Insurance Agents & Brokers – Mergers & Acquisition Activity is Accelerating

The U.S. insurance distribution market continues to consolidate, and valuations are rising. Although the absolute number of transactions declined in 2013, the number of large deals and the valuation metrics of significant, well-run agencies and brokerages increased markedly. Improved operating performance, a rebounding U.S. economy, and an influx of capital from private equity investors have driven transaction multiples above pre-crisis levels. Stronger P&C pricing is also a factor behind the uptick in agency transaction multiples, as buyers are factoring in a firming market into their valuation calculations.

In the last two and a half years, at least ten new entrants – all private equity firms – have acquired nearly $5 billion of insurance brokerage industry revenues. Private equity firms, eager to deploy capital and utilize leverage, are buying platforms to rapidly build scale through acquisition. Industry aggregators, armed with strong balance sheets and high stock prices, continue to consolidate the industry, as well. Traditional platform investments (agencies and brokerages with more than $50 million of revenue) are in high demand.

Remarkably, some agencies and brokers with as little as $15 million of revenue are being considered platform companies by investment groups and are highly coveted by serial acquirers as regional hubs. Valuation multiples and terms for sellers in this segment continue to improve as the scarcity value plays into sellers' favor.

As capital continues to wash into the industry and larger players seek growth through acquisition, we anticipate terms and conditions for sellers to improve modestly over the next twelve months. M&A activity will continue at a heated pace absent a substantial stock market correction or a sharp rise in interest rates, which could lower valuation multiples and decrease the willingness of agency owners to sell.

M&A Activity Among Private Equity Firms Accelerates

Consolidation through acquisition has long been a staple of the industry, particularly in a soft market, as publicly-owned firms driven by earnings pressure seek to augment weak organic growth. Aging owners are increasingly seeking to monetize family-run businesses, absent continued investment in the business or a perpetuation plan. Acquirers benefit from economies of scale, including investments in information technology and improved carrier relations. Insurance carriers continue to streamline their distribution networks by eliminating smaller agencies.

Not surprisingly, the absolute pace of M&A activity slowed in 2013, after a torrent of activity in the fourth quarter of 2012 in a rush to beat changes to tax law. While the total number of completed deals was lower in 2013, the number of high profile, large transactions continues to grow; and we expect an uptick in overall activity in the next 12 months.

Four of the top five most active acquirers in 2013 were companies controlled by private equity investors. Publicly traded AJ Gallagher led the pack, with 31 deals in 2013, followed by Assured Partners (GTCR), HUB (Hellman & Friedman), Confie Seguros (ABRY Partners) and USI (Onex Group). The private equity-backed insurance distribution firms are aggressively increasing market share via acquisition.

In the past two and a half years, ten private equity entrants have acquired nearly $5 billion of insurance brokerage industry revenues. Fidelity National, another new entrant, bought Digital Insurance (~$100 million revenue) in late 2012.

Selected Private Equity Platform Investments

Date	Acquiror	Target	Revenue ($MM)
Nov-13	Carlyle Group	Edgewood Partners Insurance Center (EPIC)	$80
Aug-13	Hellman & Friedman	HUB International	1,200
Jun-13	Kohlberg & Co.	Risk Strategies Co.	45
Apr-13	Madison Dearborn Partners	National Financial Partners	1,062
Mar-13	Genstar Capital	Acrisure	40
Jan-13	Lightyear Capital	Cooper Gay Swett & Crawford (Wholesaler)	348
Dec-12	Fidelity National Financial	Digital Insurance	98
Dec-12	ONEX Group	USI Holdings	850
Nov-12	KKR & Co.	Alliant Insurance Services	460
Nov-12	ABRY Partners	Confie Seguros	244
May-12	New Mountain Capital	AmWins (Wholesaler)	400
Sep-11	GTCR/Assured Partners	Neace Lukens	88
		Total Acquired Revenue	**$4,900**

GTCR and Assured Partners, which bought Neace Lukens as a platform in late 2011, reached nearly $300 million of revenue by year-end 2013 through over 45 acquisitions.

USI, with fresh capital from the 2012 investment by Onex Group, recently announced the acquisition of 42 offices from Wells Fargo Insurance Services, adding $180 million of revenue or nearly 20% to its top line. USI completed eight deals in 2013.

Genstar Capital, following on the heels of its successful exit from its investment in personal lines consolidator Confie Seguros in the sale to ABRY Partners, invested in Acrisure in 2013 as a new commercial lines platform. Acrisure was a successful investment of GCP Capital.

Although insurance distribution is an attractive industry for private equity firms, several barriers to entry exist. New entrant private equity firms are often at a competitive disadvantage when seeking their initial platform investment. Compared to strategic acquirers, new entrants face daunting cost add-backs where others see synergies. This phenomenon typically causes investment firms to seek larger platforms in order to recoup their investments in a shorter period. But in today's market, high valuations and scarcity among larger platforms are prompting strong interest in smaller firms being considered as platform investments by new entrants or as regional hubs by aggregators.

Private Equity Exits Capitalizing on Strength of the M&A Market

Several private equity firms are selling their distribution investments to capitalize on the robust M&A environment. In several cases, distribution firms are being traded among private equity firms, often the sign of a peak in market activity. We expect several more high profile exits in the next 12 months.

Selected Private Equity Exits

Date	Target	Seller	Acquiror
Nov-13	EPIC	Stone Point	Carlyle Group
Aug-13	HUB International	Morgan Stanley, Apax Partners	Hellman & Friedman
Jun-13	Bollinger	Evercore Partners	AJ Gallagher
Jun-13	Beecher Carlson	Austin Ventures, Financial Partners Fund	Brown & Brown
Mar-13	Acrisure	GCP Capital	Genstar Capital

Dec-12	USI Holdings	Goldman Sachs	ONEX Group
Nov-12	Alliant Insurance Services	Blackstone Group	KKR & Co.
Nov-12	Confie Seguros	Genstar Capital	ABRY Partners
May-12	AmWins (Wholesaler)	Parthenon Capital Partners	New Mountain Capital
Feb-12	Crump Group (Wholesaler)	J.C. Flowers & Co.	BB&T
Feb-12	Arrowhead General Ins (MGA)	Spectrum Equity Investors	Brown & Brown
Jan-12	THOMCO (MGA)	Century Capital	Markel

Mid-Sized Targets are in High Demand

Mid-sized insurance distribution firms are particularly attractive to large strategic buyers and fast-growing private equity-backed platforms as a means to quickly add scale, leadership, geographic reach and product expansion. Approximately 65 firms with revenue between $30 million and $200 million generate an estimated $4.6 billion of revenue and offer attractive consolidation opportunities for acquirers with large balance sheets and/or aggressive expansion plans. These firms typically dominate a geographic region and/or maintain sought-after industry expertise. Some bring a strong management team with an institutionalized client base and salesforce, sound internal systems and controls, and a proven track record of identifying and completing tuck-in acquisitions, providing a new pipeline for larger acquirers. Current transaction multiples are tempting many owners of these mid-sized firms to consider selling.

Valuations for solid insurance distribution firms continued to inch up during 2013. Not surprisingly, larger companies commanded higher purchase multiples than smaller companies. Hellman & Friedman's purchase of HUB International and Brown & Brown's purchase of Beecher Carlson both closed at prices in excess of 12 times EBITDA. Well-run properties are fetching 8x-10x EBITDA or >2x revenue. A disciplined, competitive sale process can help sellers achieve better results and superior deal terms in a transaction.

Buyer demand

- Strong corporate balance sheets and an influx of private equity capital are driving multiples higher
- Large strategics are aggressive but still selective on product mix and concerned with margins
- Private equity backed players are expanding, seeking to rapidly achieve scale before an exit
- Improving P&C pricing and strong employee benefits market support higher growth prospects and valuations
- Heightened competition among buyers can be exploited in a sale process

Dynamics among mid-sized agencies

- Large acquirers favor mid-sized targets to quickly gain scale, leadership and geographic reach, although integration risk can be high
- Mid-sized agencies offer attractive platform opportunities and/or geographic and product expansion
- Mid-sized firms can dominate a geographic region and/or possess attractive industry expertise
- Scarcity value drives increased interest and competition in transactions

Banks Are Evaluating Their Participation in the Insurance Distribution Sector

Banks continue to evaluate the strategic importance of their insurance agencies. Banks are attracted to the fee income, cross-sell opportunities and high return on equity generated by the insurance distribution business. Some banks have determined, however, that insurance brokerage is non-core, poses business risk, and involves higher expenses compared to other banking operations. A relatively small insurance agency can create distractions for senior leaders of large financial institutions.

Reasons for banks to sell

- Senior management distraction
- Not a "core banking" product
- Different client base
- Business risk
- Opportunity to raise and redeploy capital
- Eliminate expense base; improve efficiency ratio
- High valuations for insurance brokerage businesses

Reasons for banks to hold

- Attractive fee income
- Cross-sell opportunities with retail and commercial banking clients
- High ROE and ROA
- Inability to redeploy capital efficiently

At least ten banks have exited the distribution segment in the past ten years, as outlined below.

Year	Seller	Agency/Broker	Insurance Revenue ($MM)
2012	TD Bank	TD Insurance	$ 60
2012	Compass BBVA	Compass Insurance	27
2011	First Place Bank	First Place Insurance	4
2011	First Financial Holdings	First Southeast Insurance	21
2010	PNC	National City Insurance	13
2009	First Banks	Adrian Banker	10
2008	Webster Financial	Webster Insurance	30
2007	Capital One	Hibernia	18
2007	BNC National Bank	BNC Insurance Services	19
2006	Citizens Financial Group	Citizens Clair, Brewer & Lord	45

In early 2014, Wells Fargo Insurance Services (WFIS) divested 42 offices, representing approximately $180 million of revenue, or approximately 10% of WFIS' total insurance distribution revenues. Wells Fargo sold the offices to USI, which has acquired at least four bank-owned agencies in the past decade. WFIS has been restructuring for several years; and the remaining 55 offices represented approximately 90% of WFIS revenues.

Particularly in a period of heightened M&A activity and rising transaction multiples, we anticipate banks will continue to evaluate the strategic importance of their insurance brokerage operations as they look to streamline operations and redeploy capital.

Conclusion

We expect current M&A market dynamics will continue to favor sellers over the next 12 to 24 months, with strong demand for well-positioned agencies and brokerages with revenues in excess of $15 million and particularly for those in the $50 million to $200 million segment. Private equity-backed consolidators are deploying capital at a rapid pace in order to quickly gain share, build large successful industry leaders, and exit in a timely manner. Private equity firms have their work cut out for them, however, as the industry aggregators continue to grow aggressively, as well.

For more information, see our Industry Primer issued in October 2012 and contact:

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