Seminar on Reinsurance

June 5–6, 2023

Westin Philadelphia

Philadelphia, PA

‘Franchise Value’ Conflicting Points of View

Investors

- Grow and maximize shareholder value over medium and long term
- Predictability of performance is a key towards value maximization
- Time to realization matters

Increasing Enterprise Value

Regulator/Rating Agency

- Protect the capital base from tail events
- Ensure business continuity of operations
- Time is less of a factor than certainty
- Not accountable to investors

Protect Capital & Policy Holders

Employees

- Platform needs to allow for accomplishment of goals
- Expect higher income year-over-year
- The ‘Brand’ they are employed by matters
- Not necessarily accountable to shareholders

Compensation & Benefits

Board of Directors

- Protect the organizational reputation from business outcome and litigations
- Aligning management compensation to relative performance
- Accountable to investors

Relative Value & Reputational Risk

All Constituents Do Not Necessarily Share a Point of View of Franchise Value

‘Franchise Value’ a Management Perspective

Generating long-term shareholder value is core deliverable for management teams of public companies

Aspects to Consider

Opportunities

- **Recognizing How Management is Judged** - Over-time public company management teams will be judged both by the ‘absolute’ and ‘relative’ value they created for shareholders
- **Connected Decision Making** – Need to connect decision making back to core organizational value drivers
- **Accepting Trade-offs** - Properly understanding the trade-offs between cost and opportunity not only at the transaction level, but how the transaction integrates to the company level result

Challenges

- **Timeline** – Reporting periods and value creation periods are often mis-aligned, which can lead to sun-optimal decision making
- **Communication** – As it relates to public company valuation investors are limited to what a company reports, however, the attributes of individual transactions can be obscured
- **Conflicting Priorities** – Even within smaller organizations differences in expectations and incentives can lead to conflicts about what is most important

Valuation Considerations: Public vs Private

Factors Affecting Public and Private Business Valuations

Public Considerations

Revenue Trends	Reoccurring revenue growth is a key consideration as companies who demonstrate consistent and historic revenue growth will be valued at a higher EBITDA multiple compared to the companies with below average, flat revenue growth or only a one time revenue spike
Dividends	Dividends can be an important component of equity performance, and provide year-to-year indications of a company's growth and profitability, outside of the up-and-down movements that occur in a public company's stock price throughout the year
Return on Equity	A company's Return on Equity (ROE) is an indication of whether a company is earning profits without putting new equity capital into the business. An increasing ROE is a representation of management effectively using investors' capital as well as giving shareholder more for their money
Market Perception	A company's market perception plays a key role in a company's valuation in addition to a company's long term success. Company's with a positive market perception are perceived to offer quality, high-value products and services thus they garner a higher valuation, but company's with a negative market perception do not receive as favorable valuations
Macroeconomic Variables	Public companies may be affected by changes in the macroeconomic environment, such as interest rates or currency rates. Since the macro economic environment rapidly changes, this encourages public companies to operate on a shorter time horizon as a public company share price ties to quarterly results
Marketing	Companies with successful marketing strategies can build brand awareness with not only consumers but also investors. Well known brands may generate more interest and create an increase in value

Private Considerations

Profit Margins	Companies with high gross profit margins command a higher valuation premium as high gross profit margins are indicative of a company possessing competitive advantages through differentiated offerings, unique distribution channels, or enhanced production capabilities which usually lead to a high EBITDA multiple as well
Unique Distribution	Companies with access to business not readily available to traditional insurance companies are garnered at a higher valuation premium. A unique business is always seen as more valuable than standard product lines.
Competitive Advantages	Sustainable competitive advantages are necessary to protect a business from potential intrusion of competitors, which helps reduce business risk and increase growth prospects. Companies with intellectual property, technology, unique capabilities/services, or proprietary process can boost their premium multiple
Industry Concentration	Companies with revenues concentrated in a particular part of the market are at greater risk to the impact of sector variables, such as cyclical nature, the introduction of new regulations, increased competition, etc. However, in certain situations industry concentration can be viewed positively if the part of the market the company serves is growing faster than the GDP
Consumer Concentration	The magnitude or absence of customer concentration can significantly effect a companies enterprise value. Companies with significant customer concentration command lower than average EBITDA multiples than industry peers with equal revenues and profitability with a more diverse customer base
Strength & Depth of Management Team	The market is more likely to grant a higher value to companies possessing a more complete management team with talented individuals leading the key functional areas such as Finance, Operations, and Sales & Marketing rather than a company overly dependent on it CEO

M&A Valuations

A Company is Worth What Another Company is Willing to Pay

When valuing an insurance company, the first, and often easiest, place to start is by using financial metrics. However, valuations based on financials alone will exclude key benefits that both the buyer and target will realize post acquisition. In essence, traditional valuation metrics are merely guidelines

Non-Financial Metric	Commentary
Synergies	The most obvious reason for companies to increase their valuations beyond normal metrics. Potential savings can be factored into models post transaction to justify overpaying. Examples including staff savings, reduction in rental / office costs , reinsurance pricing decreases, and reduction of system costs and general overhead
Growth	Most companies are under pressure to grow but some more than others. Particularly private equity owed companies. Missing out on a prior deal may also cause undue pressure or a determination to pay whatever it takes
Distribution	The attraction of new markets or cross sell opportunities may increase the value
Niche	A unique or niche book of business creates interest and desire. For public companies this can be reflected in the valuation but for private companies it is hard to understand the magnitude of the uplift. Separately from that more standard companies or undesirable lines of business may be undervalued. Despite making profits there may be no active buyers for companies where organic growth is achievable
Market Perception / News Cycle	Decent companies can be impacted by the market they are in and vice versa. Recently we have seen underperforming insurtechs ride the wave up and decent performing ones ride the wave down. The Florida homeowners' market is another market recently impacted by negative press
Market Trends	Trends in markets change. Once sought after companies or products can become undesirable overnight. A recent example has been the move towards ESG. Insurance companies writing coal insurance will now find good valuations hard to come by no matter how profitable the book of business is. On the other hand, ESG compliant companies may attract a premium
Relationship Between Parties	Sometimes it just comes down to two management teams knowing each other and liking the idea of collaborating. That may just be the incentive to pay a little more
Financial Buyers vs. Strategic Buyers	Motivations are different. Financial buyers tend to be driven more by metrics and returns. Strategics are more inclined to think about softer issues

Case Studies

A Company is Worth What Another Company is Willing to Pay

AmeriTrust

Acquired by

AF Group

$740M

In State Merger

- Accident Fund acquired AmeriTrust in early 2023
- The closeness of both businesses in terms of location and relationships made sense
- Office buildings in Michigan were close to each other creating obvious synergies.
- AF Group further protected its status as a major player in Michigan

Narragansett Bay Insurance Company

Acquired by

HERITAGE INSURANCE

$250M

Diversification

- Acquisition served as a means of geographic diversification and source of growth along the Eastern Seaboard
- The acquisition created new distribution channels and relationships
- Significant reinsurance savings enabled the group to get a higher valuation

SPINNAKER INSURANCE COMPANY

Acquired by

hippo

$91M

Protecting Capacity

- Spinnaker previously served as Hippo's capacity for several years
- Hippo was the largest MGA on Spinnaker's paper
- When Spinnaker decided to run a sale process Hippo’s relationship could have been under threat
- It made sense that Hippo would become he highest bidder

Alleghany

Acquired by

BERKSHIRE HATHAWAY

$11,600M

Relationship Between Companies

- Similar to Berkshire Hathaway and Alleghany operates a set of unintegrated (re)insurance businesses
- Joe Brandon, CEO of Alleghany, formerly worked for Berkshire Hathaway a chairman and CEO of Berkshire’s subsidiary General Re between 2001 and 2008
- The deal came only months after Joe Brandon formerly took over as CEO of Alleghany following the retirement of longtime Alleghany CEO Weston Hicks

Untangling market behavior analytically

The search for quantitative measures of how insurance performance metrics influence valuation

Valuation is to complex to ascribe to any single variable

The Challenge

- Develop quantitative measures of how key insurance metrics influence valuation
- Reduce uncertainty around critical questions like how much CAT-related income volatility is acceptable, or how markets are likely to react to shifts in premium growth vs. losses

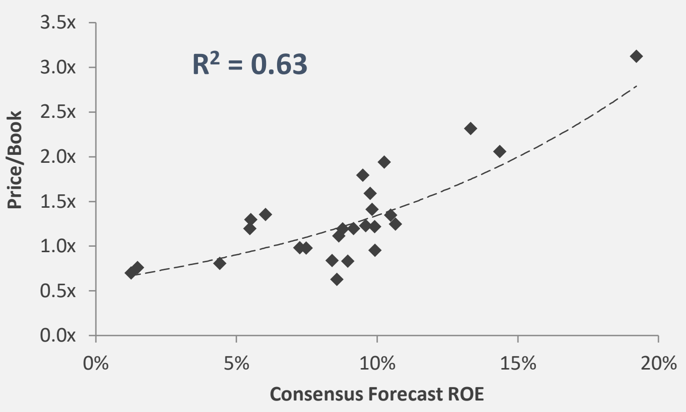
Conventional Wisdom – Risk vs. Return

- Started with the common convention of valuation in context of risk (volatility) and return
- Surveyed commentary from professional investors and sell-side analysts for anecdotal accounts of how key market participants approach valuation
- Used conventional tools like linear regression to confirm that many factors influence valuation

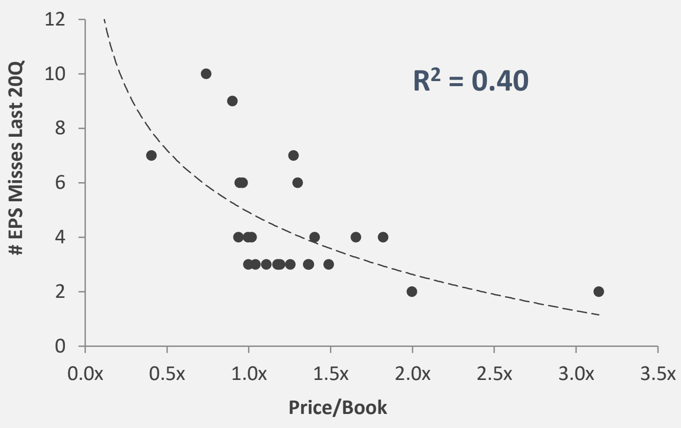
Discoveries and next steps

- Investor treatment of valuation varies widely
- Not all sources of profit or volatility are treated equally
- Traditional analysis cannot fully account for the innumerable complex interactions that add up to value creation or destruction

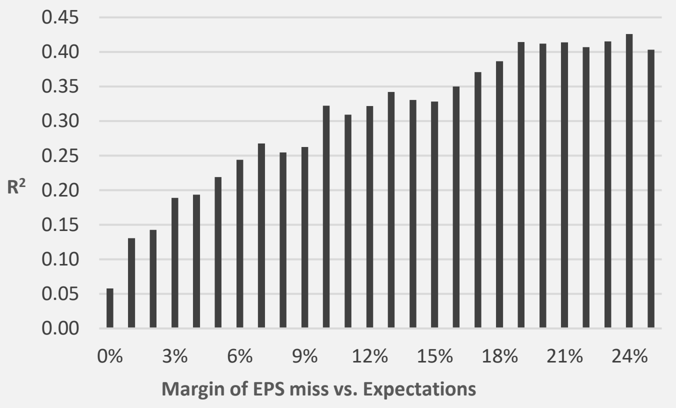
Impact of Return



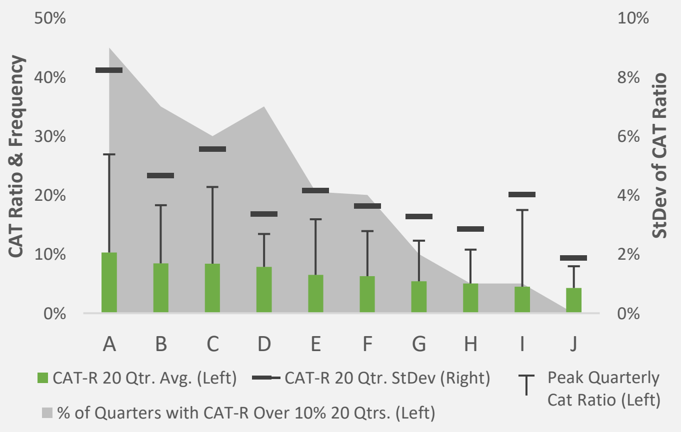
Impact of Volatility



When does volatility matter?



What are the sources of volatility?



How much CAT volatility is too much? Do markets care about small movements in Expense Ratio? Is premium growth rewarded?

GC ValueSight: a snapshot of the model

Predictive analytics for reinsurance decisions

ValueSight

- *Explains how simultaneous changes to drivers of return and volatility impact 'price to book' ratio*
- *Uses big data and machine learning to enable 'what-if' testing of solutions (including reinsurance) that can improve franchise value*

Inputs

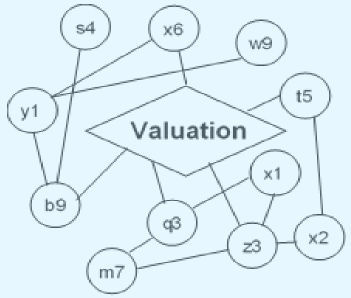
Base variables

- 24 reported company metrics
- 30 macro & environmental
- 8 broad market

Transformations

- Absolute
- Volatility measures
- Relative to Average
- Trend
- Actual vs Expected

Machine learning matrix



c800,000 data points from 10-years' worth of quarterly performance data

Output

Top Drivers of P/B Change

P/B Forecast Algorithm

Optimized Metric Position

P/B stands for 'Price to Book' ratio

Use

Portfolio Management

Risk Tolerances

Reinsurance Decisions

Actionable insights on CAT, Underwriting & Reserving risk

Model predicted P/B ratio 1 year forward within +/- 20 %pts of the actual ending ratio 89% of the time

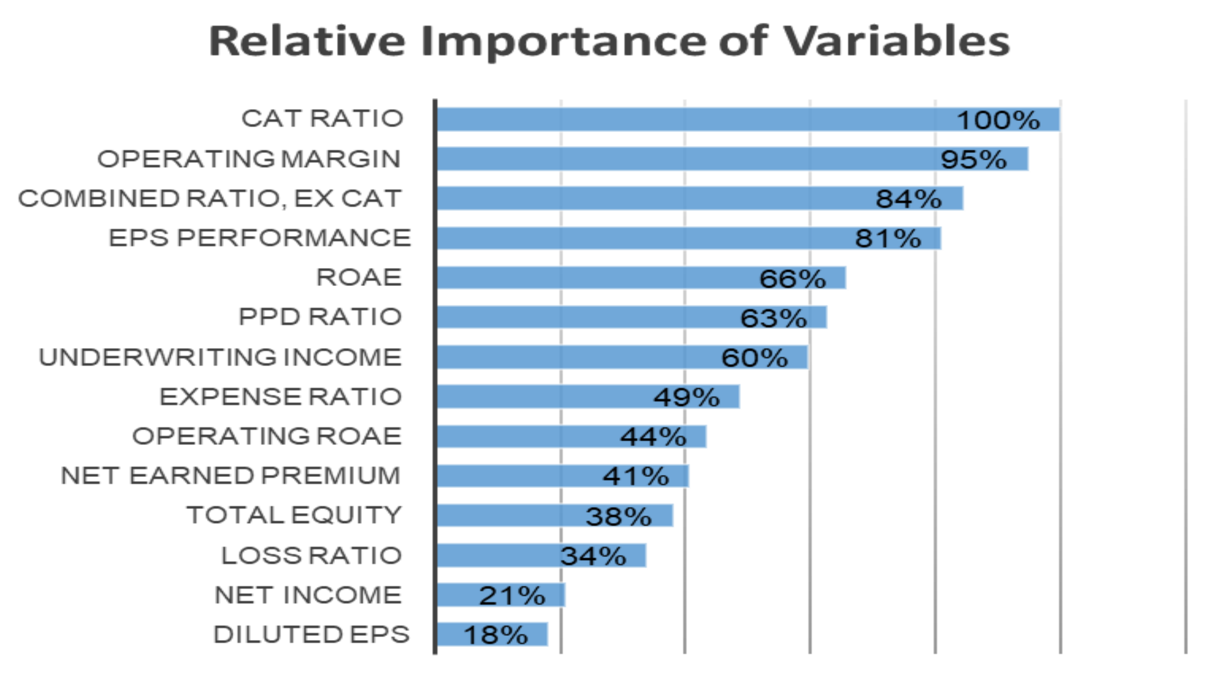
How is ValueSight different? – holistic and agile

Holistic & agile: uses big data and machine learning for a superior identification of what drives valuation

ValueSight

- Evaluates large data sets and dynamic interactions between variables
- Produces a holistic understanding of valuation
- Identifies the performance metrics management may influence to maximize value over time.

Advanced predictive modeling evaluates the dynamic interrelationships between numerous data elements



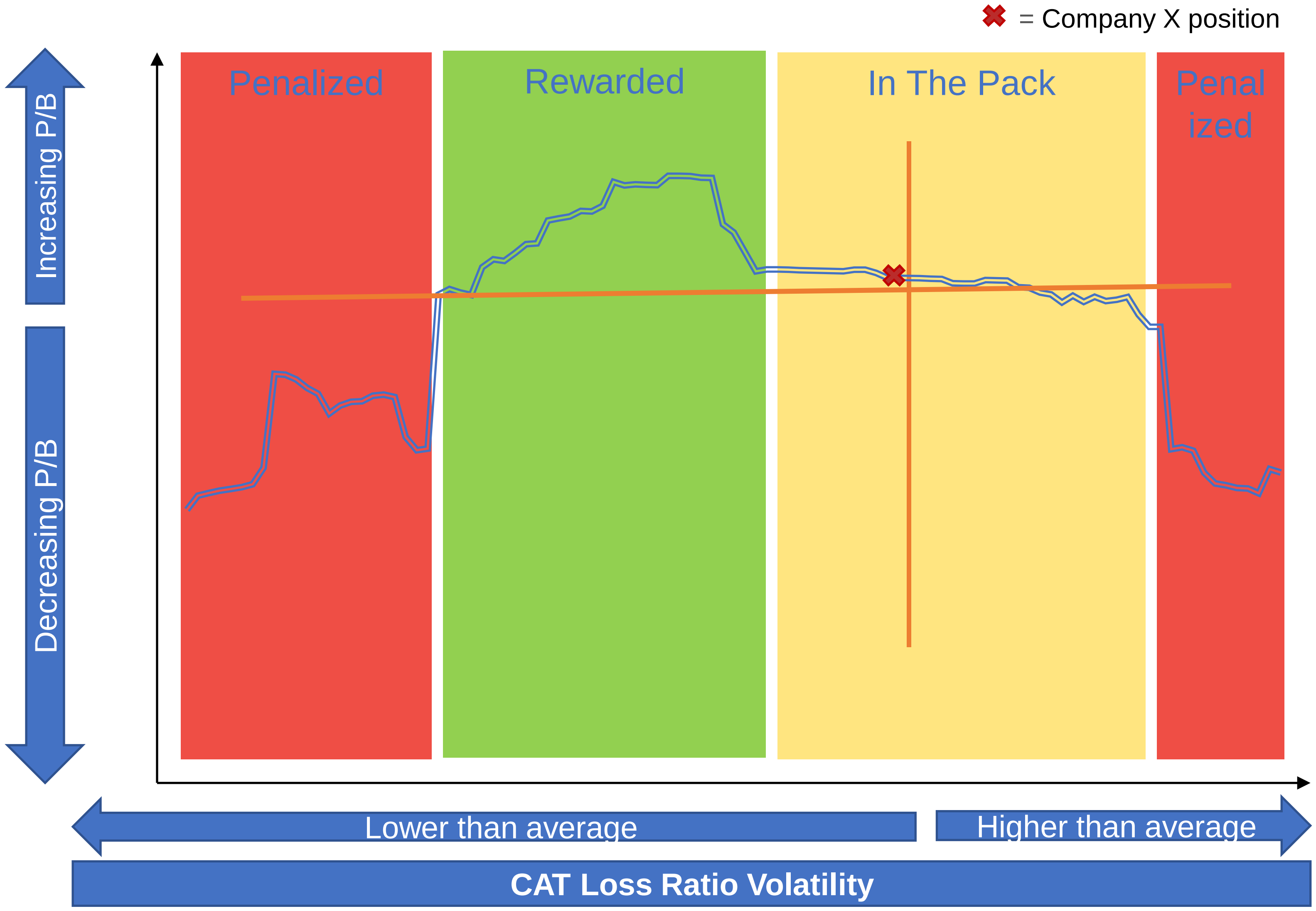
This allows us to objectively compare the importance of the “usual suspects” …

… examine how market perception of key metrics is evolving over time

… and identify metrics that investors may be watching as red flags

GC ValueSight in action – Insights on CAT management

Both higher and lower cat loss ratio volatility lead to decreases in P/B Multiples



Industry Observations

- Both low and high outliers are negatively impacted
- A range around average volatility is a 'safe zone'
- Slightly lower than average CAT loss ratio volatility is the optimal spot with the benefit dropping when volatility is too low

Company X Observations

- Company X's relative CAT volatility suggests that it has c3%pts of upward wiggle room on its volatility vs. peers.
- Reducing relative volatility by just 1%pts may build value over time

Note: this is a relative volatility comparison, reflecting the importance of not just managing CAT vol, but ensuring that company results are not outlier vs. peers.

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Contact

Charles J. Sebaski
Managing Director, Investor Relations

(212) 208-3222
ir@ambac.com

GuyCarpenter

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