Brokerage Research Digest

May 2, 2013

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American International Group, Inc. (AIG – NYSE) $42.13

Note: FLASH REPORT; more details to come; changes are highlighted. Except where noted, and highlighted, no other sections of this report have been updated.

Reason for Report: Flash Update: 1Q13 Earnings Results

Previous Ed.: Flash Update: AIG Buys Back Warrants from Treasury, Mar 4, 2013.

Flash Update (earnings update to follow)

On **May 2, 2013**, American International Group (AIG) announced its **1Q13** financial results. EPS of $1.34 significantly beat the Zacks Consensus Estimate of $0.88. However, earnings fell from the year-ago quarter's $1.62 per share. Consequently, operating net income plunged to $1.98 billion from $3.05 billion in the year-ago quarter.

On a GAAP basis, including extraordinary items, AIG reported a quarterly net income of $2.21 billion or $1.49 per share as compared with $3.21 billion or $1.71 per share in the year-ago quarter. The year-ago results include pre-tax incomes from the fair value of the AIA Group Ltd. (AIA) and Maiden III totaling $3.05 billion.

Results reflected operating growth in the insurance businesses along with stronger underwriting results, lower expenses and higher profitability in Direct Investment Book (DIB). These factors also drove the book value per share and combined ratio, while also enhancing capital efficiency. However, higher interest expenses, lower investment income and lower return on equity (ROE) were the partial dampeners. Volatile equity markets, widening credit spreads and reduced interest rates were the other downsides.

Total revenue decreased 9.2% year over year to $15.89 billion, although it surpassed the Zacks Consensus Estimate of $12.55 billion. Meanwhile, total benefits, claims and expenses marginally increased 0.2% to $13.06 billion.

Segment Details

AIG Property Casualty (P&C) – conducted through Chartis and its sub-segments: Commercial & Consumer Insurance – reported an operating income of $1.6 billion, up 76.3% from $910 million in the year-ago quarter. The year-over-year upside primarily resulted from lower claims and acquisition expenses, which led to an underwriting income of $231 million against a loss of $180 million in the year-ago quarter. Moreover, investment income increased 11% to $1.36 billion.

However, net premiums written dipped 4.3% year over year to $8.4 billion on the back of unfavorable currency and the effect of recognizing ceded premiums written for excess of loss reinsurance agreements at the beginning of the contract rather than over the entire period of the contract. Excluding this factor, net premiums written increased 4% year over year during the reported quarter.

Both commercial and consumer insurance segments reported operating income on account of high value business mix as well as enhanced risk selection and pricing initiatives. Subsequently, combined ratio

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improved to 97.3% from 102.1% in the year-ago quarter.

Operating income at ***AIG Life and Retirement*** (conducted through SunAmerica) escalated 82.1% year over year to $1.57 billion based on higher premiums and policy fees as well as lower mortality costs and positive spreads. These were partially offset by lower net investment income, base yields and interest crediting rates. Additionally, AUM rose 12% year over year to $297 billion as of Mar 31, 2013.

Additionally, premiums, deposits and other considerations stood flat at $5.6 billion. A significant decline in fixed annuities amid the low rate environment was offset by improvement in variable annuities. Meanwhile, retail and institutional segments witnessed modest improvement.

The ***Other*** Operations reported operating loss of $152 million versus an income of $2.3 billion in the year-ago period. Within this, the Mortgage Guaranty – conducted through United Guaranty Corporation (UGC) – recorded an operating income of $41 million, higher than $8 million in the year-ago quarter, driven by increased mortgage originations as well as new and expanded distribution channels. Consequently, net premiums written rose 28.8% year over year to $246 million.

In addition, AIG's Direct Investment book (DIB), comprising the Matched Investment Program (MIP) and the non-derivative assets and liabilities of the previous AIG Financial Products Corp. (AIGFP) portfolios, recorded operating income of $329 million against a loss of $156 million in the year-ago period.

Global Capital Markets, consisting of AIG Markets Inc. and the remaining AIGFP derivatives portfolio, recorded an operating income of $227 million, significantly improving from $92 million in the year-ago quarter.

Meanwhile, the Aircraft Leasing business, conducted through ILFC, has been declared a discontinued operation following the decision to sell 90% of ILFC in Dec 2012, to a Chinese consortium. The deal awaits regulatory approvals and is scheduled to culminate by the second quarter of 2013.

Financial Update

At the end of Mar 2013, total investments stood at $369.7 billion, down from $375.8 billion at 2012-end. Total cash increased to $1.23 billion from $1.15 billion at 2012-end, while long-term debt reduced to $45.3 billion from $48.5 billion at 2012-end.

Shareholders' equity totaled $99.5 billion, up from $98.0 billion at the end of 2012, whereas total assets marginally increased to $548.9 billion from $548.6 billion at 2012-end.

At the end of Mar 2013, AIG's book value per common share, including accumulated other comprehensive income, escalated 16.9% year over year to $67.41. However, operating ROE reduced to 9.2% from 12.8% in the year-ago period.

MORE DETAILS WILL COME IN THE IMMINENT EDITIONS OF ZACKS RD REPORTS ON AIG.

Portfolio Manager Executive Summary [Note: Only highlighted material has been changed.]

American International Group Inc. (AIG) headquartered in New York, is the leading U.S.-based international insurance and financial services organization and among the largest writers of commercial, industrial, and life coverage in the U.S. It writes life and non-life coverage in 130 countries

and jurisdictions. The company also participates in a broad range of other financial services, including aircraft leasing, consumer finance, asset management and commodities and derivatives trading.

Almost 53% of the firms in the Digest group covering AIG had a positive outlook, while 47% had a neutral view on the stock. None of the firms rated the stock negatively. Of the 19 firms covering the stock, 13 provided target prices ranging from $33.00 (1.0% upside from the current price) to $45.00 (37.7% upside from the current price), the average being $39.12 (19.7% upside from current price).

Positive or equivalent outlook – 10/19 or 52.6%: The bullish firms believe that AIG will be able to achieve return on equity (ROE) of over 10% by 2015 by undertaking cost cutting initiatives, efficient management of capital, attaining high interest yield and executing its daily operations properly. These firms believe that even before the company starts working on these goals it should seek stability of operations. They opine that if the company makes proper deployment of cash, invests in areas that will earn good returns and pays regular quarterly dividend, then AIG's stock prices will improve. These firms believe that AIG's recent decision to sell the majority of ILFC and repay the total government bailout loan amount along with ample positive returns reflects prudent management and paves the way for future growth opportunities, given the declining government interference in the company.

These firms also opine that investors averse to taking risks should be interested in buying the shares of AIG because as the pricing improves across the industry, the company's earnings would follow the same pattern and witness a turnaround. Moreover, the company's business restructuring initiatives have also been lauded by these firms. They believe these initiatives will reap long term benefits for the company as by raising interest rates and going in for investments in underwriting tools will sufficiently reduce risks. Even though expenses are slated to rise over the next couple of years it will not have adverse effect on any of its operations. According to these firms, the progress made by the company will also help it initiate dividends in 2013, thereby retaining shareholders' confidence in the stock.

Neutral or equivalent outlook – 9/19 or 47.4%: The firms with a cautious stance believe that AIG has performed well in the quarters gone by and remains positive on its efficiency in doing away with government interference. They believe once the market starts recovering; the company can opt for the sale of assets, freeing up of capital and deploy the same in repurchasing its shares or initiate other programs to boost shareholders value. These firms are also skeptical about the performance of AIG's insurance businesses given the low rate environment, leading to instable ROE, which already trails lower than its peers. Even though the segments are expected to perform well, the overall performance level will be below that of its peers based on higher expenses and catastrophe losses. Further, despite the repayments of government bailout loans, risks of Federal oversight and other extreme regulations continue to hover upon the stock.

Overview [Note: Only highlighted material has been changed.]

Based in New York, American International Group, Inc. is the world's leading international insurance and financial services organization with operations in more than 130 countries and jurisdictions. American International Group member companies serve commercial, institutional, and individual customers through the most extensive worldwide property-casualty (P&C), and life insurance networks of any insurer. In addition, AIG companies are leading providers of life insurance and retirement services around the world. AIG common stock is listed on the New York Stock Exchange, as well as the stock exchanges in Ireland and Tokyo.

In 1Q12, the company had three reporting segments: Chartis, SunAmerica Financial Group (SunAmerica) and Aircraft Leasing. The company's website is www.aig.com

According to the brokerage firms, the following are the major issues to be considered while assessing the stock:

Key Positive Arguments	Key Negative Arguments
• American International Group has a diversified and unique leading franchise with a competitive advantage in both domestic and international markets. • With a chunk of bailout money being repaid, AIG will soon liberate itself from government interventions. Settlement of most of its litigations will now help the company to focus more on its core business. • Heavy restructuring and huge debt repayment have enabled AIG to access the debt and stock markets to raise funds when necessary. • AIG's strategic asset divestments have also relieved it of the redundant operations, while also aiding the company to focus on its core property-casualty and life insurance businesses. • The company will sell many of its assets relieving a substantial portion of blocked capital which can be deployed to repurchase shares or make payment of dividend to boost shareholders value.	• American International Group earns a significant portion of revenue from traditional P&C operations, in which earnings are susceptible to losses from catastrophes. • Persistent low interest rates, a flat yield curve, and increased competition across most products are likely to pressurize results of most life insurers over the next year. • Sale of Treasury's stake in AIG raises concern of fresh regulatory challenges and raises the risk of rating downgrades. • Amidst an uncertain environment, AIG may lose its talented management in the new operating model and capital structure.

NOTE: The company's fiscal references coincide with the calendar year.

Long-Term Growth [Note: Only highlighted material has been changed.]

The Zacks Digest long-term growth rate is currently pegged at 10.8%.

Management has cited a long-term goal that by the end of 2015 it would achieve mid-teens earnings growth along with an increase of over 10% in ROE. AIG also expects the combined ratio at Chartis to be within 90–95% by 2015, although the firms opine this to be an overambitious target. Gradual improvement in margins expansion and the deployment of excess capital and liquidity are likely to lead to an upside in returns.

Overall, the firms believe that AIG's core insurance business is relatively favorable and expect steady return on equity (ROE) and book value per share expansion along with above-average EPS growth over the next few years. However, the firms expect results of the non-core units to be mixed and also forecast AIG's overall ROE to remain significantly below that of its peer group for the near future. Nevertheless, AIG has several non-core assets, which could be monetized over time.

The bullish firms opine that the company is well poised for growth in the long-term and the turnaround of the Chartis segment will largely contribute to its growth story. AIG plans to reposition and restructure this line of business by increasing the prices and leveraging the investments in profitable ventures, which can eventually aid its earnings.

Meanwhile, the bullish firms believe that the company should generate significant excess capital over the next few years, aided by its sizable deferred tax assets. The proposed share repurchase program should further enhance shareholders' value and help them retain confidence in the stock over time. Most firms assume AIG to continue repurchasing shares in 2012 and forecast capital deployment to add roughly 100 bps to the ROE through 2015.

Target Price/Valuation [Note: Only highlighted material has been changed.]

Rating Distribution	
Positive	52.6%↓
Neutral	47.4%↑
Negative	0.0%
Avg. Target Price	$39.12↑
Digest High	$45.00
Digest Low	$33.00↑
No. of Analysts with Target Price/Total	13/19↑

Risks related to AIG include the Federal oversight and stress test, earnings volatility, unfavorable reserve development and changes in management level. Other risks include deteriorating Chartis underwriting profitability, catastrophe losses, rating agency or regulatory pressures along with credit and interest rate volatility.

Recent Events [Note: Only highlighted material has been changed.]

On **Mar 1, 2013**, American International Group announced that it wrote off the US government's stake in the company by repurchasing the final warrants from the US Treasury for $25 million. This makes the company independent insurer once again.

Although AIG had wound up the $182.3 billion government bailout loan in Dec last year, the Treasury still owned warrants that could help it possess about 2.7 million shares of the company at $50 per share and another set of 150 shares at $0.00002 per share, issued in 2008 and 2009, respectively. AIG bought both set of warrants for a total of $25 million.

Revenue [Note: Only highlighted material has been changed.]

Total revenue reported in 3Q12 surged 38.8% y/y to $17.65 billion, outperforming the Zacks Consensus Estimate of $12.29 billion. Increased policy fees, investment income, net realized gains, and other income drove growth.

Provided below is a summary of total and segment revenue as provided by the Zacks Research Digest:

In $ million	3Q11A	2Q12A	3Q12A	4Q12E	2011A	2012E	2013E	2014E
Chartis	$10,067.0	$9,973.0	$9,979.0	$9,817.4	$40,037.0	$39,695.7↑	$39,865.3↑	$41,193.5↑
SunAmerica	$3,544.0	$3,817.0	$3,863.0	$3,782.5	$15,308.7	$15,687.0↑	$15,661.0↓	$16,200.3↓
Aircraft Leasing	$1,126.3	$1,123.0	$1,145.0	$1,106.0	$4,467.4	$4,527.0↑	$4,621.7↑	$4,778.5↑
Realized Capital gains & (Losses)								
Digest Avg.	$12,716.0	$17,123.0	$17,648.0		$64,237.0	$66,806.0		
Digest High	$12,716.0	$17,123.0	$17,648.0		$64,237.0	$66,806.0		
Digest Low	$12,716.0	$17,123.0	$17,648.0		$64,237.0	$66,806.0		
YoY Growth		*2.7%*	*38.8%*			*4.0%*		
Q/Q Growth Rate	*-23.7%*	*-7.2%*	*3.1%*					
Zacks Consensus				$12,314.0		$50,129.0	$50,386.0	

Note: Blank cells denote brokers did not provide figures.

Revenue from Premiums

Chartis

AIG's property and casualty segment, Chartis, has substantially completed the reorganization of its businesses into two operating segments – Commercial Insurance and Consumer Insurance, supported by a global distribution team and four principal regions.

In 3Q12, net premiums written edged up 0.6% y/y to $8.71 billion, while net premiums earned slipped 3.2% y/y to $8.75 billion, primarily on the back of unfavorable currency, risk selection, business mix, and retention. While growth decelerated in the Commercial Insurance segment, results improved in the Consumer Insurance segment.

Outlook: Chartis' business mix restructuring initiatives are focused on the international markets of India, China and Brazil, according to management. Growth in its major lines of business will consistently be driven by improved risk selection, particularly in the casualty line of business in the U.S., shift to higher value business along with continued emphasis on direct marketing as part of its multiple distribution channel strategy. Chartis continues to implement strategic initiatives to improve its mix of business and derive higher value and reduce capital-intensive lines of business coupled with steps undertaken to focus more on loss making segments.

The cautious firms believe that the company will experience a humble growth in premium. They opine that the premium will increase at slower pace over the next few years. They also anticipate that commercial and consumer businesses will grow at a sluggish pace. The overall premium in these sectors will be aided by the premium generated from emerging markets. Poor economic conditions will further add to the woes of the company, as it will also obstruct the premium growth in this segment.

SunAmerica

AIG's life insurance and retirement products' segment, SunAmerica, reported an 18.6% y/y decrease in premiums, deposits and other considerations, totaling $4.8 billion in 3Q12. The decline was primarily attributable to decreasing group retirement deposits and individual fixed annuities due to the low interest rate environment and consumer's unwillingness toward purchasing such annuities. Policy fees increased 5.0% y/y to $691 million in 3Q12.

Individual variable annuity deposits totaled $1.0 billion in the quarter, up 27.9% y/y, mainly due to competitive product enhancements. Moreover, net cash flow at SunAmerica was positive for the seventh consecutive quarter.

Outlook: The cautious firms have rendered a concerned outlook for this segment of the company. It will likely experience a decline in retirement premiums and deposits due to the low interest rate and sluggish life insurance premiums and deposits.

Aircraft Leasing

AIG's aircraft leasing unit, conducted through International Lease Finance Corporation (ILFC), recorded rental revenues of $1.1 billion in 3Q12, flat y/y. This primarily indicates the re-lease of old aircrafts at a lower rate together with the impact of aircraft recovered since December 31, 2011, which includes a limited delivery schedule of new aircraft over 2011. These were partially offset by revenue from AeroTurbine, acquired in 4Q11.

Management has agreed to sell 90% of ILFC to the Chinese conglomerate for $5.28 billion. The deal is expected to culminate by 2Q13.

Other Operations

AIG's other operations currently include results from AIG Financial Products Corp (AIGFP) and other non-aircraft leasing. Under this, Mortgage Guaranty reported net premiums written of $219 million in 3Q12, up 6.3% y/y. Domestic first lien new insurance written totaled $10.7 billion at the end of 3Q12, substantially escalating from $5.7 billion in the year-ago period. The upside was primarily driven by increased mortgage originations, greater market reception for UGC's risk evaluation, a performance premium pricing along with higher sales focus in certain channels and the benefit from fewer competitors.

Please refer to the Zacks Research Digest spreadsheet on AIG for specific revenue estimates.

Pre-tax Operating Income [Note: Only highlighted material has been changed.]

Total benefits, claims and expenses dropped 11.4% y/y to $15.05 billion in 3Q12. Interest expenses totaled $416 million against $406 million in 3Q11.

Segment Operating Income

Chartis

In 3Q12, Chartis reported operating income of $949 million, up 72.2% from $551 million in 3Q11. The y/y upside primarily resulted from improvement in pricing trends, higher investment income and growth from higher value business, partially offset by higher underwriting expenses that led to underwriting loss of $441 million. This complemented the year-over-year reduction of 8.6% in claims and adjusted expenses that reduced to $6.25 billion. Subsequently, combined ratio improved marginally to 105.0% in 3Q12 compared with 105.9% in 3Q11, reflecting reduced catastrophe losses although adverse reserve development remained high.

Outlook: Management expects expense ratios to increase at least through 2013 based on slow but steady property-casualty rate increases, repositioning casualty lines and AIG's focus on expanding its international consumer business. However, these initiatives will likely generate consistently low loss ratios in the long run. Moreover, most firms expect accident-year combined ratios to decline.

Nevertheless, some firms project margins to gradually expand at Chartis, aided by growth in the foreign business and management's mix shift in the U.S. toward higher-margin consumer lines and re-pricing initiatives.

SunAmerica

Operating income at SunAmerica escalated 75.4% y/y to $826 million, based on higher net investment income, positive equity market performance and disciplined management of interest crediting rates. These were partially offset by lower base yields and interest crediting rates. Benefits and claims decreased 1.2% y/y to $3.04 billion in 3Q12.

Outlook: Low interest rates pose a major headwind for fixed annuity sales growth and margins at SunAmerica for 2012 and 2013 as well, but some cautious firms expect sales/flows to improve given the recovering macro-economic conditions and management's restructuring initiatives. However, it will remain below the level of its peers.

Meanwhile, the firms expect modest growth in retirement-driven fee, while continued investment volatility is anticipated in the alternative investment portfolio. However, the acquisition of Woodbury Financial is expected to strengthen its mutual fund distribution network by adding about 1,400 advisors to SunAmerica's existing 4,800 advisors.

Aircraft Leasing

In 3Q12, ILFC recorded an operating income of $3 million, which improved from a loss of $98 million in 3Q11. Expenses plunged 54.6% y/y to $1.16 billion in 3Q12.

Outlook: AIG expects to record a non-operating loss of about $4.4 billion on the sale of this non-core asset, which includes a $1.8 billion worth of non-cash charge related to the tax utilization of net operating loss carry forwards from the scheduled divestiture of ILFC.

Other Operations

In 3Q12, AIG's other operations reported operating income of $844 million versus a loss of $4.2 billion in in 3Q11. Other corporate expenses and eliminations increased to $166 million in 3Q12 compared with $648 million in 3Q11.

Mortgage Guaranty's operating income for 3Q12 was $3 million against an operating loss of $98 million in 3Q11. While net reserve development remained favorable, delinquency rates remained high.

Alongside, AIG's Direct Investment book (DIB), consisting of the Matched Investment Program (MIP) and the non-derivative assets and liabilities of the previous AIG Financial Products Corp. (AIGFP) portfolios, recorded operating income of $428 million against $119 million in the year-ago period.

Global Capital Markets, consisting of AIG Markets Inc. and the remaining AIGFP derivatives portfolio, recorded an operating income of $190 million in 3Q12, significantly improving from a loss of $174 million in 3Q11.

Outlook: AIG expects to control expenditures more efficiently. As well, it plans to strengthen its financials and operating infrastructures with special focus on financial reporting, financial operations, and human resources.

Please refer to the Zacks Research Digest spreadsheet on AIG for specific operating income estimates.

Earnings per Share [Note: Only highlighted material has been changed.]

AIG's **operating EPS** of $1.00 reported in 3Q12 outperformed the Zacks Consensus Estimate of $0.85 as well as the loss of $1.58 in 3Q11. Consequently, **operating net income** surged to $1.64 billion in 3Q12 from a loss of $3.0 billion in 3Q11.

During 3Q12, AIG reported **GAAP net income** of $1.86 billion or $1.13 per share as compared with a net loss of $3.99 billion or $2.10 per share in 3Q11. The reported results primarily included net realized capital loss of $387 million against $430 million in the year-ago quarter. Additionally, gain from discontinued operations was recorded at $1 million versus a loss of $221 million in 3Q11.

The reported quarter also included non-qualifying derivative hedging gains of $5 million against $62 million in 3Q11 and deferred income tax valuation allowance release of $229 million as against a charge of $1.16 billion in the year-ago quarter. It also included gain from changes in benefit reserves worth $393 million compared with $102 million in the year-ago period.

Provided below is a summary of EPS as provided by the Zacks Research Digest:

EPS	3Q11A	2Q12A	3Q12A	4Q12E	2011A	2012E	2013E	2014E
Digest High	($1.56)	$1.06	$1.00	$0.91	$1.10	$4.62↑	$4.28↑	$4.84↑
Digest Low	($1.58)	$1.06	$1.00	$0.08	$1.07	$3.79	$3.00	$3.35↑
Digest Average	($1.58)	$1.06	$1.00	$0.63	$1.07	$4.35↑	$3.50↓	$3.92↑
Y/Y Growth	*-39.6%*	*55.9%*		*-24.8%*			*-19.5%*	*11.7%*
Sequential Growth		*-35.8%*	*-5.6%*	*-36.9%*				

Highlights from the above chart are as follows:

- 2012 forecasts (11 firms) range from $3.79 to $4.62; the Digest average is $4.35.
- 2013 forecasts (11 firms) range from $3.00 to $4.28; the Digest average is $3.50.
- 2014 forecasts (6 firms) range from $3.35 to $4.84; the Digest average is $3.92.

Outlook

Previously, management projected a long-term goal of achieving mid-teens earnings growth, from $2.62 per share in 2010, by the end of 2015.

AIG has shown stark improvement in its financial results so far in 2012, based on lower catastrophe losses, reducing interest expenses and superior performance from its primary businesses – Chartis and SunAmerica.

However, most firms lowered their EPS estimates for 4Q12, 2012 and 2013 based on approximately $2.0 billion of catastrophe losses, the $4.4 billion charge related to ILFC divestment and lower-than-expected share buybacks. These firms noted that the ongoing low interest rate environment and the non-core assets would continue to create quarter-to-quarter volatility in margins and earnings, given the ongoing fluctuations faced by AIG with respect to the market values of AIG's stakes in AIA and Maiden Lane III as well as mark-to-market gains/losses in its capital markets.

As per the Zacks Digest model, analysts expect the share count to decrease 5.3% y/y to 1,703.6 million by the end of FY12, followed by a decline of 11.9% to 1,500.1 million by the end of FY13 and a decrease of 0.7% to 1,489.9 million by the end of FY14. This represents a three-year negative CAGR of 6.1% on FY11 shares outstanding.

As per the Zacks Digest model, FY14 EPS estimate is expected to grow at a three-year CAGR of 54.0% driven by a proforma net income growth at a CAGR of 43.3% and negative CAGR of 6.1% on 2011 shares outstanding.

Please refer to the Zacks Research Digest spreadsheet on AIG for more extensive EPS figures.

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