MS&AD Holdings Conference Call (held on August 24, 2017)

Acquisition of First Capital Insurance, Singapore's Commercial Property and Casualty Insurer
Global Partnership Between Mitsui Sumitomo Insurance and Fairfax

Summary of Questions and Answers

The following summarizes the questions and answers exchanged during the IR conference call held on August 24, 2017.

The company names are abbreviated as follows:

MSIG Singapore: MSIG Insurance (Singapore) Pte. Ltd.

First Capital Insurance: First Capital Insurance Limited

Fairfax: Fairfax Financial Holdings Limited

Q1 : What is the average profit level of First Capital Insurance? Page 11 of the materials mentions 7.0 billion yen after being multiplied by an equity interest of 97.7%. This is the profit in FY2016, but when looking at the annual report, it seems that while the combined ratio was considerably lower than usual in FY2016, the portion of company expenses included in this was a little larger than normal. Can you please explain this, including your view on how stable First Capital Insurance's expense ratio and loss ratio are?

A1 : We believe that First Capital Insurance will be able to continue to ensure stable profit. As the top line will grow in response to various synergies resulting from First Capital Insurance's entry into the MS&AD Insurance Group, we believe that the level of profit will expand accordingly. Regarding your question about expenses, although they certainly increased compared to the previous fiscal year in FY2016, we hear that this was because the allocation of expenses was revised within the Fairfax group. These expenses increased in FY2016 due to this factor, but after First Capital Insurance joins the MS&AD Insurance Group, the style of business management will change so the payment burden in terms of business management in this area will also change according to the management style going forward. More specifically, as we believe that these expenses will decline, we are confident that the profitability and earning power of First Capital Insurance itself will continue to grow in accordance with the past trend.

Q2 : Regarding the state of revenues and expenditures, an item that appeared to be management fees increased substantially in the previous fiscal year, but this seems to be a management guidance fee paid to Fairfax, so is it correct to assume that this portion will decrease?

Furthermore, as the loss ratio has shown a broad range from a level of just over 70% to more than

80% in the past, I would also like to know what you see as the average loss ratio.

A2 : In regard to the first point of management fees, your understanding is correct. As we will be responsible for business management going forward and will actually send officers and employees to First Capital Insurance, we expect these fees to decrease.

Regarding the second point of the loss ratio, First Capital Insurance's past loss ratio has steadily improved and declined. This is partly due to a change in the portfolio structure. Owing to changes in the portfolio structure including lines with high retention ratios and those with low retention ratios, the loss ratio has fallen in the past several years. If we conduct portfolio management based on the present style, the loss ratio should continue to decline.

However, the company has had a business structure with a high ratio of reinsurance ceded so far, and as we will decide what to do about this after carefully examining the portfolio, I trust you can understand that it is difficult to estimate the average level.

Q3 : First, regarding the ratio of reinsurance ceded, although it is very high as you have just said, Fairfax appears to be a company without a large amount of capital. Therefore, I presume that profit will increase if you reduce reinsurance ceded more once First Capital Insurance is part of the MS&AD Insurance Group. Is it reasonable to expect such an effect?

My second point concerns management fees. These amounted to SGD 250,000 in FY2015 and then increased to SGD 8,136,000 in FY2016. I think how fast and how much these management fees will decline is a key factor, so could you explain in a little more detail?

A3 : First, regarding the first point, you pointed out the fact that we could probably act as the primary insurer to a somewhat greater degree. As the portfolio has originally shown a good performance, we believe it has potential for growth in earnings if we retain a little higher percentage of policies as the primary insurer, which is our usual business practice. However, as we also accept facultative reinsurance from the offices of our other local subsidiaries, one factor here is that we will have to look at the accumulation of risk. Then, as to the point of whether increasing our retention is good or not from the perspective of management soundness in light of the current capital adequacy of First Capital Insurance, our view is that we should increase our retention and reduce reinsurance ceded on an overall basis. However, our current policy is that we intend to decide this after carefully examining the contents of the portfolio.

As for your second point regarding management fees, although we will specifically work out from here on our state of business management after the integration of First Capital Insurance, we roughly estimate that these fees will be reduced by approximately half from the level of 2016.

Q4 : Could you elaborate on the synergies with MSIG Singapore, which are mentioned on page 7? You say that MSIG Singapore has strength in Japanese corporates and retail while First Capital Insurance has strength in local corporates, so there is a complementary relationship in terms of customers. I would therefore like to know what kind of synergies can be expected in the case of cross-selling.

A4 : As there is a complementary relationship, there will also be so-called cross-selling based on our respective strengths. For example, we will apply the expertise regarding large local corporates that First Capital Insurance possesses to our existing customers. Furthermore, there is a major reason why First Capital Insurance chose to join the MS&AD Insurance Group in the first place. To grow further, it is essential for the company to expand its portfolio in the individual and retail business domains since it has grown steadily in the corporate business domain so far. In this regard, the question here is how to leverage the strength that First Capital Insurance itself has by using the ASEAN network that we have developed. Specifically, the answer lies in digital technology, and First Capital Insurance is already actually expanding earnings by using digital technology in India. By applying this to our ASEAN network, we aim to expand income in the retail business domain together. In other words, by making use of this mutually complementary relationship, we expect to create a portfolio that did not previously exist and generate profit from it.

Q5 : Does this mean MSIG Singapore is also involved in the retail business and its business activities are complementary so it won't be possible to generate some kind of cost synergies?

A5 : Business integration, for example, with MSIG Singapore could be a theme going forward but we will continue management in the present form for the time being. We are considering synergies including integration or including back office integration as a future theme, and we have not factored in the cost synergies you mentioned at the present time.

SQ : As you will integrate back offices in the future, there should be some kind of effect, shouldn't there?

SA : If we actually end up integrating them in the future, we believe that cost synergies will of course be generated.

Q6 : I would like to hear more about the criteria for investment and the timing. I believe that this acquisition is likely to boost Group Core Profit whatever the acquisition price is, and you explained that the price is equivalent to a PBR of 3.3x. When you make acquisitions, do you establish some kind of quantitative criteria? If so, I would like to know what they are. Also, could you explain why you ended up making this acquisition at this time?

A6 : First, in regard to the criteria for investment, we naturally calculate the effects of business investment based on future estimates. A PBR of 3.3x certainly seems high, and although it is slightly higher than the average in light of past cases of M&A in Asia, we do not see it as particularly high. In the first place, we have not factored in various synergies that will arise from the acquisition of First Capital Insurance, and so we have determined this valuation at the stage before factoring these in. Therefore, we expect to see synergies that emerge directly from the integration with First Capital Insurance and also various global cooperative synergies with Fairfax as a group. In that sense, when looking at the so-called upside potential based on strengthening our foundation in Asia through this investment, we decided that it was adequate for investment.

Regarding the timing, we had been constantly watching various business investment opportunities for some time, and we had been looking at these not only in Asia but all over the world. Meanwhile, we happened to hear about this opportunity from the other party, and we were originally considering them as one of the candidates for M&A but we reached this outcome by chance.

Q7： I would like to ask questions about two points. First, I would like to know what your outlook is for the non-life insurance market in Singapore. More specifically, is there a possibility of growth and softening in terms of the loss ratio?

My second point overlaps the previous question, but I think that a PBR level of 3.3x seems somewhat high. This relates to the first question, but please confirm if your view is the following; a PBR of 3.3x seems somewhat unjustifiable after taking into account such factors as the potential growth of this company, which is a leading player in Singapore, however, such a PBR is justified if you factor in upside potential including business synergies at a level of reasonable probability. If we include the fact that this acquisition eventuated when the other party started talking to MS&AD, could you provide a more detailed explanation regarding the rationality of the acquisition price?

A7： First, regarding the outlook for the Singapore non-life insurance market, we continue to project stable growth. First Capital Insurance, in particular, has shown high growth in terms of profit averaging more than 10% during the past ten years, but we have a somewhat conservative view in the sense that we expect a slight slowdown going forward. We are projecting an average growth rate of roughly 8% for the next ten years.

I cannot say anything about the possibility of softening, but the prevailing view is that this Asian market is a comparatively soft non-life insurance market by nature, so it is unlikely to decline substantially. Another factor here is that First Capital Insurance has a corporate culture that emphasizes long-term and stable relationships with customers. In addition, another strength is the fact that the company does not have the kind of portfolio that would be dragged along directly by a softening of the overall market. This is partly because the company has direct transactions with customers. As this also supports the fact that in the past the company steadily recorded good results in the Singapore market, where competition is said to be comparatively fierce, First Capital Insurance's strengths should continue from this perspective. Therefore, we do not expect the company to be influenced much by any softening.

As to the second point of how we view the PBR of 3.3x, as you mentioned, the fact is that we are looking at various factors as potential developments that cannot be factored into the numbers on hand at present. In regard to the expansion of various portfolios with First Capital Insurance, one is the potential to apply First Capital Insurance’s digital technology to our customer base and to use our base to expand the retail business domain. In addition, we will consider from here on various forms of collaboration with the Fairfax group not only in Singapore but all over the world. Consequently, as we are convinced that there could be fairly wide-ranging potential synergies that cannot be quantified at present, we think that this valuation of 3.3x is reasonable.

Q8 : Regarding the global partnership with Fairfax, could you provide slightly more specific examples of what you are considering? I could not understand the content in the presentation of Fairfax as well. Could you be more specific about this?

A8 : In regard to what initiatives we will undertake and how we will carry them out together with the Fairfax group, we are at the stage where we intend to engage in specific discussions from here on and enter into partnership agreements as a result. Therefore, I am sorry I cannot present any specific initiatives at the current stage.

Both we and the Fairfax group have various large and small offices in various countries. In some places we have strength in retail business while Fairfax is involved only in the corporate business domain, so this is highly significant in terms of a complementary relationship, and we are likely to be able to do various things in various countries and regions. Since we are both insurance companies, we can share the fruits of exchanging reinsurance as a result of working together. Therefore, from that point of view, we are at the stage of investigating ways to increase enterprise value together at both companies.

Q9 : Which party initiated talks about a business partnership? In addition, you said that various kinds of business alliances would be possible. Fairfax has grown by investing and making acquisitions very extensively here and there, but as it has expanded so much while having no leeway in terms of capital, was it attracted to MS&AD because it wished to gain access to your company's capital?

A9 : First of all, to answer your first question, in regard to the course of considering a business partnership so far, a business alliance was a matter that naturally emerged in repeated talks, beginning with the acquisition of First Capital Insurance. It was not necessarily just a request from Fairfax. We will acquire First Capital Insurance, but the Fairfax group will continue to underwrite a certain percentage of First Capital Insurance's portfolio in the form of reinsurance after the acquisition as well. In this way, the Fairfax group also has a strong intention to play a part in the growth of First Capital Insurance, which will join the Mitsui Sumitomo Insurance Group. This became one starting point for the partnership, and we thought there were also various other things we could do together, so it was an idea that naturally emerged.

We understand that the Fairfax group itself certainly does not have a very large capital surplus. However, the parties that we will promote specific alliances with going forward will probably be Fairfax’s insurance subsidiaries that are developing businesses in various countries and regions, and we believe that individual insurance companies naturally have sufficient capital adequacy in light of regulations or ratings in each country. Therefore, Fairfax is not actually relying on the capital of the MS&AD Insurance Group and we will not actually acquire the entire Fairfax group, so I think that Fairfax is not leaning on us for support.

Q10 : I would like to know more about the reinsurance scheme with First Capital Insurance. As the loss ratio is 70-80% and the combined ratio is at the 60-70% level, I believe that the receipt of reinsurance commissions has lowered the overall combined ratio. In relation to reinsurance transactions with Fairfax, could you briefly explain to the extent possible whether or not the profit structure in this area may change since ownership will change going forward? I also have another question. As part of the series of conversations today, in regard to the global partnership with Fairfax, it was stated that the First Capital Insurance acquisition price took into account the benefits of certain future collaboration. However, in promoting the global partnership and tie-ups going forward, is there a possibility of an additional capital commitment with Fairfax or not? Could you comment on this to the extent possible?

A10 : First, in regard to the first point of reinsurance ceded commissions, as you understand, First Capital Insurance is involved in a great deal of reinsurance, so there is a structure where reinsurance commissions earned end up improving the combined ratio. As I mentioned earlier, the Fairfax group has said that they would like to underwrite some policies with reinsurance, as it does at present, even after we have acquired First Capital Insurance. As existing reinsurance has produced steady results that can be sustained, we could continue to cede reinsurance in the current form if we wish to. However, as I also mentioned previously, if we intend to hold policies as the primary insurer as a result of a review of the portfolio, the source of profit could naturally change from income based on reinsurance commissions to income based on holding policies as the primary insurer, and so we believe that holding policies in this way will probably increase.

Regarding the second question about expansion going forward, this is something that we will certainly investigate from here on. However, although there may be a capital commitment in the sense of doing something together locally when we do something together in various countries or regions, we are not currently considering something such as capital participation in the entire Fairfax group.

Q11 : I would like to know about the impact on ESR. To what extent will the ESR, which was 203% at the end of June 2017, decline due to this acquisition? Do you have any estimated value in this regard?

A11 : Although we have not made any detailed calculation regarding the impact on ESR, our current rough estimate is that it will decline by around five points. Therefore, I can simply say that compared to 203%, it will be about 198%. We will report on this in more detail at a later date.

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