The Sky Definitely Is Not Falling … At Least Not Yet

Update on Private Equity and Insurance Brokerages

In our previous article, we reported that the COVID-19 pandemic had not diminished the pace of mergers and acquisitions transactions we are seeing in the insurance agency and brokerage sector. The number of transactions we are working on has not abated. We continue to see robust demand for the companies we bring to market. Furthermore, over the last few months, Sica|Fletcher closed one new, very significant PE investment in an insurance brokerage. We are currently working with a number of PE firms as they actively explore possible new investments in the sector.

The question is, "Why?". After all, our world has changed substantially. We are now in a global recession with record unemployment and numerous businesses shut down or dramatically altered. We face a future of uncertainty. No one really knows how the pandemic will play out from a medical, economic, political, or societal perspective.

The answer relates to private equity and the availability of capital to fund acquisitions and the need to deploy this capital. We will try to decipher the answer to this question in this article.

The State of Private Equity Pre-Pandemic

Prior to the advent of the pandemic, the private equity market exhibited strong fundraising, robust deal markets, and positive investor sentiment. As described by Prequin, the foremost provider of data, analytics, and insights to the alternative asset community:

- **In 2019, 1,316 private equity funds closed, securing $595 billion.** This was the fourth year in a row fundraising surpassed half a trillion dollars, with 2017, 2018, and 2019 recording the highest amounts of capital raised in history.
- **PE-backed deal flow declined somewhat in 2019.** In 2019, there were about 5,100 PE-backed buyout deals announced, with an aggregate value of $393 billion, down from 6,500 deals announced in 2018 with a value of $493 billion. This reflected the impact of valuations on deal flow and an increasing imbalance of potential sellers and buyers.

- **Dry powder reached $1.4 trillion as of December 2019, a record high.** Dry PE powder had almost doubled since the end of 2015, when it stood at $750 billion. This was symptomatic both of how the PE industry expanded in recent years and the impact of sky-high valuations on deal making activity.

As Bain reported, in 2019 the average multiple of enterprise value to EBITDA reached an all-time high in 2019 of 11.5X in the US. In part, this was supply/demand driven and, in part, this was fueled by historically low interest rates and the advent of "covenant-lite" bank loans. Deals with debt multiples higher than 6X EBITDA rose to greater than 75% of the total, again the highest in history, and in dramatic contrast to the years following the 2008 financial crisis, when the number gradually increased from nearly zero to about 60% by 2017.

The result of all these trends was that dry powder was piling up globally. As described above, the PE industry's dry powder has nearly doubled in the past 5 years. This torrent of available capital was even more pronounced when taking into effect the increasing levels of leverage used in these transactions.

In several previous articles, we documented, in detail, the impact of these trends in the insurance agency and brokerage market. Over 30 PE-backed brokerages were created in the last 7 years or so. Over 70 PE firms involved themselves in our sales processes. PE-backed agencies now dominate the M&A market and have grown and created enormous wealth for sellers, PE investors, and management. Multiples have also increased dramatically.

Then the Pandemic Hit

In summary, when the pandemic hit, the PE markets reached an unprecedented level of dry capital, fueled further by remarkably cheap debt. An increasing subset of these PE firms discovered the insurance agency and brokerage sector, pushing up multiples and changing the face of the industry.

The pandemic has not changed the enormous levels of dry capital that private equity firms currently hold. These firms remain "on the clock" to deploy their capital. They need to find ways to invest and reach their return requirements, and they need to do this in a dramatically changed economic environment where many industries have been radically affected by the economic devastation brought about by the pandemic.

However, insurance brokerages remain relatively unscathed from the fallout. Yes, firms have had to adapt to the new reality, and some brokerages in certain sectors have seen dramatic declines in their cash flows. In our experience, though, most brokerages continue to report remarkably stable financial results. The bottom line is individuals and businesses continue to require insurance and, to the extent they are able, continue to pay insurance premiums.

Consequently, for a meaningful subset of private equity firms, insurance brokerages represent a bit of a "shelter from the storm"—a relatively stable and predictable source of cash flow in a remarkably unpredictable time.

Furthermore, as seen in the following exhibit, the high yield bond market for insurance brokerages has stabilized dramatically in the past few months. The trading levels of this debt are much closer to pre-pandemic pricing than those seen in mid-March when the full force of the pandemic first hit. Helicopter money, as we had hoped, ended up saving the day and stabilizing the debt markets (see our blog here), and at least to some extent, the overall economy.

						1-Jun-2020		20-Mar-2020		21-Feb-2020	
	Issuer	Issue Date	Amount	Coupon	Maturity	Price	YTW	Price	YTW	Price	YTW
Insurance Brokerage	Acrisure	Jan-19	$950	8.125%	Feb-27	105.75	5.28%	90.75	11.10%	107.50	4.34%
	Acrisure	Aug-19	400	10.125	Aug-26	103.63	9.22	93.00	11.71	111.00	7.62
	Alliant	Oct-19	690	6.750	Oct-27	101.75	6.28	87.50	9.07	104.50	5.63
	AmWINS	Jul-18	550	7.750	Jul-26	106.38	5.97	97.00	8.37	109.50	4.65
	AssuredPartners	May-19	475	8.000	May-27	98.38	8.31	86.00	10.86	107.25	6.03
	Hub International	Apr-18	1,320	7.000	May-26	103.13	5.82	84.50	10.50	104.00	5.61
	NFP Corp	Jul-17	650	6.875	Jul-25	95.88	7.87	89.00	9.56	102.50	5.74
	USI	Apr-17	615	6.875	May-25	101.63	5.96	88.00	9.92	103.00	5.40
	Mean		**$671**	**7.625%**		**102.01**	**6.81%**	**88.29**	**10.00%**	**105.96**	**5.81%**
	Median		**$615**	**7.000%**		**102.44**	**6.13%**	**88.00**	**9.92%**	**104.50**	**5.63%**

Sources: Bloomberg, Goldman Sachs, S&P Global.

Note: Amounts in USD millions unless otherwise noted.

We believe that these factors explain why the pandemic has not had the impact on the insurance agency and brokerage M&A market that many had predicted and feared. Private equity firms continue to drive transaction pace and value. They have enormous amounts of dry powder that they must deploy, and they continue to have access to very inexpensive debt. In comparison to other sectors of the economy, insurance agencies and brokerages represent a relatively stable and predictable source of revenue—a "shelter from the storm". Of course, no one can predict the course of events in the future. But for now, the sky is certainly not falling, at least in terms of insurance agency and broker M&A.

If you would like to have a discussion about your strategic options in these uncertain times, please contact us 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.