Conference Call Transcript: Assurant and The Warranty Group Amend Transaction Structure

January 9, 2018

PARTICIPANTS

Corporate Participants

Suzanne Shepherd – Vice President, Investor Relations, Assurant, Inc.
Alan B. Colberg – President, Chief Executive Officer & Director, Assurant, Inc.
Richard S. Dziadzio – Executive Vice President, Chief Financial Officer and Treasurer, Assurant, Inc.

Other Participants

Mark D. Hughes – Analyst, SunTrust Robinson Humphrey, Inc.
Jamminder Singh Bhullar - Analyst, JPMorgan Securities LLC
Gary Kent Ransom – Analyst, Dowling & Partners Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Assurant's Conference Call to discuss the transaction updates for the acquisition of The Warranty Group that were announced this morning. At this time, all participants have been placed in a listen-only mode and the floor will be open for your questions following management's prepared remarks. [Operator Instructions]

It is now my pleasure to turn the floor over to Suzanne Shepherd, Vice President of Investor Relations. You may begin.

Suzanne Shepherd, Vice President, Investor Relations, Assurant, Inc.

Thank you, operator, and good morning, everyone. This morning, we issued a news release noting an amended structure of our previously announced acquisition of The Warranty Group from TPG Capital. In addition to the news release, our investor presentation and Form 8-K filing are available on assurant.com. On today's call, we look forward to discussing the amended structure, the rationale for the modifications, as well as other company updates related to U.S. tax reform. We also will have time to address any questions you may have.

Joining me are Alan Colberg, our President and Chief Executive Officer; and Richard Dziadzio, our Chief Financial Officer and Treasurer. Alan and Richard will begin with prepared remarks that will correspond to the investor presentation before moving to Q&A. Some of the statements made today may be forward-looking including statements about the proposed transaction, its benefits, synergies, the combined companies' results of operations, the impact of recently enacted U.S. tax reform and other financial metrics. Actual results may differ materially from those projected in these statements. Additional information on factors that could affect Assurant's results can be found in our SEC report.

I will now turn the call over to Alan.

Alan B. Colberg, President, Chief Executive Officer & Director, Assurant, Inc.

Thank you, Suzanne, and thank you everyone for joining our call, and apologies for my voice, I'm getting over a cold. This morning, we issued amended terms for our previously announced $2.5 billion acquisition of The Warranty Group from TPG Capital.

As we discussed during the transaction announcement call in October, The Warranty Group is a company we have followed for many years. We continue to believe the transaction represents an attractive opportunity for Assurant given the strategic fit, significant growth potential and operating synergies of our combined operations.

Our discussions with TPG Capital largely coincided with the start of the tax reform debate in the U.S. At that time, no one could know if tax reform would pass, and if so, what changes it might lead to. So, from the beginning, we focused on evaluating the strategic, financial and operational merits of the transaction, irrespective of tax considerations.

Our evaluation confirmed that as one of the premier providers of extended service contracts, The Warranty Group aligned well with our profitable growth strategy and commitment to enhance shareholder value. The original transaction was based on existing tax law and aimed to preserve the maximum flexibility for our shareholders under any plausible tax scenario. That led to the structure we announced in mid-October of last year.

The recent enactment of the U.S. Tax Cuts and Jobs Act brought certainty on the meaningful benefits of tax reform to our Assurant standalone operations. And we concluded that it would be most advantageous to our shareholders, clients and employees to amend the transaction structure and remain a Delaware corporation. This provides an important backdrop for the transaction changes we'll be discussing today.

I'll begin by reiterating the strategic and financial rationale of driving our acquisition of The Warranty Group and our initial view of the recently enacted tax reform. Richard will then review the amended transaction structure before we open up the call for Q&A.

Starting with slide 4. As we said in October, we are focused on building a stronger Assurant for the future. Together with The Warranty Group, we will be even better positioned to execute our strategy of focusing on the housing and lifestyle markets where we believe we can continue to deliver outperformance for our customers, employees and shareholders. The transaction will also strengthen our vehicle protection services business by diversifying our distribution to include new leading dealer networks and national accounts as well as new digital auto retailers.

With The Warranty Group, we expect to triple the number of vehicles we currently protect to 36 million and to increase the number of extended service contracts we write for appliances and electronics by almost 80% to 75 million.

As we've noted previously, the combination will deepen our existing global footprint, adding scale to Europe, Latin America and Asia Pacific. Our enhanced presence and global network will allow us to cross sell a broader suite of products and services and leverage our existing global infrastructure to support growth in mobile.

In addition, it will allow us to capitalize on emerging growth trends, such as the connected car. Importantly, the transaction continues to be financially attractive. We remain confident in our ability to realize significant operating synergies as we combine our operations. With a lower concentration of earnings from businesses with catastrophe risk, together we should be able to generate more diversified and predictable earnings long-term.

Consistent with what we shared in October, the transaction remains modestly accretive to 2018 operating earnings per share on a run-rate basis, with accretion now measured against higher expected Assurant standalone earnings per share due to the net benefits resulting from tax reform.

While we're still assessing the full impact of tax reform on our business, on slide 5, you will see that reform overall is a positive for Assurant.

Based on our initial view of the new legislation, we expect the following: first, a decline in our effective tax rate from approximately 33% to approximately 22% to 23% on Assurant's standalone income worldwide. The rate is slightly above the new 21% federal rate, mainly due to the mix of foreign earnings from higher tax jurisdictions like Canada and Brazil. While we anticipate a significant portion of these tax savings to drive higher earnings, we plan to reinvest a portion of the savings to support future growth.

Second, we also do not expect to incur any transition[1] taxes as defined under the new tax law. Third, future dividends from our non-U.S. subsidiaries will be paid with no incremental U.S. taxes. And lastly, in the fourth quarter of 2017, we expect a significant one-time benefit to consolidated GAAP net income, reflecting our net deferred tax liabilities at the new lower tax rate, but with a modest write-down on a statutory basis for the insurance subsidiaries due to the reduction of net deferred tax assets.

So, in summary, the amended structure under tax reform provides even greater certainty in the long-term benefits to shareholders, clients and employees. And now, let me turn the call to Richard to review the specific amendments to the deal terms and structure. Richard?

Richard S. Dziadzio, Executive Vice President, Chief Financial Officer and Treasurer, Assurant, Inc.

Thanks, Alan. Good morning. As Alan just described, the strategic rationale of the acquisition and financial benefits remain compelling. Let me now review the amended structure and key terms in greater detail on slide 6. The transaction remains valued at $1.9 billion or $2.5 billion in enterprise value, including The Warranty Group's existing debt. Under the new structure, TPG and its affiliates will receive a revised consideration mix reflecting a reduced equity stake in the combined company. Shares issued to TPG will decrease to 10.4 million versus 16 million previously, representing about 19.8% of current shares outstanding.

In exchange for a smaller equity stake, TPG and its affiliates will receive an increase in cash consideration. Cash consideration remains subject to a collar under similar terms as the prior agreement, but applies to fewer shares used as purchase consideration. At Assurant's current share price, which is around 4% above the midpoint of the collar, the cash consideration would equal approximately $860 million. And as Alan mentioned earlier, along with more certain long-term favorable tax treatment, a key benefit to the change is an overall simplified structure.

Assurant will acquire TWG Holdings Limited and its subsidiaries and will remain a Delaware corporation. As a result, the acquisition will no longer be taxable to Assurant shareholders in the U.S. or other jurisdictions. Also under the new agreement, which limits the equity issuance to TPG and affiliates to under 20%, no shareholder vote is required. This should result in a more streamlined approval process.

And turning to governance, TPG and its affiliates will now name two board members compared to three under the prior agreement, bringing the total number of board members to 14 at closing. Alan will continue to lead the combined company with support from the expertise of our Board. We expect the transaction to close in the second quarter of 2018, subject to regulatory and other customary closing conditions. We are making good progress on integration planning with our counterparts at The Warranty Group to ensure we deliver on our commitments.

Slide 7 outlines the revised financing plan in greater detail. As you can see, it is largely similar to the originally announced transaction with some modifications. TPG will receive 10.4 million shares valued at $1.04 billion as of yesterday's closing price. We currently expect to finance the higher cash consideration and outstanding TWG debt with a mix of debt and equity issuance.

Subject to market conditions, we expect to issue approximately $400 to $500 million of equity. After taking into account the collar and our current share price, total shares to be issued to TPG and the market, in aggregate, should be modestly below the 16 million shares considered under the prior structure.

Also, we plan to use subordinated debt as part of the financing and no longer plan to issue preferred stock. Upon closing, the debt to capital level of the combined company will increase under our current financing plan to roughly 28% to 29% on a GAAP basis, higher than the previous structure due to subordinated debt in lieu of preferred stock but within our debt capacity. And lastly, a new bridge loan for $1.5 billion has also been secured for the transaction compared to $1 billion under the previous structure.

Turning to slide 8, as before, the transaction is expected to remain modestly accretive to 2018 operating earnings per share on a run rate basis and significantly more accretive after excluding an estimated $30 to $35 million of pre-tax amortization of transaction-related intangibles.

It's important to note that accretion is now being measured against a higher expected standalone earnings base for Assurant following tax reform. Even after this increase, the transaction remains modestly accretive. We also continue to expect to realize $60 million of pre-tax operating synergies by the end of 2019. This has been further validated by the ongoing work of our integration planning office.

As noted on the slide at year-end, we completed the return of $1.5 billion in capital to shareholders as planned. Once we complete the transaction, we plan to resume share repurchases later in 2018, albeit at a more moderate level than in prior years, as we focus on the integration of The Warranty Group and set aside funds to complete our purchase of Iké.

In 2019 and beyond, we expect our businesses to continue to generate strong cash flows to support additional investments and to return excess capital to shareholders.

I will now turn the call back over to Alan to wrap up.

Alan B. Colberg, President, Chief Executive Officer & Director, Assurant, Inc.

Thanks, Richard. In conclusion, we remain very positive about this acquisition and the value it will create for our shareholders. The new transaction structure is overall more simplified and enables us to optimize the financing mix.

Together with The Warranty Group, we'll be better positioned to capitalize on growth opportunities and benefit from an enhanced financial profile with more predictable and diversified earnings, and we continue to expect to generate attractive shareholder returns.

And with that, operator, please open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Thank you. Our first question is coming from Mark Hughes from SunTrust.

<Q – Mark Hughes –SunTrust>: Thank you. Good morning.

<A – Alan Colberg – Assurant, Inc.>: Good morning.

<Q – Mark Hughes –SunTrust>: Could you give any updated thoughts on capital deployment this year with the new transaction structure and with tax savings, how are you looking at it today versus a couple of months ago?

<A – Alan Colberg – Assurant, Inc.>: Yeah. So, Mark, let me start and then Richard, you can go into more detail. I mean, Mark, as we talked about in the prior call, 2018 is a bit of a transition year as we complete the purchase of The Warranty Group, we prepare to buy Iké, et cetera. With that said, our long-term philosophy on capital management is the same. We have a very good track record, we believe, of returning capital to shareholders while investing in growth. None of that's going to change, but, Richard, do you want to comment more?

<A – Richard Dziadzio – Assurant, Inc.>: The only thing I would add to that is that in the first half of the year, we're focusing on the closing of the transaction. And then in the second half of the year, we would expect to return and do some modest repurchases.

<A – Alan Colberg – Assurant, Inc.>: And Mark, just trying to say, in 2019 and beyond, what we've said previously and we still say is we're back to normal course for our capital management.

<Q – Mark Hughes –SunTrust>: Very good. And could you talk about the timing on your equity issuance, number one? And then secondly, any insight you may have regarding TPG's view about the potential share sales post their lock-up expiration?

<A – Alan Colberg – Assurant, Inc.>: On TPG, what we have agreed in the new amended shareholder agreement is they cannot sell any shares until 90 days have passed post-closing, then they can sell half of their equity if they chose to. And then the final half is subject to a lock-up of 180 days. What their current plans are, that'll be up to them.

<A – Richard Dziadzio – Assurant, Inc.>: Yeah. And Mark, in terms of the other part of your question about the equity raise, as we said in our notes, we'll be raising somewhere between $400 to $500 million is our expectation, that's based on current markets and we'll have to assess the market conditions in the future. And we'll come and talk about that when appropriate in terms of the timing.

<Q – Mark Hughes –SunTrust>: Thank you.

<A – Richard Dziadzio – Assurant, Inc.>: Thanks, Mark.

Operator: Our next question is coming from Jimmy Bhullar from JPMorgan.

<A – Alan Colberg – Assurant, Inc.>: Hey, good morning.

<Q – Jamminder Singh Bhullar – JPMorgan>: I had a couple of questions. First, should we assume that the impact on your cash taxes is similar to the impact on GAAP – the effective GAAP tax rate or is it slightly less for some reason?

<A – Richard Dziadzio – Assurant, Inc.>: Yeah, good question, Jimmy. I mean, I would say it's the U.S. corporate rate, let's talk about that, is 21%. Obviously, then, there are differences in timing between GAAP and stat in U.S. tax. And Alan mentioned in his remarks for example that in U.S. GAAP, we have a net deferred tax liability. So, as we finish our Q4 accounts, we expect to reduce that amount as a liability by about, I would say $160 million as of Q3, we'll roll that forward into Q4. But there will be a positive there, a one-time adjustment.

<Q – Jamminder Singh Bhullar – JPMorgan>: But then on an ongoing basis, should your cash – because part of the legislation is that there are limitations on the deductibility of reserves on DAC. So, does that affect you as much as some of the traditional life companies, or do you think that your ongoing cash tax rate will decline by a commensurate amount as well, a percentage or so?

<A – Richard Dziadzio – Assurant, Inc.>: Yeah, that's exactly right. We would expect it to just fall in line with the U.S. corporate rates and decline commensurately with that. And then in Alan's remarks, he did mention that we're looking at our overall global tax rate going to the 22% to 23% mark.

<Q – Jamminder Singh Bhullar – JPMorgan>: Okay. And then any comments on sort of expected CAT losses in the fourth quarter?

<A – Richard Dziadzio – Assurant, Inc.>: We'll come out with that in as we finish up the accounts, the only other event that we have had obviously relates to the California wildfires. We've talked already about the fires in the north. In the south, we haven't talked to the market yet. We do think that it will be a reportable event. And our reportable events...

<Q – Jamminder Singh Bhullar – JPMorgan>: Although smaller than the northern fires, right?

<A – Richard Dziadzio – Assurant, Inc.>: We haven't finished assessing the total impact of that, but our reportable events, just as a reminder for everyone, start at $5 million.

<Q – Jamminder Singh Bhullar – JPMorgan>: Okay. And then just lastly on -- any comments on the amount that you're going to likely pay for or a range that you expect to pay for the rest of Iké?

<A – Richard Dziadzio – Assurant, Inc.>: I would just say that the initial 40% that we purchased, we purchased for a little over $100 million. I think it was $115 million for the 40%.

<Q – Jamminder Singh Bhullar – JPMorgan>: And the value should have gone up since then, right?

<A – Richard Dziadzio – Assurant, Inc.>: There is a mechanism that we have in the purchase around earnings, in multiples to earnings. So, I don't want to get ahead of myself on that, and the purchase is really set for the beginning of next year.

<Q – Jamminder Singh Bhullar – JPMorgan>: Okay. Thank you.

<A – Richard Dziadzio – Assurant, Inc.>: Thanks, Jimmy.

<A – Alan Colberg – Assurant, Inc.>: Thanks.

Operator: [Operator instructions] Our last question is coming from Gary Ransom from Dowling & Partners.

<A – Alan Colberg – Assurant, Inc.>: All right. Good morning, Gary.

<Q – Gary Ransom – Dowling>: Good morning. I just had some questions on second order effects of the new tax law. And I was wondering if you could talk at all about any thoughts you have on say changes in investment strategy or changes in where your capital might reside given that it will probably be easier to move it around in the future and/or any other thing that you have thought about that might change in either your tactics or your strategies going forward?

<A – Alan Colberg – Assurant, Inc.>: Yeah. You know it's a good question. We've always said that we are a full U.S. tax payer. We follow the tax code effectively and efficiently. We have an ongoing review of the new legislation to understand what we could do differently to take advantage of the new tax law and we'll update you all when we have a better sense of what we're actually going to do differently.

<Q – Gary Ransom – Dowling>: Am I correct that you don't have any accumulated earnings offshore that would have a deemed repatriation tax on it?

<A – Richard Dziadzio – Assurant, Inc.>: Yes. Hi, Gary. It's Richard. I think you're mentioning that the transition tax there and that's right. We don't expect to have any transition tax – that amount will be zero.

<Q – Gary Ransom – Dowling>: Okay. All right. Well, thank you very much for the update.

<A – Richard Dziadzio – Assurant, Inc.>: Okay. Thanks, Gary.

Alan B. Colberg, President, Chief Executive Officer & Director, Assurant, Inc.

All right. And thanks to everyone for joining us this morning. As always, please reach out to either Suzanne Shepherd or Sean Moshier with any questions on today's announcement. And we lookforward to updating you on our progress on our earnings call next month as well as in the months ahead. Thanks, everyone.

Operator: This does conclude today's teleconference. Please disconnect your lines at this time, and have a wonderful day.

Footnotes to Script:

(1) Speaker referenced "transaction"; script has been corrected to clarify the correct word "transition"