



Home Warranty



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As we noted in our February 2018 industry report, the home warranty industry has been experiencing significant mergers & acquisition activity in recent years.

Our previous discussion highlighted the strong industry fundamentals and drivers of M&A activity in this market. The home warranty industry enjoys compelling industry fundamentals, including reoccurring revenue, and strong growth, margins, and cash flows. The largest players continue to acquire well-performing, high-quality local and regional players. Combined with obvious exit alternatives, the home warranty segment seems like a natural market to attract institutional investor interest.

In this report, we highlight four major themes relevant to M&A activity:

- 1 The big are getting bigger;
- 2 Industry players benefit from strong retention and renewal rates;
- 3 The market is growing despite low penetration; and
- 4 The outlook is promising for independents looking to sell as financial sponsors and consolidators continue to acquire.

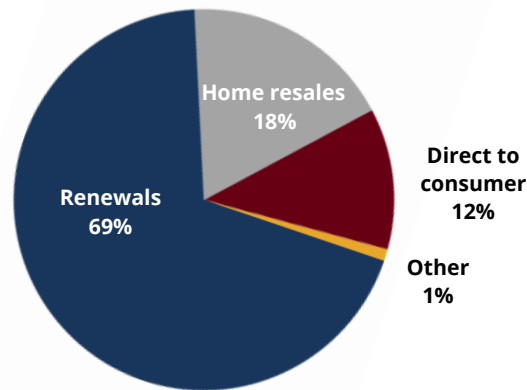
Background

Home warranties involve service contracts that protect a homeowner against costly repairs or replacements of household systems and appliances. The most commonly covered household items include electrical, plumbing, central heating, and heating and air conditioning (HVAC) systems, water heaters, refrigerators, dishwashers, and ovens and cooktops. Home warranties include a range of coverages and typically have a term of one year. Home warranties should not be confused with builders' warranties, which cover structural components of a residence, another segment of the broader warranty sector.

Distribution

Most often, new home warranties are purchased by the seller of a home and offered to the buyer as part of a real estate transaction. Real estate brokers are the primary sales channel for home warranty companies. Home warranties are also originated online and through direct-to-consumer (DTC) call centers, channels experiencing the highest growth.

Frontdoor Revenue by channel

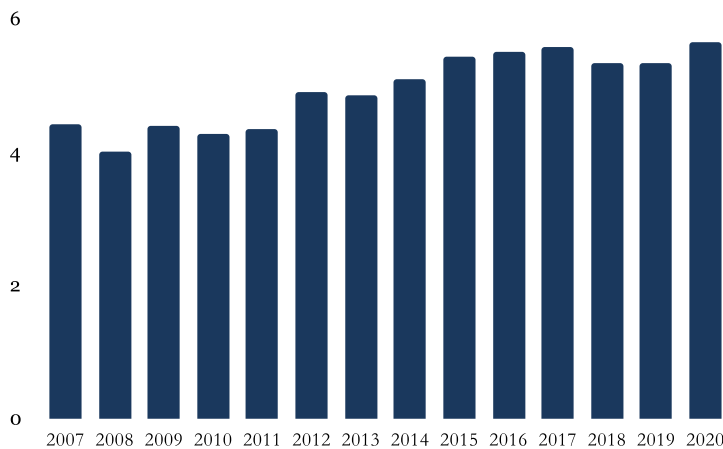


Home warranty sales are tied to home sales

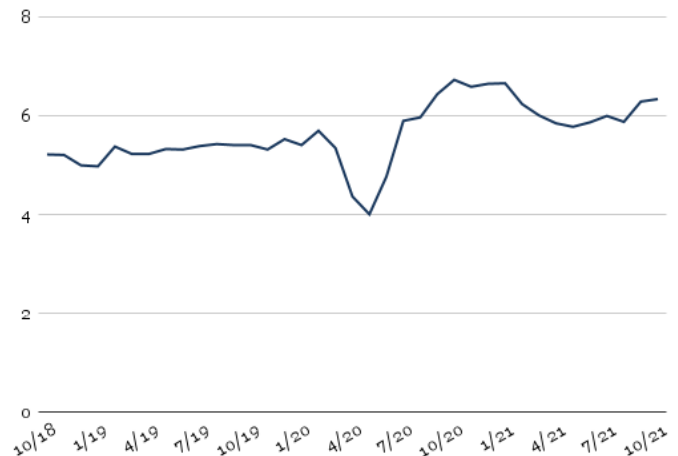
New home warranties are primarily sold through real estate brokers at the time of a home sale and are purchased by the seller. According to the National Association of Realtors, existing home resales, as measured in units, increased by approximately 5% in 2020, despite the dip in early 2020 stemming from COVID-related shutdowns.

US existing home sales (units in millions)

US EXISTING HOME SALES (units in millions)



TOTAL EXISTING HOME SALES (in millions)



High retention and renewal rates

While many home warranties are originated by realtors, most of the revenue stream for the large providers comes from existing warranty holders renewing their contracts. Renewals are typically offered near the end of the term via direct mail, phone call, or email.

Because of the peace of mind and high customer satisfaction rates, home warranties experience significant renewals, often in excess of 50%. Frontdoor, the industry's largest participant, has consistently posted retention rates of ~75% since 2018; over two-thirds of its revenue is derived from existing contract renewals. In-network service providers also promote home warranties to existing customers and new ones, typically during a repair call, to protect homeowners against future expenses.

Financing accelerates market growth

Home warranties sold through the DTC channel, like vehicle service contracts, can be financed over a term up to half the length of the warranty. DTC sales are generally independent of a real estate transaction and benefit from the opportunity to finance the product. DTC sales are available to customers through multiple channels (e.g., phone, web, email, mobile, social media).

Home warranties sold through independent DTC marketers are often designed to be longer term, up to three years. Payment plans can meaningfully increase sales of home warranty products. Some of the DTC sellers are providing financing in-house, and a few third-party payment plan companies have nascent programs. Payment plans such as PayLink Direct and WALCO Funding dominate the third party financing segment.

Low household penetration

The National Home Service Contract Association (NHSCA) claims that industry-wide direct sales to consumers now account for approximately one-third of all home service contract sales. In the DTC segment, FTDR estimates less than 5% market penetration. Every one percentage point increase in penetration results in roughly \$600 million of market opportunity, providing meaningful market growth potential.

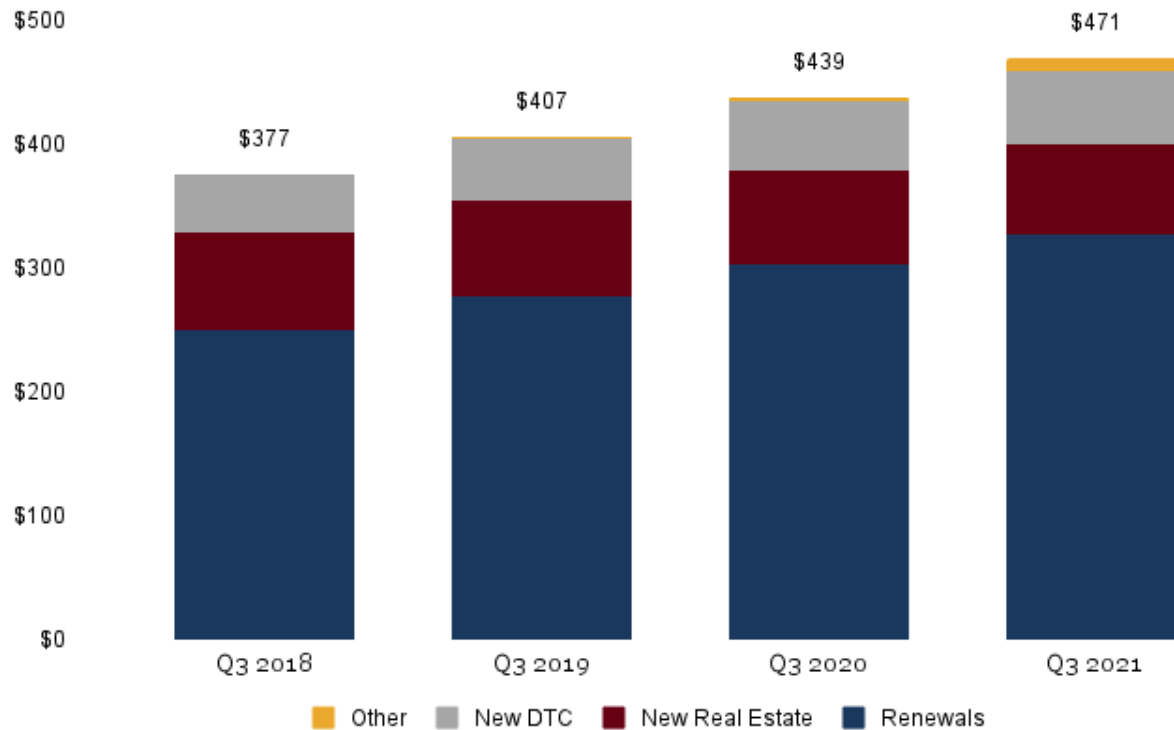
Seasonality and COVID

The industry is highly seasonal with revenues peaking during Q2 and Q3 each year, in line with peak activity within the real estate market. Based on FTDR results, it would seem Q4 generally outperforms Q1, and it is not uncommon to see a slight dip in quarterly revenue at the beginning of each calendar year.

As with most industries, COVID-19 posed challenges and opportunities for the home warranty industry. Shelter-at-home orders led to an increase in appliance- and plumbing-related service requests, while supply chain issues hampered the industries' ability to receive the necessary replacement parts in a prompt fashion. The housing market experienced a temporary slowdown in early 2020. Concerns over health and safety created the need for contractors to develop new protocols and solutions (often through technology) to limit in-person interactions.

Frontdoor had a record quarter in Q3/2021 with \$122 million in EBITDA. Abnormally high claims, as people began working from home due to Covid, caused a spike in claims in late 2020 and early 2021. In Q3/2021, contract claims decreased significantly compared to last year, causing Frontdoor's EBITDA in the quarter to improve by \$16 million. The Company has also been able to steadily grow revenue by maintaining high renewal rates of between 74% and 76%.

Frontdoor Revenue by Channel (\$ in millions)

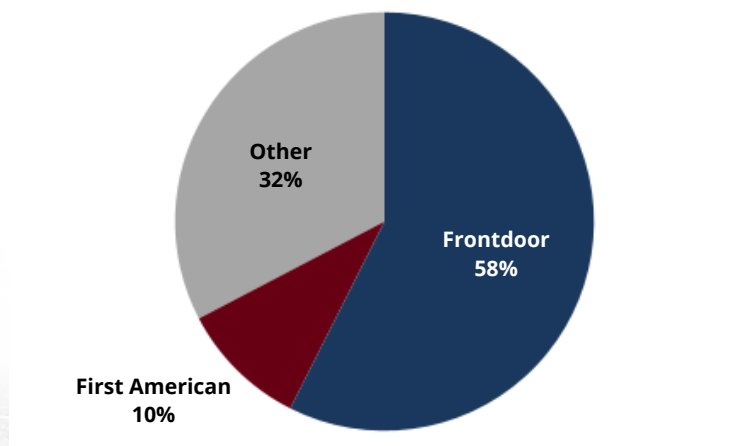


Relevant Themes

1 The big are getting bigger

The home warranty market is highly concentrated, with the top two providers commanding over two-thirds of the estimated \$2.6 billion market. Frontdoor posted nearly \$1.5 billion of revenue in 2020, estimated at nearly six times the size of its next competitor, First American Home Warranty.

US Market Size \$2.6 billion



Historically the largest ten players accounted for nearly 80% of industry revenue, creating a significant barrier to entry. Beyond that, the landscape is littered with roughly a hundred small companies operating on a local or regional basis. Larger players typically look to acquire promising providers that reach scale to cement local and/or regional coverage. Some of the larger players include:

- **Frontdoor, Inc** (NASDAQ: FTDR) claims to have founded the home warranty 50 years ago. FTDR (*dba* as American Home Shield, Landmark Home Warranty, OneGuard Home Warranties, and HAS Home Warranty) offers warranties on a national basis and serves over 2.2 million customers. Frontdoor was spun out of Terminix Global Holdings, formerly known as ServiceMaster Global Holdings, in October 2018.

FTDR has increased its market share by over 15% since our last update and now commands nearly 60% of the national market, as measured by revenue. FTDR reports that it completes more than four million service requests per year. In 2020, it reported revenue of \$1.5 billion and EBITDA margins of 18%. FTDR boasts that it has paid over \$3 billion in claims.
- **First American Home Warranty**, a unit of the specialty insurance segment of First American Financial Corporation (NYSE: FAF), operates in 39 states and the District of Columbia.
- **Old Republic Home Protection** operates as a unit of the general insurance group of Old Republic International Corp (NYSE: ORI). Founded in 1974, the company operated primarily in California until launching its national expansion plan in 1995.
- **Cinch Home Services** (formerly Cross Country Home Services), a member of the Cross Country Group (Private), sells home warranties and maintenance plans nationally through the real estate broker channel, direct to consumers in the aftermarket, and through other financial services partners. Cinch launched in the 1980s.
- **2-10 Home Buyers Warranty** (2-10 HBW), based in Denver, CO, was acquired by Genstar Capital in 2018 (its second private equity investor). 2-10 offers both structural warranties on new homes and systems and appliances services agreements (home warranties). 2-10 HBW's structural warranties are generally 10-year policies purchased by builders of new homes. 2-10 HBW's Resale Warranty Division sells primarily through real estate brokers across the country.
- **Fidelity National Home Warranty** is a unit of Fidelity National Financial (NYSE: FNF). Fidelity's home warranty operation results from the combination of Alliance Home Warranty (formed in 1995) and Chicago Home Warranty (acquired in 2000 with FNF's acquisition of Chicago Title). Fidelity National Home Warranty operates in California, Arizona, Nevada, Texas, Colorado, Washington, and Oregon.

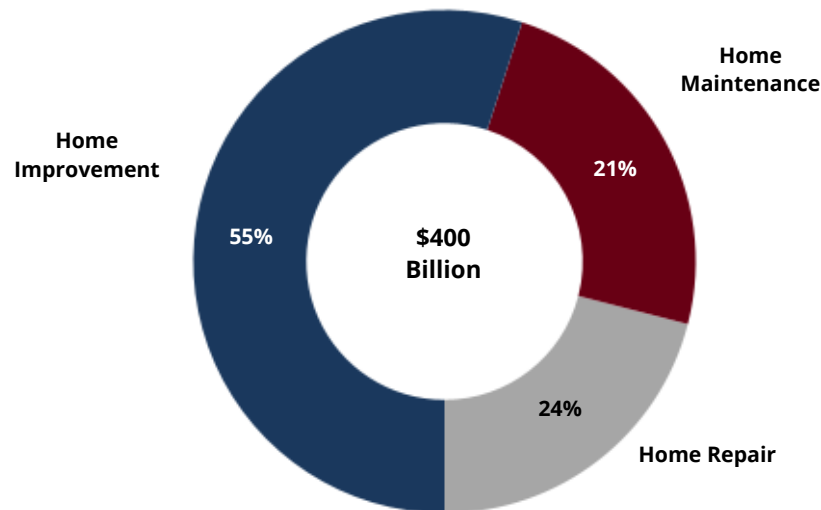
Several water and electrical utilities sell protection plans that cover appliance repairs. For instance, Dominion Products and Services (a unit of Dominion Energy, focused on the Mid-Atlantic and Northeast U.S.) and American Water Resources (a unit of American Water) offer various home appliance and related protection plans.

2 Industry players benefit from strong retention and renewal rates

The home warranty industry is characterized by a high level of customer interaction and service requirements. Home warranty providers generally partner with a preferred network of pre-approved contractors to enhance distribution and increase consumer satisfaction at reduced cost. This combination of a high-touch/high-service business model and the peace of mind the service contract delivers to the customer has led to high renewal rates in the home warranty industry.

Home warranties are an important element in the larger home services market, estimated at \$400 billion.

US Home Services Market



3 The market is growing despite low penetration

The U.S. home warranty market has grown since our last update. The market is now estimated at \$2.6 billion for 2021 and involves over five million contracts at an average retail price between \$300 and \$750. The market is estimated to be growing at 2% annually and generally tracks the sales of existing homes in the United States. Sales through smaller DTC players are growing the market faster. Some analysts say the industry could be as large as \$5 billion already.

The home warranty market is still characterized by relatively low household penetration, estimated at less than 5% by FTDR; although the industry's trade organization, NHSCA, claims that penetration in California is considerably higher. FTDR estimates nearly 30% of home resales include a home warranty. Increasing awareness and penetration among homeowners creates significant growth opportunities for providers.

A one percentage point increase in market penetration translates to roughly \$600 million of market opportunity.

4 The outlook is promising for independents looking to sell as financial sponsors and consolidators continue to acquire

While home warranty sales typically follow the housing market, warranty sales are expected to increase as appliances become more complicated and more difficult to repair, making a home warranty an increasingly attractive product. Home warranties provide buyers peace of mind. The reliability of a home warranty's professional repair network, with pre-negotiated rates, also increases the value proposition of the warranty to the consumer and spurs increased use of the product.

New entrants are also driving market growth. DTC players, fueled by payment plan providers, are accelerating market expansion.

Consolidation in the home warranty industry has continued at an accelerated pace, taking a slight reprieve during the heights of the pandemic. While we saw significant deals at a rate of only one to two per year prior to 2021, there were three significant deals in 2021.

Recent significant transactions

DATE	BUYER	SELLER
2021	Porch Group, Inc.	American Home Protect, LLC
2021	HUB International Ltd.	National Home Warranty Group, Inc. (subsidiary of Aviva Canada Inc.)
2021	Cinch Home Services	Certain Assets of Fixd Repair
2019	ANGI Homeservices	Fixd Repair
2018	Genstar Capital	2-10 Home Buyers Warranty
2018	American Waterworks Company, Inc.	Pivotal Home Solutions (subsidiary of Southern Company)
2017	Kingsway Financial / 1347	Professional Warranty Service Corp (new home warranties)
2016	American Home Shield	Landmark Home Warranty
2016	American Home Shield	OneGuard Home Warranties
2015	Fidelity National	BPG Home Warranty
2014	American Home Shield	HSA Home Warranty
2013	NRG Energy	Allied Warranty
2012	Direct Energy	Home Warranty of America

Large players in the insurance and home services industries have become increasingly active in acquiring home warranty players as a means of diversification across products while still being committed to their core markets.

CASE STUDY: Porch acquires American Home Protect

On September 9, 2021, Porch acquired American Home Protect, LLC (AHP), a company providing home warranty policies. The purpose of the acquisition is to expand the scope and nature of Porch's product offerings, add additional team members with important skillsets, and realize synergies. Total consideration related to this transaction was \$46 million.

Porch is a vertical software platform for the home, providing software and services to approximately 11,000 home services companies, such as home inspectors, moving companies, utility companies, home insurance, warranty companies, and others.

Strategic Rationale

- AHP provides an additional stream of subscription-based revenue. Warranty, like insurance, provides an additional predictable, recurring revenue stream. AHP's three-year contracts offer increased visibility into revenue while providing a base for growth.
- AHP is a scaled provider to enter the warranty market. AHP currently provides home warranty policies in 45 states and is in the process of obtaining licenses in an additional four states. Experienced marketing, sales and claims handling teams are in place that we believe will allow it to leverage the Porch ecosystem to further grow AHP.
- Strong leadership with deep expertise. Key leaders are in place with a robust team that is positioned to ramp growth under Porch. AHP's product development and marketing experience capabilities are well suited to enhance the current offering.
- Significant expansion opportunity with the Porch ecosystem. Ability to uniquely access homebuyers early is expected to provide AHP a way to acquire high-intent consumers at a lower cost. Porch will be able to improve the AHP value proposition by including a variety of handyman services as part of the core warranty offering, creating competitive differentiation. Insurance customers of Porch will have the ability to protect their home including a warranty. Finally, as Porch leverages its unique insights about properties including make and model of appliances, Porch expects to more effectively price warranties, driving growth and margin advantages.



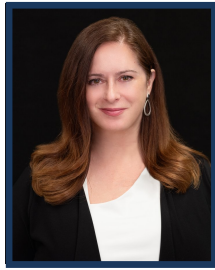
Conclusion

Industry dynamics, including reoccurring revenue, strong margins and cash flow, high retention, and positive growth, make an appealing investment thesis. This industry is growing and is ripe for further consolidation, additional investment, and financial buyer interest.

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Sources: NHSCA, Warranty Week, IBISWorld, SEC filings, press releases and corporate presentations.

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