

Insurance industry: Hard sell

AIA is proving to be a hard sell all round:

- i. For the Pru board to their shareholders
- ii. For AIG to anyone
- iii. For the Fed and AIG to the American taxpayer

BRAVE Partners concludes that AIA is worth \$35bn because it has to be and for no other reason.

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Some of the BRAVE partners drank the Pru Kool Aid and bought the stock when it tanked after the announcement that Prudential plc. was to acquire AIA for around \$35bn. The firm has kept out of the debate for that reason. Now that the dust is settling, the firm has some views to share.

A bit steep

In a world where the stock of just about every insurance company is still trading below book value, a \$35bn price tag for AIA looked expensive. However, AIA is a unique asset. If a life insurer wants to scale up into the growth markets in Asia, there is no other asset that immediately gives the size, scale or credibility of AIA. This history definitely has a goodwill value, it just seems that the Pru's shareholders don't think that value is as high as the company's management does.

AIA is the real AIG. Most people do not know the history and miss this point. If and when AIA is sold, AIG really does cease to exist.

Shanghai 1929

AIG is AIA. The original company is American International Assurance (AIA), a life company founded in Shanghai in 1929 by American, Cornelius Vander Starr. The American company, AIG, was founded by Hank Greenberg, Starr's anointed successor, in the 1960s and AIA was folded into it.

This history is immensely important in assessing the value of AIA. There has to be some doubt as to whether, under Pru ownership, AIA could maintain the deep connections that it has in China and Asia; but 90 years of history does not get created quickly in any organic growth strategy.

Making it fit

The Pru sought to justify the price of AIA by applying their own assumptions in order to calculate the value of the business. These assumptions miraculously added about \$1bn to the embedded value of AIA,

making the proposal look more reasonable. Shareholders were not convinced. It was a hard sell as some of the Pru assumptions look pretty heroic.

The issue to BRAVE Partners was that AIA needed to be valued on a reasonable amount of goodwill. It is a hard sell to convince investors of goodwill in a market where most similar businesses are trading at a discount to book value.

Back to square one

The Pru investors revolted. The management was told to seek a lower price – rumour was a price of a little over \$30bn. AIG and in particular the Federal Government, the real owner of AIA, said no and the deal was off.

Bloomberg is now awash with stories that AIA will fetch at least \$35bn in an IPO, but there is no time or place set for the IPO. It is easy to make such claims, but as an American would say: “the proof is in the pudding”.

The question that BRAVE Partners seeks to answer is: “Could AIG have sold AIA for less than \$35bn and still had a credible chance of repaying the American Government?” The answer to this question is critical in assessing the health of AIG.

The cat in Schrödinger’s thought experiment is in a zombie state until the box is opened. Selling AIA for under \$35bn could have been the same event for AIG as opening the box to find the cat dead. Is it better that AIG keeps the box closed and look to convince the market that the cat is alive, by claiming that AIA will sell for \$35bn? It might yet in the future.

AIG today

In Schrödinger’s company, BRAVE Partners suggested that no one really knows if AIG is alive or dead right now. The company certainly would have died had the Federal Reserve not made about \$180bn available to it a couple of years back. The question now is whether once the US taxpayer is repaid (and given a small return for the time value of his money and the [substantial] risk taken), is there anything left for shareholders?

The fact that the stock trades at about zero, suggests that the markets believe that there is. Benmousse, the 4th CEO after Hank Greenberg’s departure is keen to encourage this thinking.

“AIA is valued at \$35bn because it has to be and for no other reason.”

Christopher Cloke-Browne
Managing Partner
BRAVE Partners LLP

Pandora

In Greek mythology Pandora’s box (in fact a jar) unleashed many terrible things on mankind. In much the same way, BRAVE Partners wonders whether the opening of the box to find the cat dead would unleash many terrible things on AIG, the Federal Reserve and the economic system. In the myth of Pandora, hope was left in the jar. In

contrast hope would appear to be the item outside the box in this case.

The value of AIA

The value of AIA is extremely tough to call. Clearly a lot of smart, sophisticated Pru shareholders thought that it is not \$35bn, even with the synergies that can be driven from incorporating it into the Pru. It seems a stretch then to think that an IPO, which would usually command a lower valuation than a strategic sale, would value the company at above \$35bn. However, the speculation at BRAVE Partners is that, for now, AIA has to be seen to be worth at least \$35bn.

AIA is certainly a valuable property, but a part of the issue is whether or not this value can be realised outside AIG and the associated personalities, relationships and history. AIA was founded in Shanghai, not the Pru. A Prudential owned AIA would have a different relationship with China.

No money back guarantee

One day the value of AIA will be determined. Until that is done in a real transaction, BRAVE Partners will keep an open mind as to whether or not the US taxpayer will be repaid by AIG, regardless of what the Fed and AIG management tell us.

The firm strongly believes that AIA is valued at \$35bn because it has to be and no other reason.

BRAVE Partners services

The BRAVE partners have tracked the AIG story closely. The firm is well placed to comment on the risks associated with AIG's outstanding debt.

Interaction

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- There is a clear difference of opinion on the value of AIA
- The management of Prudential plc, AIG and the Federal Reserve all value it at \$35bn.
- Some of the largest and most influential shareholders of Prudential plc value it at \$30bn or less.
- BRAVE Partners analyses the situation and concludes that AIA is worth \$35bn because it has to be and for no other reason.
- The impact of AIA being worth less than \$35bn on AIG, the Federal Reserve and the economy is too great.

enquiries@bravepartners.com

www.bravepartners.com