M&A in Non-Life Insurance:
Steps and factors to be considered in selling a non-life insurer

May 2007

Michael Knoll, Head M&A Lead Advisory / Corporate Finance
Maria Y. Bogomolova, Senior Manager, Financial Services practice

Degree of concentration in the Russian insurance market

The Russian insurance market consists of – despite the ongoing disappearance of insurers due to more regulatory rigor as well as slightly increased M&A activity over the last 12 months – still over 900 insurers.

Table 1: Recent M&A activity in the insurance industry

in USD mn

№	Target Name	Completion Date	Acquirer Name	Stake acquired	Deal value	Price for 100% of equity (1)	Gross written premium* (2)	(1)/(2)
1	Progress-Garant	May 2007	Allianz (Germany)	100,0%	300,0	300,0	150,2	2,00
2	RESO-Garantia	May 2007	EBRD	10,0%	150,0	1500,0	833,5	1,80
3	Moskva Re	March 2007	ZAO Insurance Group (Russia)	100,0%	40,0	40,0	37,0	1,08
4	Standart Rezerv / Solidarnost' dlya zhizni	March 2007	Wiener Staedtische (Austria)	15,0%	25,0	166,7	186,4	0,89
5	ROSNO	February 2007	Allianz (Germany)	49,2%	750,0	1524,4	740,5	2,06
6	NASTA(1)	February 2007	ZFS Group (Switzerland)	66,0%	n/a	n/a	241,9	n/a
7	Russia Re	October 2006	ACE Group	15,0%	13,0	86,7	24,5	3,54
8	Regiongarant	June 2006	Surguteks (Russia)	93,9%	24,0	25,6	7,7	3,32
9	Medekspress	June 2006	ROSNO (Russia)	51,0%	6,6	12,9	19,3	0,67
10	Chrezvychainaya Strakhovaya Kompania	February 2006	Ingosstrakh (Russia)	71,5%	10	14,0	18,8	0,75
11	Standart Rezerv	February 2006	Bank of Moscow (Russia)	51,0%	61,2	120,0	145,1	0,83

(1) Zurich Financial Services Group has a as call-option to increase its share in NASTA up to 100% by 2010.

* Not inclusive of premiums for obligatory medical insurance

However, given the tremendous growth of the large and larger Russian insurance companies in recent years, the market is already fairly concentrated, which is reflected by the fact that the 10 largest insurers account for almost 50% of total written premiums.

Table 2: Top 10 non-life insurers in Russia in 2006

№	Company name	Written premiums excl. life and compulsory medical insurance $ m	Market share*
1	Rosgostrakh	1,574.0	11.0%
2	Ingostrakh	1,121.6	7.8%
3	SOGAZ	850.5	5.9%
4	Reso-garantiya	818.8	5.7%
5	Rosno	701.2	4.9%
6	VSK	457.3	3.2%
7	Soglasie	399.0	2.8%
8	Alfa-strahovanie	321.9	2.3%
9	Maks	296.0	2.1%
10	Uralsib	281.6	2.0%
	TOTAL	6,821.8	47.7%

*Share in written premiums of top 500 insurers excluding life and compulsory medical insurance

Source: RBC Rating, PwC Analysis

Given the fact that most insurers have insignificant market shares and that the large players drive market developments, size becomes more of an issue going forward. As a result, many owners will be faced with the question as to how to secure the long-term prospects of their insurance business. Similarly, the Russian insurance regulator has an interest in making sure that the Russian insurance industry gains strength. Moreover, the Russian business community will move – over time – away from pursuing various business interests simultaneously (‘conglomerate approach’) to holding on to businesses where they have strong competitive advantages (‘core competencies approach’). Accordingly and as a result of these three driving forces (subcritical size, increased regulatory pressures and a focus on core competencies), it is expected that the Russian insurance industry will see much more M&A activity over the next few years. If disposals, acquisitions or mergers are considered, however, it is advisable to go about it in structured way. This article describes how a professionally managed sales process is structured and which factors need to be emphasised.

Sales methods and steps in a controlled private auction

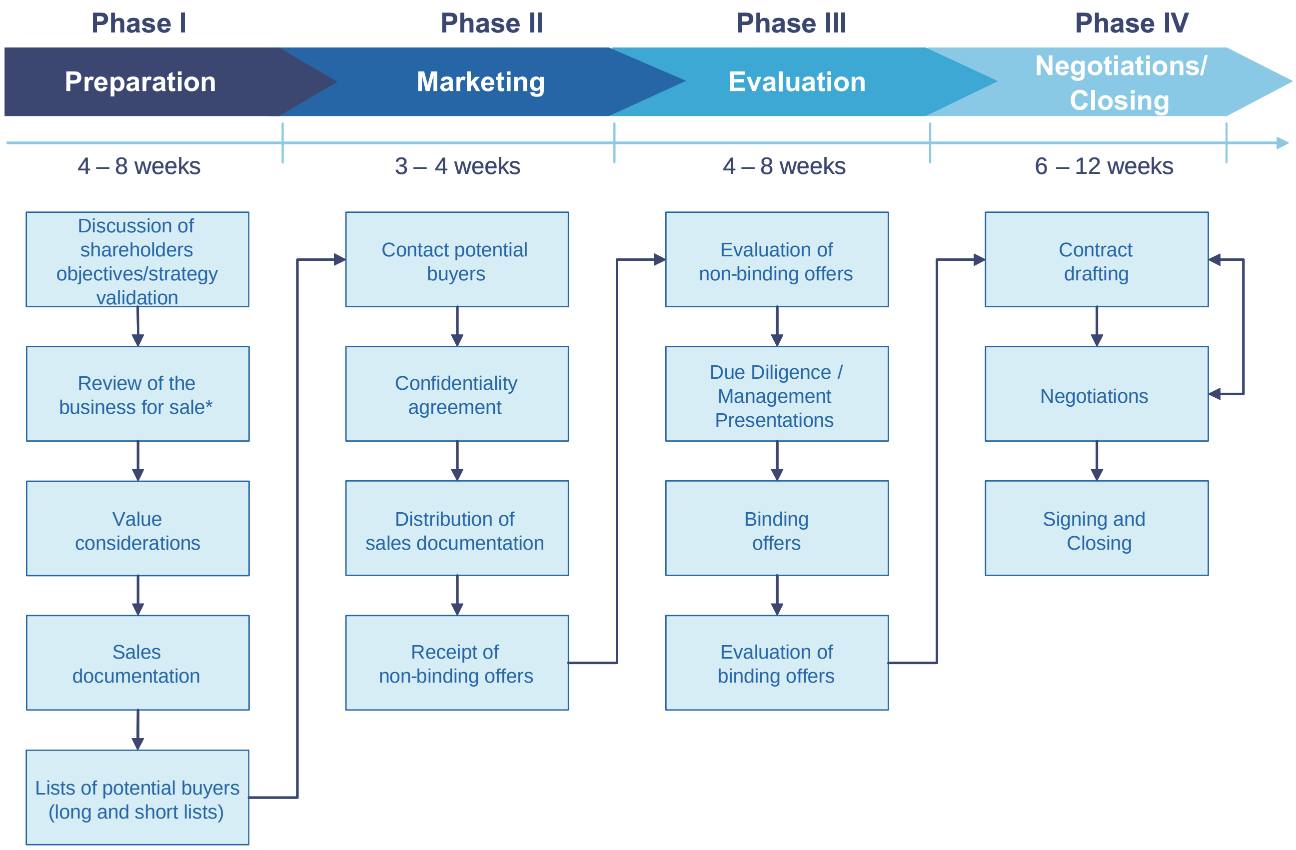
The first question to answer is related to the choice of the appropriate sales method for the envisioned disposal. One can choose from the following three methods:

Figure 1: Sales methods

	Bilateral Negotiations	Private Auction	Public Auction
Advantage(s)	Confidentiality	Price maximization Stewardship over the process	Pricemaximization Transparency
Disadvantage(s)	No competition (lack of alternative buyers)	Confidentiality less guaranteed	Less control over the process Auction known to the public (not confidential)

Bilateral negotiations are chosen if other elements than price maximization are of greater importance. Bilateral negotiations are simpler to deal with from a process point of view and ensure generally the highest level of confidentiality. As for the controlled private auction, this sales method is well structured and involves a small number of interested buyers. The controlled private auction allows creating a competitive environment among buyers and promises the seller the highest sales proceeds. Similarly to the controlled private auction, the public auction is a well structures sales method. The principal disadvantage of a public auction as compared to a private one is the risk of unexpected developments (for instance, appearance of an "unwanted" buyer). Real life experience shows that sellers generally opt for the controlled private auction, which can be divided into four phases:

Figure 2: Phases of the sales process



** depending on the outcome, adjustments might be needed to prepare the business for sale*

A good preparation is the foundation for success

The first thing to deal with during the preparation phase is to define with the owner why the insurance company/the insurance portfolio is to be sold and which objectives are to be achieved with the envisioned disposal. In addition, the financial advisor needs to get a good understanding of the business for sale and has to assess the likelihood of success given prevailing market conditions. Another important aspect is to come up with a realistic valuation range. Together with an actuary the financial advisor will in particular have a close look at the insurer's investment portfolio and the technical reserves. The drafting of a "long list" (a list of potential buyers) requires a very good market understanding, both in terms of potential Russian and foreign buyers. Once the long list is ready, it is discussed with the owner to arrive at a short list, which contains those potential buyers that will be contacted in the second phase of the sales process. Another important element of the preparation phase is to define the transaction structure from a financial, tax and legal point of view (in particular 'what is for sale' and whether the deal should be structured as a 'share' or 'asset deal').

Non-binding offers need to meet certain criteria to receive good quality offers and make them comparable

The marketing phase entails contacting potential buyers as per the approved short list. By describing – on an anonymous basis – the key characteristics of the business/portfolio for sale, interest of short listed buyers is verified. In case a potential buyer confirms its interest, the 'blind profile' or 'teaser' (a brief description of the investment opportunity on an anonymous basis) together with the confidentiality agreement is despatched. Upon receipt of the signed confidentiality agreement, the Information Memorandum (a detailed description of the investment opportunity) and the procedure letter are sent out. The procedure letter provides information on what is for sale (e.g. sale of 100% of shares or sale of the portfolio) and specifies which questions need to be answered in the indicative offer (non-binding offer). Generally, interested parties must provide answers to the following questions: strategic intent (why are they interested?), integration plans (how will the acquired business be integrated?), received/needed approvals for the transaction (e.g. board and/or regulatory approval), financing means/needs, due diligence requirements, etc. The procedure letter also sets the deadline for submitting the indicative offer. Following the receipt of indicative offers, offers will be evaluated and the best suited potential buyers recommended to the seller(s). The owner(s) must then decide which of the potential buyers should be admitted to the next phase.

A well prepared due diligence secures an efficient process and increases the chances of successfully selling the business

Once the decision is taken with whom to move to the next phase, all parties are informed about the outcome and those who were admitted to due diligence receive detailed instructions about the due diligence content, time available, etc. In addition, a second procedure letter outlines the requirements for the final (binding) offer and states the deadline for submitting the offer. Potential buyers will have two to three weeks to conduct due diligence on the business for sale. Admitted potential buyers will also have an opportunity to attend a management presentation. The management presentation has two purposes: on the one hand, buyers will be in a position to receive the latest available information on the business' performance, on the other hand, it will allow them to get to know and get a feel for the quality of the management team.

Following the due diligence and the management presentation, interested parties should be in a position to submit a binding offer. The financial advisor of the seller(s) will then again review the quality of the offers and recommend to the owners with whom to move to the last stage, i.e. the negotiation phase.

Negotiations should not just focus on price

During the negotiation phase and depending on the situation, the seller(s) might have to grant exclusivity to one of the potential buyers for a limited period of time. Apart from price, seller and buyer will typically negotiate the following points: payment mechanism (which part of the agreed upon price is paid at closing of the transaction and which part is deferred), risk-sharing arrangements (e.g. in regards to risks which might materialise following the closing of the transaction, but which were taken on under the former owners), and representations and warranties (who e.g. will step in if legal claims arise following a transaction, but which were 'assumed' years ago). If the deal is 'negotiated' in all details and the contract is ready (be it a share purchase or an asset agreement), it is signed. Finally, once regulatory approval has been received, the transaction can be 'closed'.

As described, conducting deals on the basis of a controlled private auction requires discipline and it takes time. However, the advantages of this sales method outweigh the investment by far. Going through a controlled private auction process will not only increase the chances of successfully selling the business, but it will result in a better price and it is likely to make sure that the long-term future of the company is secured.