

The Role of the CFO in Creating Shareholder Value

An Insurance Industry Case Study

Actuaries Clubs of Hartford/Springfield and Boston, Joint 2012 meeting

Mark Kaye, CFO, U.S. Retirement

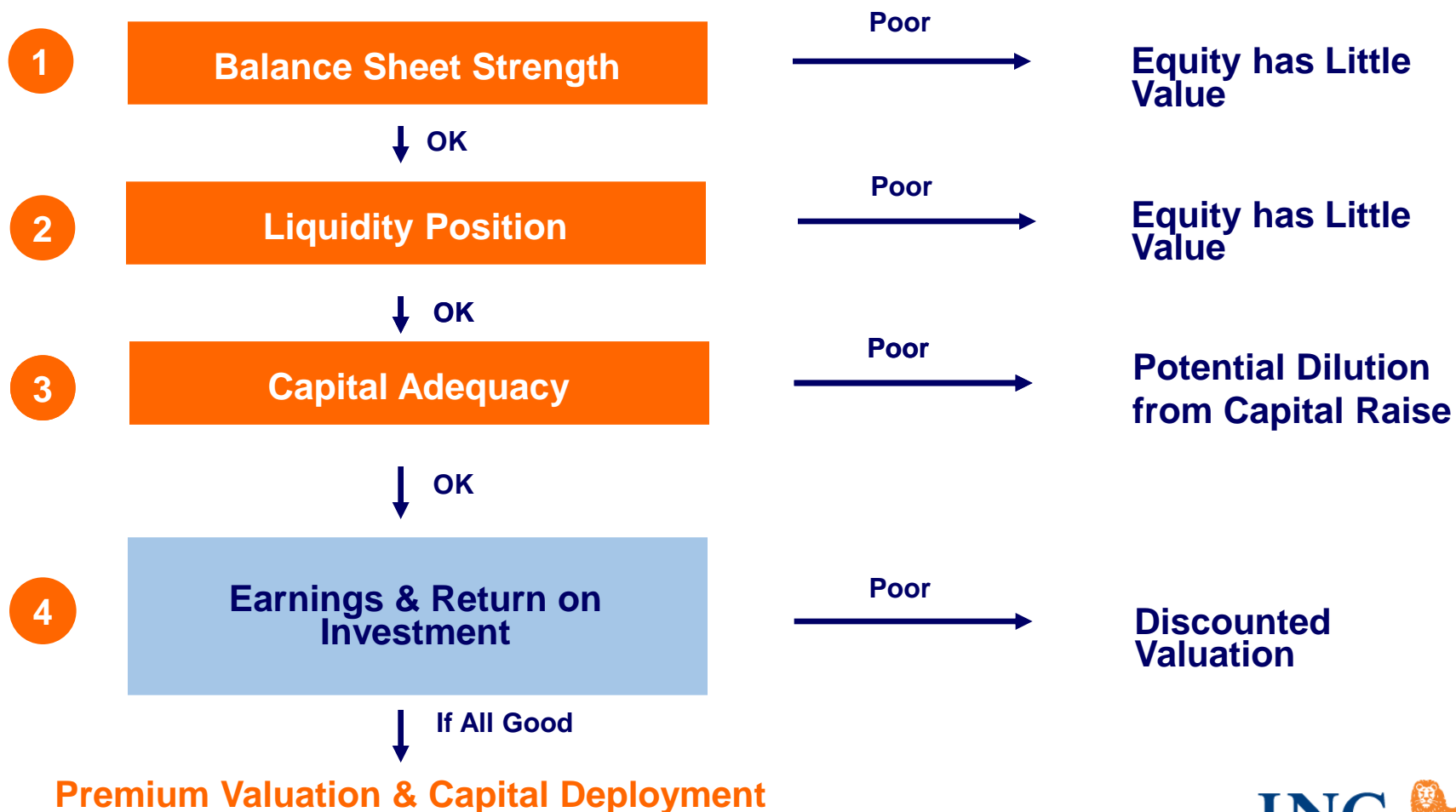
November 15, 2012

Agenda

- About me
- The Role of the CFO
- Principles underlying risk and return
- Case Study and Market Behaviors
- Guiding metrics in driving success
- Q & A

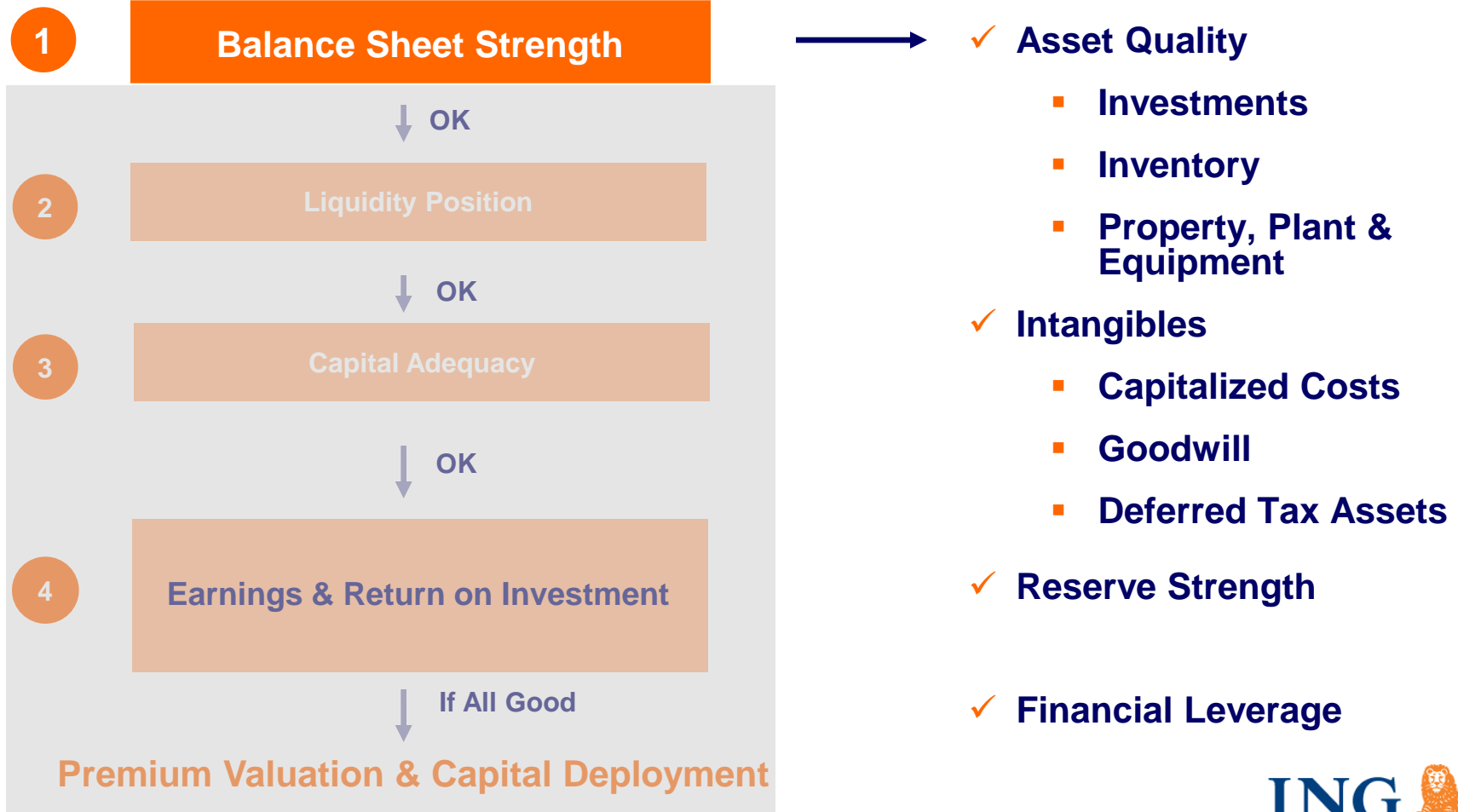
Role of the CFO – Maintain a Strong Base

Investor Valuation Decision Tree



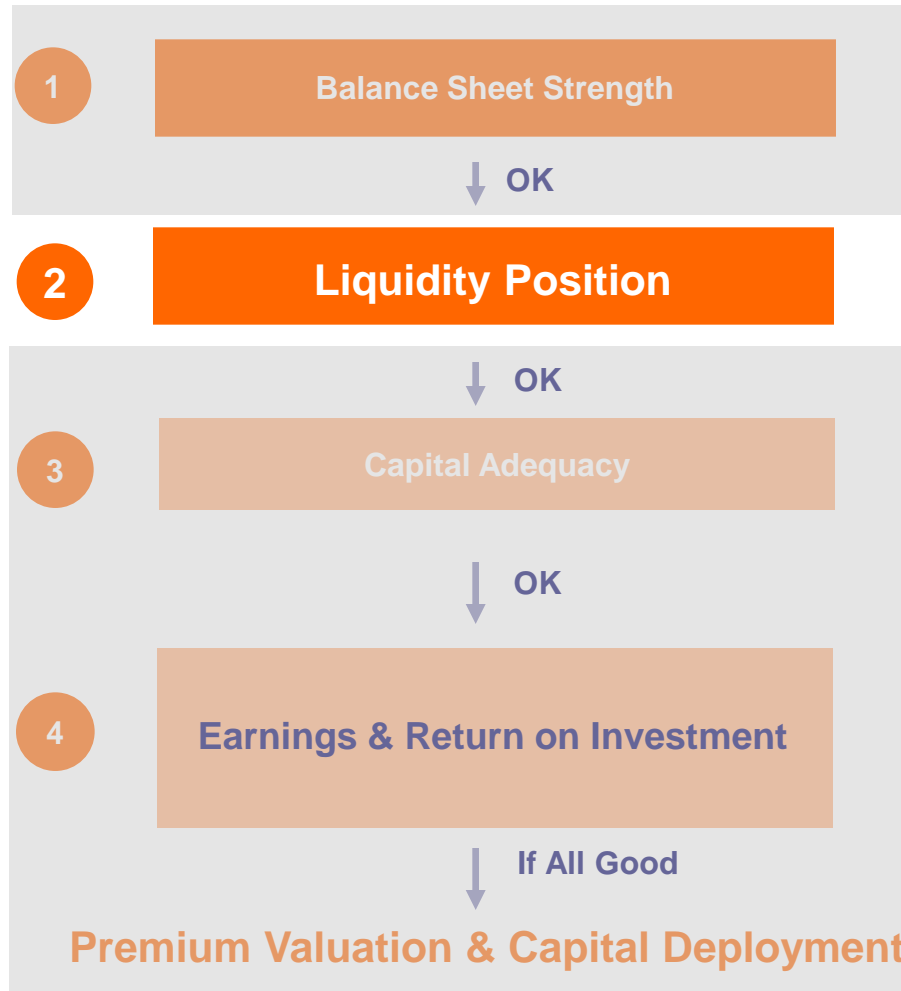
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Investor Valuation Decision Tree



- ✓ **Holding Company Flexibility**
- Working Capital
 - Interest/Dividend Coverage
 - Debt Maturities
 - Lines of Credit
- ✓ **Subsidiary Flexibility**

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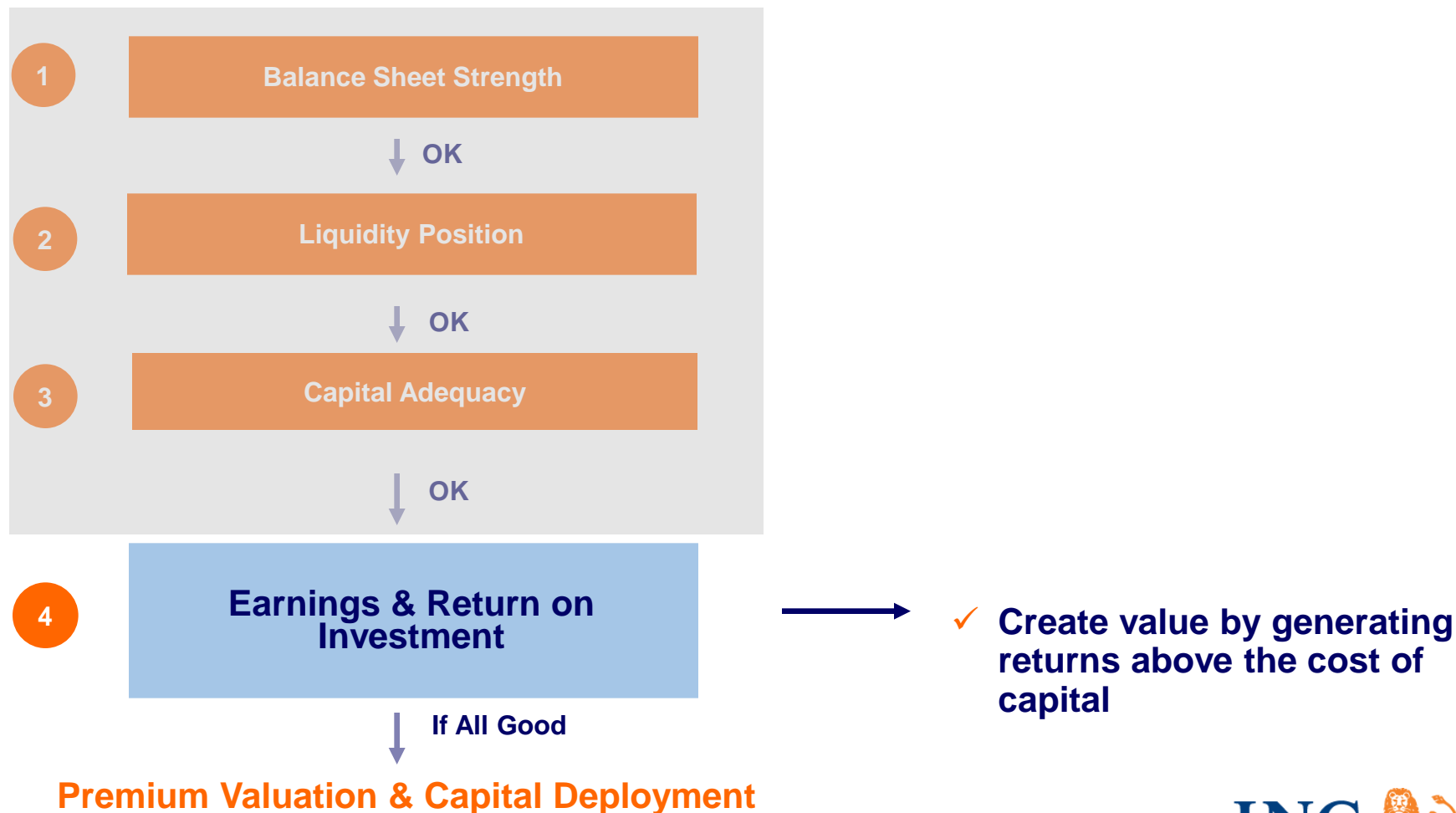


- ✓ **Capital Ratios**
 - Risk Based Capital (Insurance)
 - Tier-1 Capital (Banks)
- ✓ **Operating Leverage**



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Guiding Principles / Questions in Balancing Risk-Return Tradeoffs

Fairness

- ❑ Design, develop, and sell our products with the explicit mission of:
Obligations to shareholders or customers or regulators

Market neutral

- ❑ Develop products, take hedging positions, or make decisions that are / are not based on individual market views?

Price discipline

- ❑ Exit a market when conditions become irrational?
- ❑ Willingness to lose market share?

Measured risk

- ❑ Expand risk appetite to achieve financial targets?
- ❑ Evaluate risk at the product or enterprise level or both?

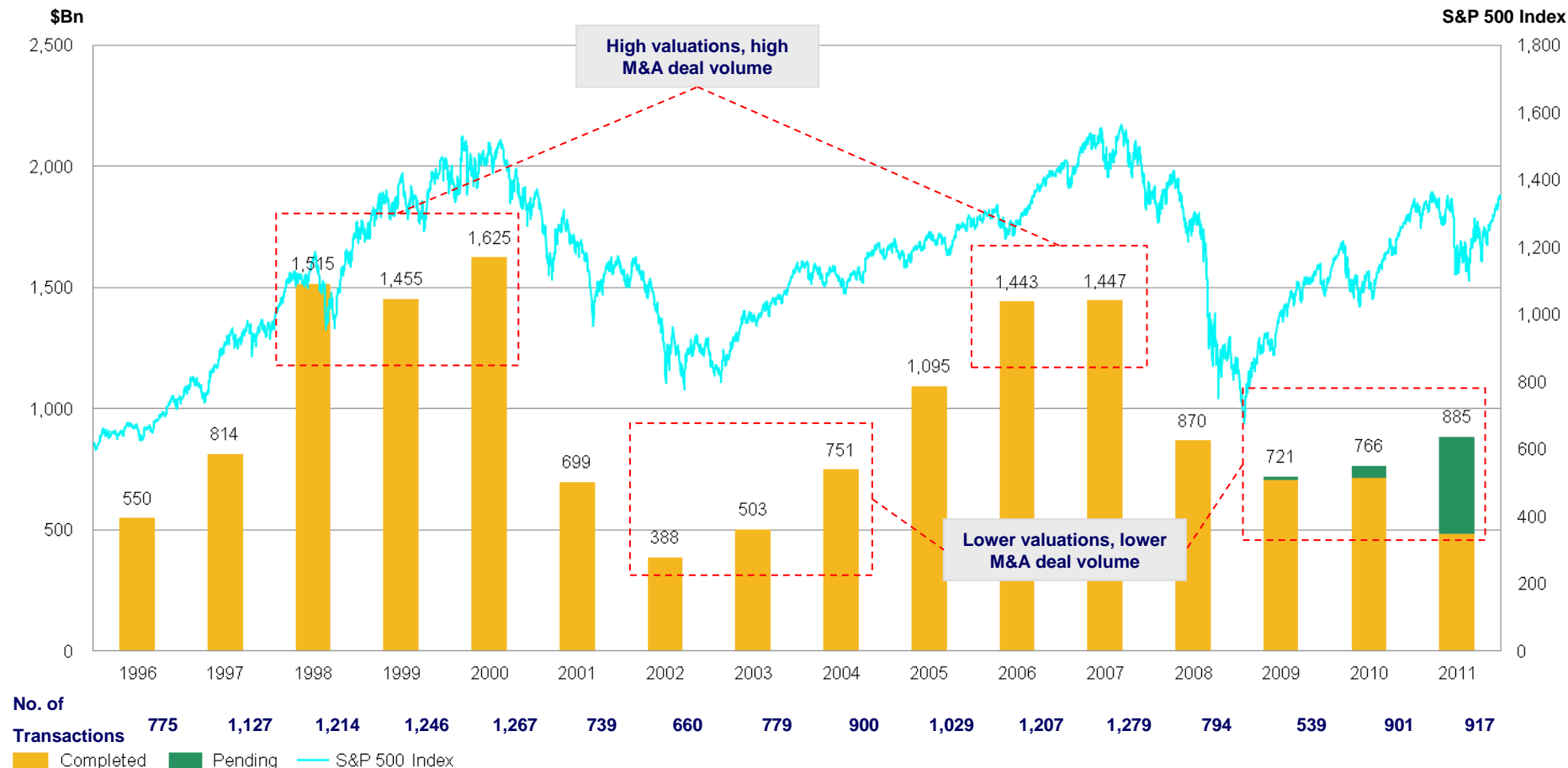
Long-term view

- ❑ Manage from a short-term or long-term perspective?
- ❑ Value of stability / predictability in results?



Observed Behavior – Acquisitions

M&A Volume vs. S&P 500 Index



Notes:

Source : Morgan Stanley, Thomson Reuters, Capital IQ

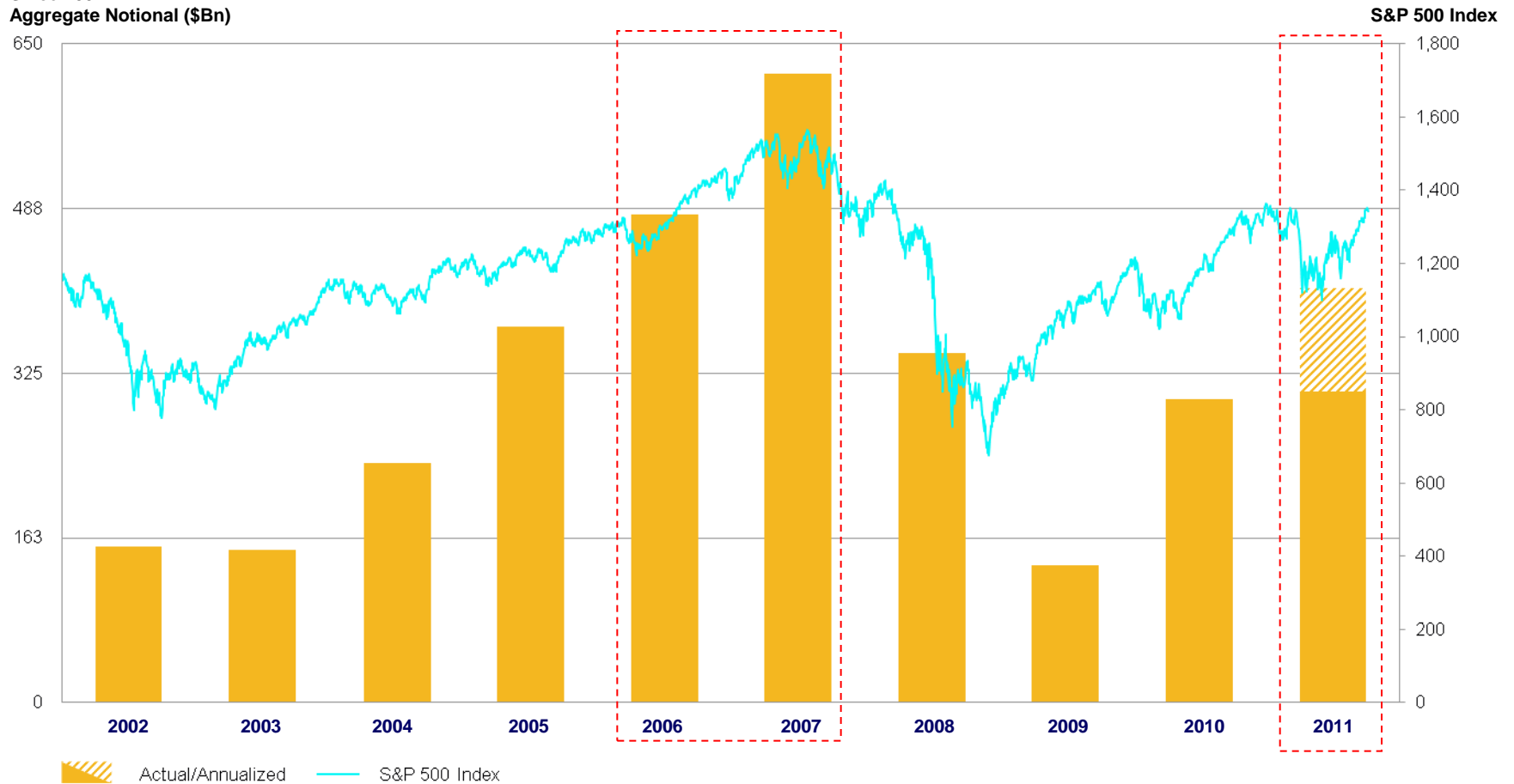
- Includes announced transactions, each with an aggregate value of \$100MM or more. Includes transactions with estimated values. Excludes terminated transactions. Future terminations of pending transactions will reduce totals shown
- Includes transactions announced as of 31 December 2011



Observed Behavior – Share Repurchases

Share Repurchase Activity vs. S&P 500 Index

Since 2002
Aggregate Notional (\$Bn)



Source: Morgan Stanley, CapitalIQ, Yahoo Finance



What sets “10X” firms apart?



10X Case	Performance relative to industry since IPO*	Performance relative to market since IPO*
ALL VALUES THROUGH 2002.		
Amgen	77.2X	24.0X
Biomet	11.2X	18.1X
Intel	46.3X	20.7X
Microsoft	118.8X	56.0X
Progressive Insurance	11.3X	14.6X
Southwest Airlines	550.4X	63.4X
AVERAGE	135.9X	32.8X

*Returns benchmarked against aggregate industry and market indices constructed using historical data from the Center for Research in Security Prices (CRSP) at U. Chicago - Booth.

Source: CRSP, *Great by Choice* (Collins and Hansen, New York: Harper Collins, 2011).



10X firms: Resilient despite macro headwinds

- ❑ Progressive has consistently outperformed the SNL U.S. Insurance Industry Index
- ❑ Since the start of the most recent recession, Progressive is up +21% versus -30% for the industry index



Source: SNL



Amundsen vs. Scott (*Great by Choice*)

Roald Amundsen

(First explorer to reach South Pole)



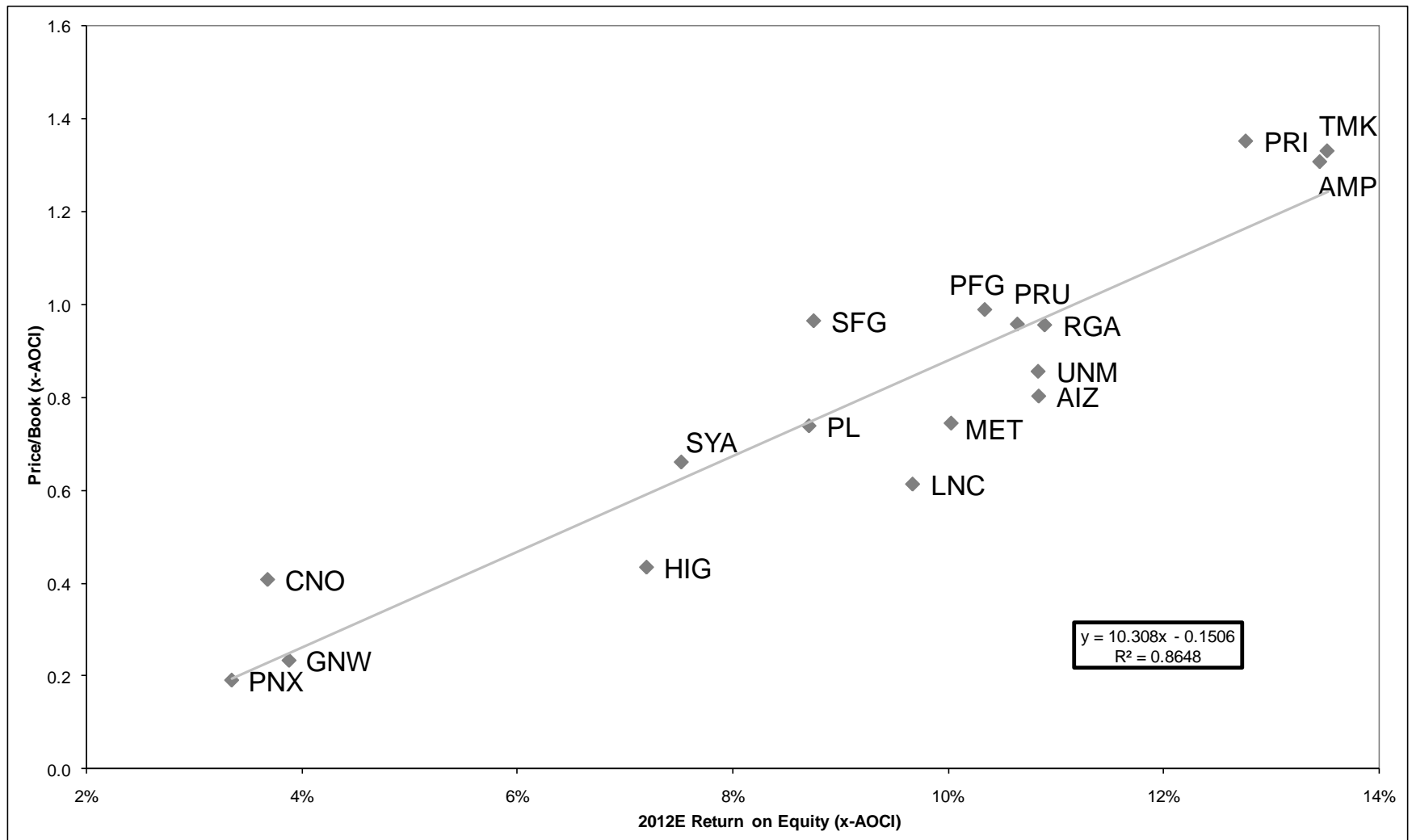
Robert Falcon Scott

(Perished in the attempt)



- ❑ Productive paranoia
- ❑ Fanatic discipline
- ❑ Empirical creativity

Improvements in ROE Are Critical For Valuation



Prices as of 04/26/2012



Free Cash Flow is Key

Free cash flow (FCF) “represents the cash that a company is able to generate after laying out the money required to maintain or expand its asset base”*.

Distributable earnings are a key driver of FCF, which ultimately impacts how much room we have to pursue opportunities which enhance shareholder value, such as:

- ❑ Investment in organic growth / capital investments
- ❑ M&A
- ❑ Return of capital to shareholders

Think about this in the context of what actions firms take in different market environments.

*Source: *Valuation* (Copeland, Koller and Murrin, New York: John Wiley & Sons, Inc., 1995), Investopedia.com

Conclusion

- I. Strong Balance Sheet
- II. Ingrained Guiding Principles
 - A. Productive Paranoia
 - B. Fanatic Discipline
 - C. Empirical Creativity
- III. Tools to Evaluate Success
 - A. (Risk Adjusted) ROE Expansion
 - B. Free Capital Generation
 - C. Profitable Sales



Questions?

