Clearview

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Insurance

Carriers are undergoing a “perfect storm” which is benefiting a number of players across the insurance market.

Inside:

- MGAs benefiting from the current market conditions
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Consolidating market

Insurance groups have been experiencing a combination of adverse factors which have negatively impacted their return on equity:

- A prolonged environment of historically low interest rates, which are putting negative pressure on insurers' investment returns
- Softer pricing driven by excess capacity and increased competition from alternative capital, including pension schemes and hedge funds, which have recently flooded the insurance market in search of higher yield
- Tighter regulatory capital rules with the implementation of Solvency II, which has increased capital charges and negatively impacted carriers' operating margins through inflated compliance costs.

MGAs are ideally positioned to benefit from the current market backdrop

Carriers are looking to access new ways to grow and enhance their underwriting margins by targeting specialty and niche business lines in order to reinvigorate their organic Gross Written Premium (GWP) growth. As a result, carriers are increasingly deploying capacity into specialty business lines and the SME market. However, given their significant size and infrastructure, coupled with their lack of expertise in smaller volumes, specialty niche markets with lower average premium size, carriers are unable to deploy capacity profitably and are therefore relying on specialty Managing General Agent (MGA) platforms to underwrite on their behalf. Traditional insurers are therefore becoming 'asset manager' type vehicles allocating capital across internal and external underwriting teams through delegated underwriting authority agreements. As a result, the MGA sector has undergone significant growth. MGAs are ideally positioned in highly profitable niches of the insurance market and are extremely well placed to address insurers' needs for higher underwriting margin business. At the same time, the excess of capital in the insurance market allows MGAs to be more competitive on pricing without bearing any risks on their balance sheet.

Binding together

The MGA market is still highly fragmented with one-third of the Lloyds market's GWP serviced by over 4,000 MGAs. As a result, MGAs are joining forces.

The sector has attracted significant interest recently from private equity. After the cornerstone deal between Vitruvian Partners and CFC Underwriting at a reported enterprise value of approximately €255m in March 2017, valuing the business at about 15 times CFC's current year EBITDA, other private equity investors have entered the market assessing opportunities for buy-and-build. In January 2018, Preservation Capital purchased Ascent Underwriting, which specialises in cyber / tech and healthcare & medical billing underwriting. More recently Magenta Partners joined forces with Gary Burke at Eaton Gate Vigilis.

Many insurers are trying to integrate vertically by acquiring specialist MGA platforms. In regards to downstream integration, UK-based insurer Beazley expanded its presence in Canada with the acquisition of the specialist MGA Creechurch Underwriters in February 2016. US-based broker Arthur J. Gallagher made a similar, but upstream move in May 2018 by acquiring Pronto Insurance, a Texas-based MGA for c. €255m. In the UK market, a few MGA platforms including Nexus Underwriting are playing a central role in consolidating the market in order to diversify geographically and broaden their classes of business and products. Nexus has made 12 acquisitions over the past 10 years, the most recent being the purchase of Altitude Risk Partners' assets, an aerospace MGA specialist. Nexus' strategy allows for significant revenue synergies mainly driven by cross-selling opportunities by leveraging targets' distribution platforms and expanding underwriting expertise across existing geographies.

Intermediator consolidation

Distribution has become a more strategically important and valuable part of the insurance value chain in the context of increased competition and downward pressure on premiums.

This factor has driven buoyant M&A activity in the broking sector over the past few years. While still very fragmented 10 years ago, the industry is consolidating rapidly and has seen record levels of M&A transactions with more than 300 deals completed since 2013. At the forefront of this trend are domestic market brokers, which accounted for more than 50% of deals in the period. A number of sizeable transactions were closed in the UK broking market including Marsh & McLennan's acquisitions of Jelf, Bluefin and more recently JLT, for more than 14 times the UK-based broker's EBITDA. The Ardonagh Group has been a mass consolidator and platform created from a 5-way merger of Towergate, Price Forbes, Autonet, Chase Templeton and Direct Group.

This trend has been amplified by private equity funds, which have further accelerated the consolidation of the sector.

Fuelled by record levels of dry powder, financial sponsors have been attracted by asset light business models, strong cash flow conversion levels, high profitability, strong client retention rates and solid revenue growth coupled with compelling buy-and-build strategic opportunities in a fragmented market.

Valuations paid in the sector have steadily increased over time with certain transactions being completed in double-digit EBITDA multiple territory. Recent transaction values reflect the scarcity of sizeable assets, level of specialty, and ambitions of management teams. Buyers are ready to pay material premiums for assets with significant scale, which allow substantial revenue and cost synergies. Acquirers also tend to ascribe significant premiums for specialty players with strong presence in certain niches (SMEs, cyber risk, credit, surety and political and terrorist risk). JC Flowers' acquisitions of Endeavour and SSL, Carlyle's investment in PIB, and BGC Partners' investments in Besso Insurance Group and Ed Broking Group all confirm this trend.

Case Study

Clearwater International advises Nexus Underwriting Management Ltd on raising development capital

Clearwater International has advised specialty Managing General Agent (MGA) Nexus Underwriting Management Ltd (Nexus) on raising growth capital to support further M&A activity.

Founded in October 2008, Nexus is a specialty MGA and "virtual" insurance company, concentrating on niche classes of business such as Trade Credit; Accident and Health; Financial Lines and Travel amongst many others.

Now the largest and most profitable independent specialty MGA in the UK market, the business aimed to deliver c.€220m Gross Written Premium (GWP) in 2018, operate in 8 countries and will be supported by over 30 underwriting partners worldwide.

This investment from a new funding partner, along with additional funding from existing shareholder and investor, BP Marsh & Partners Plc, allows Nexus to continue its dynamic growth plan, strengthen its platform and extend its product offering, through strategic acquisitions of profitable, niche businesses.

James Barraclough, Partner, Clearwater International: "Nexus is a resilient business that has developed a strong platform. The facility will enable the company to continue with its buy-and-build strategy and broaden its services. We look forward to seeing the continued growth of the company."

> **This debt raising provides Nexus with the ability to satisfy our short-term plans of creating a virtual insurance company through a buy-and-build strategy focusing on profitable, niche MGA's.**
>
> Colin Thompson, Chairman, Nexus

Recent transactions

GRAYCE

received investment from

Literacy Capital plc

Sell-side

Undisclosed

inflexion PRIVATE EQUITY

MBO of

itm Solution delivered...

Buy-side

Undisclosed

TIKEHAU CAPITAL

acquired a minority stake in

FILIASSUR L'ASSURANCE RESPONSABLE

Buy-side

Undisclosed

UK team

James Barraclough

Partner and International Head of Financial Services, UK

Tel: +44 845 034 4774

Email: james.barraclough@cwicf.com

Guillaume Arnaldez

Director, UK

Tel: +44 845 052 0393

Email: guillaume.arnaldez@cwicf.com

International team

Jesper Agerholm **Denmark**, Thomas Gaucher **France**, Tobias Schätzmüller **Germany**, John Curtin **Ireland**, Jose Lemos **Portugal**, Javier Perez Farguell **Spain**