Where Do We Stand Now as Things Start to Open Up?

Insurance Agency & Brokerage M&A Update

Many of our clients have been asking us "now that the first phase of the coronavirus pandemic seems to be ending, where do things stand with insurance brokerage M&A?" This blog is an effort to answer that question.

In our initial article on the impact of COVID-19 on the insurance brokerage M&A market, we reported that transactions in the pipeline were still getting done, that the largest strategic players had told us "full steam ahead" on their acquisition plans and that the parties had been working around the obstacles presented by the containment efforts associated with the pandemic. With the benefit of several more weeks of living in our new reality, what are we seeing?

Here are our observations as of early June.

The Pandemic Has Not Diminished the Key Buyers' Interest in Acquisitions and the Multiples Being Paid

Each of the key active buyers, especially those comprising our SF Index, have told us that they continue to have high levels of interest in pursuing their M&A plans. There are two principal reasons. First, these brokers each have growth strategies whose success is measured by the expansion of revenues and EBITDA. Their senior managements, investors, and partner agencies are committed to the growth of their respective businesses, organic and inorganic, as a key metric of success.

Furthermore, as we have reported in previous blogs, these agencies already had their equity and debt capital lined up before the full force of the pandemic hit. As a result, they had and continue to have large pools of equity and debt capital to deploy in acquisitions. We will have much more to report on the current state of the private equity and debt markets for insurance brokers in our next blog.

For now, we simply want to point out that a number of PE firms are still looking for attractive platforms in the sector. Sica | Fletcher was able to close a major private equity investment in an insurance broker at the height of the shutdowns related to the pandemic.

As a result, despite initial concerns, to date we have not seen any reduction in valuation multiples paid in the transactions we are closing. The processes we are running have substantial interest from multiple acquirers. They remain highly competitive, and the EBITDA multiples we have been able to achieve remain at the levels we had seen before the pandemic.

The Pandemic Has Affected How Due Diligence is Conducted

The questions that buyers are asking in a due diligence have evolved somewhat to account for the pandemic. The key issue is whether an agency's historical financial results are indicative of what is going on in the business at the present time and what is likely to occur in the future. Insurance brokerage businesses can normally be viewed as predictable, basically "annuity-like" cash flows. However, in the midst of a pandemic, and with the concurrent economic fallout, this may not be the case.

Among the questions that acquirers are asking are:

- How has the pandemic affected the agency's client base and revenue stream?
- How have changes in the revenue stream affected the agency's EBITDA?
- How has potential seller adapted to remote working?
- How has the pandemic affected the agency's ability to manage its systems, customers and agency relationships?

Furthermore, management meetings have been handled remotely rather than face-to-face. As a substantive matter, this does not really change the process in a negative way, and in a certain sense seems to be more efficient. Subsequent diligence has always been handled electronically, so this has not been affected at all.

Impact of the Pandemic Differs Among Different Classes of Insurance Agents and Brokers – and May Affect Transaction Structure

Among agents and brokers who are potential sellers, the financial impact of pandemic has varied widely. While everyone has been affected by the need to work remotely, most brokers have not been damaged in a material way from a financial perspective, at least to date. A relatively small minority, however, are literally struggling to make payroll and pay the bills.

The agencies that have suffered the most economically typically have large amounts of clients who have been severely affected by the pandemic. Brokers with high levels of business from clients in the restaurant, hospitality, retail and transportation sectors have seen some, and are likely to see more, of a falloff in revenues. In contrast, there has been to date, a limited to no negative impact on agencies concentrating in other sectors – for example, personal lines, professional liability and benefits.

To date, as we mentioned before, the pandemic has not affected the multiples paid and number of players participating in our processes. If there is a risk that the seller's financial results have been or may be impaired by the pandemic, the transaction structure may be altered somewhat. These changes compensate the seller for the current value of the business, while concurrently providing a mechanism for providing additional compensation in the event that the business recovers to pre-pandemic levels. These mechanisms include traditional earn-outs or the somewhat less traditional step-up.

Not surprisingly, the reaction of whether to proceed among potential sellers in light of the pandemic has varied widely. For a not insignificant number, the pandemic has served as the catalyst to make the decision to move forward to evaluate their strategic options immediately. Others, especially those whose businesses have been dramatically affected, have taken more of a "wait and see" attitude.

As strategic advisors, we have been extremely busy fielding calls from potential sellers as to timing, market impact of the pandemic, and how they should proceed.

In Conclusion

To summarize, here is what we are seeing in the current market:

- The most active acquirers continue to be highly interested in acquisitions.
- We see the same peak multiples as before the pandemic struck and generally the same number of parties interested in the companies we are bringing to market.
- The number of transactions we are working on has not abated.
- If the sellers' financial results have been or will be significantly affected by the pandemic, acquirers are using structures like earn-outs and step ups to balance the risks and transaction compensation.

The wild card, of course, is that no one can predict the future. We cannot predict what the M&A market will look like in a year, regardless of its current vitality. There are simply too many unknowns.

Will there be a second pandemic wave or rolling "hot spots" as 2020 progresses? What will the economic recovery look like? Insurance brokerage is a GDP business. What if GDP growth is suppressed for a long time? And what if the acquirers who depend on private equity and debt capital lose their access to inexpensive capital in the future?

Only time will tell...

If you would like to have a discussion about your strategic options in these uncertain times, please visit our website, sicafletcher.com, or call us directly at 516.967.1958. We are here to help and would appreciate the opportunity to develop a dialogue and work as your strategic advisor to help you reposition your business for further growth and success.

About Sica | Fletcher

Among the brokerage community, Sica | Fletcher is well known as the leading strategic advisory firm in the U.S. that specializes in the insurance brokerage space and related industries that compliment it. In 2019, we led the country with 92 transactions completed for the insurance agents and brokers, and in 2018, we led the country with 79 closed transactions. We are also the leading advisor to the private equity firms that are most interested in investing in insurance brokerages and in the private equity sponsored agencies that have been created in recent years.

The firm was founded in 2014 by Michael Fletcher and Al Sica, two of the industry's leading insurance M&A advisors who have closed over $6 billion in insurance agency and brokerage transactions since 2014.