Equity Research
North America

United States of America

Insurance - Property-Casualty

American Int'l Grp

Reuters: AIG.N Bloomberg: AIG NYSE: AIG

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Change in Recommendation

March 14, 2001

Upgrading the Global Giant to Strong Buy

STRONG BUY

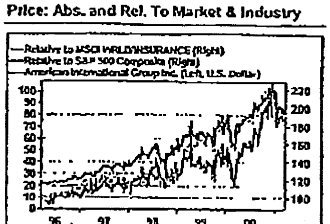
Price (March 13, 2001):	$78.79
Price Target:	$110
52-Week Range:	$103.75 - 54.42

WHAT'S CHANGED

Rating:	*Outperform to Strong Buy*

- **We are upgrading AIG from Outperform to Strong Buy**
  Our target remains $110.
- **Our upgrade is based on recent price performance**
  The stock has pulled back 24% from its 52-week high and there is now 39% upside to our target.
- **We see several catalysts**
  In addition to a more attractive valuation, we cite AIG's expected first quarter earnings performance relative to large-cap peers and the possibility of more clarity on the management succession process.

Price: Abs. and Rel. To Market & Industry



Data Source: FactSet Research Systems Inc.

Company Description

American International Group is the leading U.S.-based international multiline insurance and financial services organization and the largest commercial underwriter in the U.S. AIG has an extensive global presence, particularly in Japan and Asia, in both life and non-life operations. It also has major asset-management and financial-services divisions, including the world's largest aircraft-leasing company.

FY ending Dec 31:	1999A	2000A	2001E	2002E
EPS ($)	2.13	2.45	2.85	3.25
Prior EPS Ests. ($)	–	–	–	–
Consensus EPS Ests. ($)	2.13	2.45	2.82	3.23
CEPS ($)	–	–	–	
P/E	37.0	32.2	27.6	22.8
P/E Rel. to (local Index)	–	–	–	–
P/CE	–	–	–	–
Price/Book	5.5	4.8	4.1	3.5
EV/EBITDA	–	–	–	–
Yield (%)	0.2	0.2	0.2	0.2

Market Cap ($ m)	182,443
Enterprise Value ($ m)	–
Debt/Cap (12/00) (%)	35.6
Return on Equity (12/00) (%)	16.1
L-T EPS Gth ('yy - 'yy) (%)	
P/E to Growth	–
Shares Outstanding (m)	2,315.6

Q'rtly EPS	2000A actual	2001E curr	2001E prior	2002E curr	2002E prior
Q1	0.58	0.66	–		–
Q2	0.61	0.70	–		–
Q3	0.61	0.70	–		–
Q4	0.65	0.78	–		–

E = Morgan Stanley Dean Witter Research Estimate

Please refer to important disclosures at the end of this report.

Upgrading the Global Giant to Strong Buy

We are upgrading AIG from Outperform to Strong Buy, keeping our $110 target. The stock has pulled back 24% from its 52-week high and there is now 39% upside to our target. We do believe some additional risk should be incorporated into the expected return right now given the choppiness of the market and the recent multiple contraction among the largest cap names. However, with the stock trading below $80 we believe an upgrade is due and now consider AIG one of our two best ideas (the other being XL Capital ($77.25)). Our upgrade is also based on our conviction that AIG has the earnings power to outperform the market for the foreseeable future. Our target is 34x 2002E and 495% of 2002 book value (roughly in line with the current valuation).

- AIG is now trading at 130% of the S&P 2001 multiple. Historically the stock has traded at about 110% of a market multiple, although that average includes long-previous periods when the earnings mix was more heavily weighted toward the volatile property-casualty lines. With earnings growth in the mid-teens, and likely sustainable, we believe the stock should receive a premium valuation.

- AIG is trading at 27.7x 2001E, 24.12x 2002E, and 480% of book value. The latter compares with an absurdly wide historical valuation range of 120% (in 1994) to 600% (in 2000). The stock is not "cheap" in the traditional sense of price/book value. However, our float valuation model indicates that AIG merits an even higher premium because of the sustainability of its earnings growth rate.

- Looked at another way, even if AIG traded down to 3x book value from the current level and remained there, an investor would earn a compounded return of 7.4% a year for the next decade simply due to the high earnings growth rate. At 4x book value, an investor would earn 10.4% compounded. We do not necessarily expect the stock to continue to trade at the current valuation a decade out; we can't see that far into the future. However, we believe a 3-4x multiple expectation is not unreasonable considering the company's outstanding growth potential (which will still be in an early stage in some vastly important countries, such as China, a decade from now).

AIG is far more than a property-casualty insurer. Its operations run the gamut of financial services, including mutual funds, private and global equity funds, corporate financial services, infrastructure funds, aircraft leasing, derivatives and commodities trading, and all kinds of life, personal lines, and commercial lines of insurance. The company is a true growth story in the financial services industry as well as being the most consistently profitable major insurer in history.

Growth with earnings. AIG today has outstanding opportunities in the emerging markets, where insurance and asset accumulation are growth products. The company's strategy of international growth focused on asset accumulation, risk management, and these rapidly-expanding markets has produced standout results. AIG's performance-oriented, entrepreneurial culture is legendary. So is its position as the low-cost producer in every business.

We have analyzed AIG's potential in key markets and believe the company has set the stage for mid-teens growth for the next decade. After visiting key markets and competitors, we note that the company's business is relatively concentrated today yet it has laid the groundwork for strong growth in important markets.

- Its best opportunities will continue to be outside the US, in Japan, China, India, and the rest of Asia.
- The company has a small market share in its largest current and potential markets -- Japan, India, and China.
- Insurance and retirement products in Asia are one of the fastest-growing sectors of the economy. Individuals have high savings rates and an emerging middle class seeks income protection through life insurance.
- AIG enjoys relatively weak competition and a favorable regulatory environment in many jurisdictions.
- AIG knows how to run the machine right -- training agents, getting licenses, setting up an infrastructure, and outgrowing its indigenous and foreign competitors in nearly every market it enters.

We also believe AIG is a likely consolidator. The company has spoken of its desire to be a buyer in the life insurance and asset management industries. Most recently it has

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downplayed credit cards, and we believe would not seek the volatility of broker-dealers or personal lines insurers. There is obviously risk of arbitrage pressure on the shares if the company makes a stock acquisition (see Risk Factors). Depending on the specifics, that could be an even more attractive buying opportunity.

First quarter earnings: We estimate first quarter earnings of $0.66, in line with consensus. The outlook for the property-casualty sector in general is quite mixed, and the S&P large-caps are reporting and preannouncing disappointing numbers every day. We believe that AIG will continue to be an exception to this trend given its below-average exposure to most of the risk factors in the quarter (asbestos, catastrophe, loss reserves, inflation). In addition, we believe that AIG's personal lines operation will show improved results. Our investment thesis is that valuations will begin to diverge as the limited number of companies with solid earnings continue to produce strong results. We should be returning to a stock-picker's market. If so, we anticipate that the stock will begin to recover from its current participation in the general-selloff.

Management succession: AIG's legendary CEO, Maurice "Hank" Greenberg, has steered the company for most of its history, with results that have been rewarding to shareholders for decades. As Mr. Greenberg is now 75 years old, investors are understandably concerned with who will take the helm, particularly since his designated successor and son, Evan Greenberg, left the company last fall. We believe that AIG has many structural advantages, such as its enormous scale, and therefore is unlikely to lose its competitive advantage quickly even if the successor falls short of his predecessor's record. Nevertheless, this issue is a very important one for the company and we believe Mr. Greenberg has been giving it considerable thought. AIG's annual report will be hitting the street any day, and the shareholder meeting is just around the corner. We would not be surprised if there were some more explicit commentary, at least on the planning and transitional process, in the near future. In general, we believe this would be a positive catalyst for the stock unless the company named a specific successor who would be - assuming the role in a relatively short time frame.

No surprises. Investors appreciate the company's "no surprises" earnings track record. However, there's been no evidence of AIG accelerating revenue, deferring expenses, booking one-off gains as operating items, and so forth. If anything we believe the company does the opposite -- recognizes income conservatively so that it doesn't run the risk of surprises.

Risk factors:

We believe management succession, as described above, is a risk factor.

If AIG makes a sizeable stock acquisition, we believe the stock would likely experience arbitrage pressure. However, based on its history, any deal would almost certainly be earnings-accretive, contribute to the company's growth, be a clear strategic fit, and bring strong management to the company. Although it has not made a large number of material acquisitions, AIG has been successful in integrating those it has made. Investors may remember the company's last major acquisition -- SunAmerica. The stock sell-off when that deal was announced was one of the best opportunities to buy AIG in several years, in our view.

AIG is sensitive to the world economy. As Asian growth rates slow, its organic growth may be affected. However, we note that during the Asian crisis of 1998, the company never missed a quarter and was able to take advantage of the situation by investing in undervalued assets and making opportunistic acquisitions. We would expect a similar opportunity to develop for AIG simply because its triple-A ratings and enormous liquidity enable it to capitalize on the situation. In addition, the company's strong brand in the Asian markets and pristine balance sheet should continue to benefit it in a "flight to quality" situation. Its ILFC aircraft leasing operation has repossession rights and currency export agreements with local governments.

AIG carries political risk. A material unfavorable change in the relationship between the US and China, failure of China to enter the World Trade Organization, significant worsening of relations between China and Taiwan, a reversal of insurance privatization in India, are examples.

Like all insurers, AIG is subject to interest rate and inflation risk. Loss reserves could develop unfavorably. However, we believe that AIG's exposure to factors such as poor loss reserve development and asbestos are below average. The company's annuity sales could be weaker than anticipated due to difficult capital markets. AIG sells derivatives and other financial products that involve a level of market risk. The company also is exposed to currency risk, although it is not a net exporter and is to some extent naturally hedged.

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