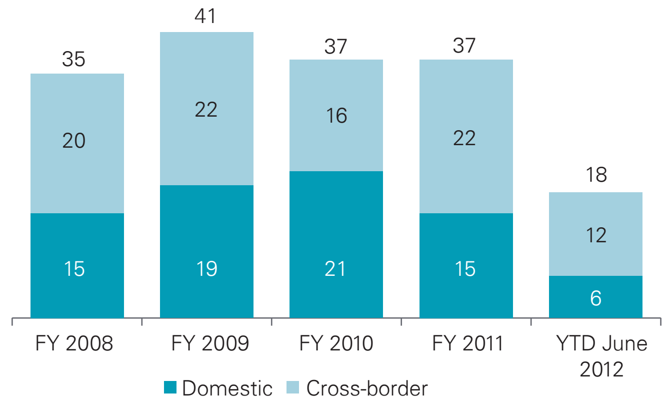
The long-term economic outlook for all key market participants is very strong. All key market participants are expected to reach a CAGR of over 3.7 percent by 2021, except Brazil that is expected at 3.5 percent. Panama is expected to achieve the highest CAGR 8.0 percent.

Demographic factors play favorably for Brazil, Argentina, Colombia, and Mexico, of which each country has a total population of over 40 million (Brazil 196 million and Mexico 115 million).

A positive outlook

Despite the challenges, LatAm is one of the hotter M&A marketplaces for insurers. The volume of M&A transactions in the LatAm insurance market has been consistent over the past few years, despite the global financial crisis. Between January 2008 and June 2012, an average of nearly 37 transactions were completed per year, reaching a total of approximately 170 transactions during the period.

Volume of transactions in LatAm

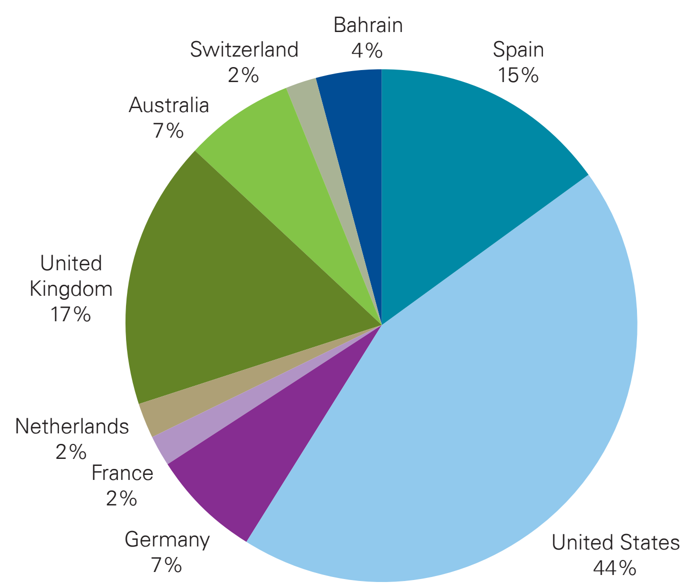


Source: Thomson Reuters

Cross-border transactions, in which international insurance companies enter LatAm and LatAm-based companies acquiring companies outside their home countries, represented nearly 55 percent of the total volume between 2008 and 2012.

Approximately 60 percent of cross-border LatAm transactions were related to an outsider acquiring a LatAm-based insurer. The top acquiring country into LatAm (by number of transactions) is the United States, followed by the United Kingdom, and Spain.

Acquiring countries in cross-border transactions in LatAm

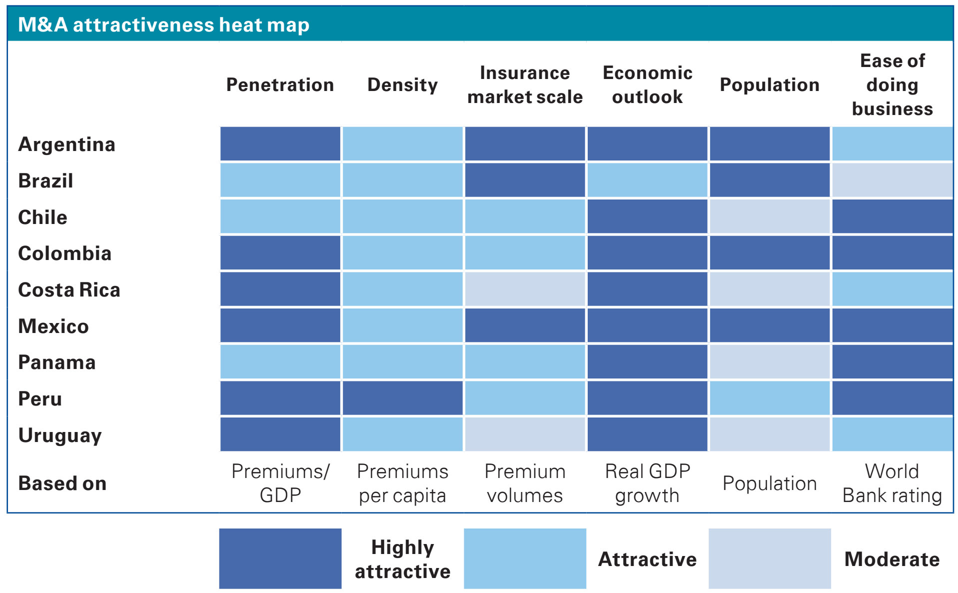


Source: Thomson Reuters

Our analysis indicated that LatAm's insurance industry is poised to continue growing at a significantly faster pace than the rest of the world, at least for the next several years, primarily because of the expectation that the average per capita GDP will continue to keep rising, sparking demand for consumer goods as well as savings products. Increased banking penetration will also likely drive premium growth, as insurers align with banks for better customer interaction and delivery channels.

In addition to steady premium growth, retirement-savings and general investment products are expected to be widely purchased in the region. Concurrent with increasing automobile purchases, auto insurance continues to grow, and the upward track of health and personal accident insurance is expected to continue as the regional economies build on their strengths.

Emphasis on deal structuring, due diligence, and risk management



Source: Swiss Re Sigma Reports, World Bank, and KPMG LLP analysis

As the chart above illustrates, insurers are contemplating inorganic growth opportunities now and in the future in a number of LatAm countries.

Taking advantage of the current conditions—and the expectations for future growth—places a very high premium, however, on insurers' abilities to develop strategies for the successful execution of M&A that lowers the potential downside risks, while enhancing chances for success. That approach to enhancing the odds for success begins by having a relentless focus on careful target selection, thoughtful structuring of deals, disciplined due diligence, and—perhaps most important—patience. Rushing into a deal in order to be first could potentially lead to failure.

Deal structuring and due diligence characteristics:

- Structuring the deal
  - How well understood is the current regulatory environment, and potential implications of contemplated regulatory changes on the horizon?
  - Are earn-outs common where there is significant uncertainty on earnings?
  - Would it make sense to initially consider an acquisition of <100 percent interests, with an option to purchase remainder in 3–5 years?
  - Is it possible to obtain real guarantees against risks identified?
  - Are escrow arrangements frequently used?

- Quality of financial information
  - Has the target shown evidence in the past of delivering accounting and management information in a timely manner?
  - Are stand-alone audited financial statements available for the target business?
  - Are reliable budgets and forecasts readily available?
  - Is information accurate or is there evidence of conflicting data?
  - Is costing provided in a sophisticated manner?
- Internal controls
  - Are you satisfied that the organization has processes and procedures in place that support strong financial controls and a solid approach to governance?
  - Does management information reconcile to the tax and statutory accounts?
  - Is there any evidence of multiple sets of books?
  - What processes are in place to guarantee approvals?
  - Are there compliance policies and procedures that address the Foreign Corrupt Practices Act, and antibribery and corruption risks?
- Labor and employment issues
  - Are protections in place against indiscriminate employee termination?
  - How prevalent are labor unions in the organization?
  - Is there too much dependence on a few key employees?
  - Are all effective employees currently compensated through the payroll system?
  - How significant are the contingent liabilities regarding employee benefits?
  - Are you aware of potential issues that could cause labor claims in the future?
- Tax compliance issues
  - Are there any historical issues that could lead to significant tax exposures and risks?
  - Is the tax compliance process managed in a timely manner?
  - Is there any risk that historical transactions and/or structures will negatively affect the future tax position?
- Intercompany and related-party transactions
  - How extensive are such transactions?
  - How solid is the evidence the transactions are arm's length?
  - Is there evidence of inconsistent allocation of costs or revenue?

Focus beyond simply the desire to "go global"

In their zeal to expand their global footprint while taking advantage of the increasing purchasing power of LatAm's strengthening middle class, acquirers must guard against moving too quickly. Patience is a virtue when it comes to LatAm M&A. Unrealistic market expectations or economic assumption and misinformation about the competitive landscape are common pitfalls when dealmakers rush in. Too often, critical financial, tax, labor, cultural, regulatory, and competitive landscape assessments are not thoroughly vetted during a rushed transaction evaluation process. This could potentially lead to unsuccessful investments or M&A deals that may not achieve the desired outcomes of the inorganic growth objectives in the LatAm market.

The pragmatic approach, which balances risk with growth potential based on careful target selection, thoughtful structuring of deals, and in-depth due diligence can result in better investment decisions and increase the odds of success.

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