

top issues

An annual report

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Strategy

The insurance deals market: At long last, momentum

The insurance industry in 2015



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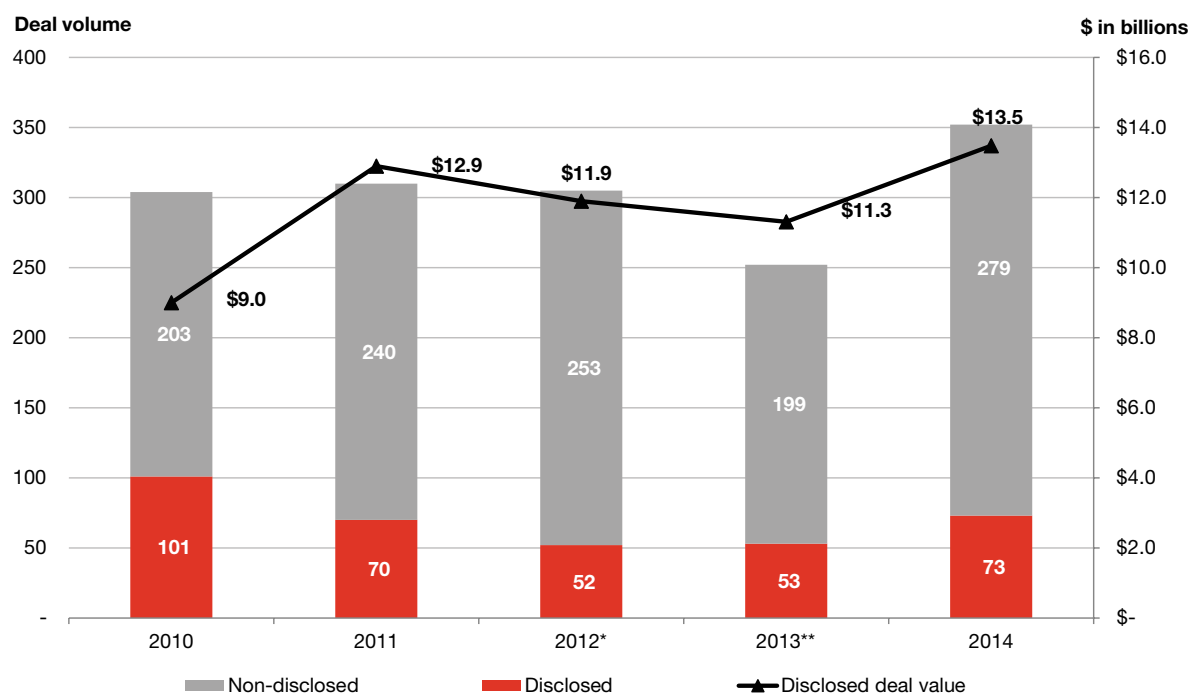
The insurance deals market

At long last, momentum

Insurance M&A activity in the US increased significantly in 2014 compared to recent years. There were 352 announced deals with a total announced deal value of \$13.5 billion, up from 252 announced deals with a total announced deal

value of \$11.3 billion in 2013. Q4 2014 represented the strongest insurance deals quarter in recent memory, and this momentum has already continued in 2015.

Figure 1: Announced US insurance deal activity – Annual data



* Includes KKR & Co LP's \$1.8 billion acquisition of Alliant Insurance Services Inc. not disclosed in SNL data,

** Includes Hellman & Friedman LLC's \$4.4 billion acquisition of Hub International not disclosed in SNL data,

Source: SNL Financial and various other sources

The largest announced deal of the year (and the past several years) occurred in the life and annuity space when Japan-domiciled Dai-ichi Life Insurance Company agreed to buy Protective Life Corporation for \$70 per share, or approximately \$5.7 billion. This represented a roughly 34% premium on the share price prior to the deal announcement. Interestingly, in 2013, Protective Life was on the other side of the largest announced deal in the life insurance sector when it announced the acquisition of MONY Life Insurance Company for \$1.1 billion.

We expect foreign interest in the US insurance market to continue as overseas corporations, particularly those in Asia with excess capital, seek to invest in markets with higher yields.

Figure 2: Top 10 US insurance deals announced 2014 (by value) – Excluding managed care

Rank	Date announced	Target name	Acquirer name	Sector	Value (\$ in millions)	% of total
1	6/3/2014	Protective Life Corporation	Dai-ichi Life Insurance Company, Limited	Life & Health	5,580	41.4%
2	3/21/2014	Warranty Group, Inc.	Wolverine Acquisition, Inc.	Property & Casualty	1,225	9.1%
3	12/16/2014	ARX Holding Corp.	Progressive Corporation	Property & Casualty	875	6.5%
4	12/23/2014	Radian Asset Assurance Inc.	Assured Guaranty Corp.	Financial Guaranty	810	6.0%
5	6/23/2014	Western World Insurance Group, Inc.	Validus Specialty, Inc.	Property & Casualty	690	5.1%
6	1/15/2014	Wright Insurance Group, LLC	Brown & Brown, Inc.	Property & Casualty	640	4.7%
7	12/30/2014	Meadowbrook Insurance Group, Inc.	Miracle Nova II (US), LLC	Property & Casualty	433	3.2%
8	12/18/2014	Fireman's Fund Insurance Co.	ACE Limited	Property & Casualty	365	2.7%
9	1/9/2014	Summit Holding Southeast, Inc.	Great American Holding, Inc.	Property & Casualty	260	1.9%
10	3/3/2014	Conseco Life Insurance Company	Wilton Reassurance Company	Life & Health	237	1.8%
Top 10 deal value					11,115	82.4%
Total disclosed deal value					13,481	100.0%

Source: SNL Financial

Unlike in prior years, when the largest announced deals were primarily in life and annuity and insurance brokerage, 2014 saw a significant increase in property & casualty (P&C) deal activity. The second largest disclosed deal in 2014 occurred in the P&C space when private equity firm TPG Capital Management acquired private equity-owned Warranty Group, Inc. for \$1.2 billion. The Warranty Group offers extended warranty products for auto, home, consumer goods and travel industries in 40 different countries. This deal is roughly double in size of the largest P&C deal in 2013.

Additionally, during the fourth quarter of 2014, Assured Guaranty announced its acquisition of Radian Group Inc.'s Radian Asset Assurance for \$810 million. While the deal is significant because of its size, it also is important because it is the first major deal in the financial guaranty space in a number of years.

The overwhelming majority of announced deals in the insurance sector relate to acquisitions in the insurance broker and agency space. These are significant from a volume perspective, but the deals usually do not have announced values. While we have seen large, multi-billion dollar transactions in this space in recent years, we did not in 2014. The largest deal, valued at \$640 million, was Brown & Brown's acquisition of Wright Insurance Group (which SNL Financial classified as a property & casualty transaction).

This was consistent with our expectations for both 2014 and the coming year, as the largest insurance brokers all were recently acquired or recapitalized.

In addition to the disclosed transactions listed in the tables above, there were a number of transactions involving US insurers that are not in the tables because the business that is the subject of the transaction has been moved offshore. An example is the Canada Pension Plan Investment Board's acquisition of Bermuda-based Wilton Re Bermuda Ltd. for \$1.8 billion. (Much of Wilton's operations and assumed risk are actually in the US.) In addition, in late 2014, in an all-Bermuda deal involving companies with significant US operations, RenaissanceRe announced its acquisition of Platinum Underwriters for \$1.9 billion, representing a 21% premium on Platinum's closing price prior to announcement.

It is likely that private equity firms will continue to show strong interest in life and annuity companies, insurance brokers, and particularly MGAs and MGUs.

Drivers of deal activity

There are a number of factors that we believe will impact deals activity in 2015. Some of them already had an impact on the market in 2014, while others are emerging trends. They include:

- **Low investment yields** – Throughout 2014, many academics and Wall Street analysts predicted that interest rates would begin to rise and end the year on an upward trajectory. However, interest rates have remained at close to historic lows, and the Federal Reserve appears reluctant to raise rates despite a recovering US economy. While increased interest rates would have a positive impact on insurance company earnings (particularly in the life and annuity space), insurers have adapted their business models to the persistent low interest rate environment.
- **Regulatory** – The evolving global regulatory environment continues to drive insurance M&A as companies continue to assess their businesses and seek to optimize capital and profitability. Solvency 2 in Europe has led some companies to exit certain businesses, while others have sought to enter new businesses to diversify their portfolios and risk profiles. In the US, increased state insurance commissioner scrutiny of the use of captives or shadow insurance and private equity-backed insurance company expansion continues to be a concern to potential buyers.
- **Foreign entrants** – As we noted previously, a Japanese insurance company made the largest announced acquisition of a US insurance company in 2014. In addition, in the seventh largest announced deal of the year, Hong Kong-based Fosun International announced its acquisition of Meadowbrook Insurance Group in December 2014. We expect foreign interest in the US insurance market to continue as foreign corporations, particularly those in Asia with excess capital, seek to invest in markets with higher yields. It is important to note that foreign entrants into the US market may drive up valuations, as they historically have been willing to pay significant premiums for US companies.
- **Private equity** – Prior to 2013, private equity and financial investors were increasingly active in the insurance sector as insurance companies looked to clean up their balance sheets and exit volatile and capital intensive lines of business. We expect to see continued interest from private equity firms in life and annuity companies and insurance brokers, and particularly managing general agencies (“MGAs”) and managing general underwriters (“MGUs”). MGAs and MGUs are of particular interest to private equity because they allow them to share in the risk/reward of the insurance business they underwrite without the regulatory risk/burden associated with acquiring an insurance company. Of note, there were a number of private equity-driven announced deals in the MGA space in 2014 with no disclosed deal values (as well as several unannounced deals).
- **P&C reinsurance consolidation** – In response to a soft P&C reinsurance market, many reinsurers are turning to mergers or acquisitions in an attempt to generate operational and capital efficiencies, improve pricing power, and offer a wider range of products. A case in point is the announced acquisition of Platinum Underwriters by RenaissanceRe that we cited previously. Both companies provide reinsurance for P&C catastrophe claims risks. Additionally, at the beginning of 2015, XL Group Plc announced its acquisition of Catlin Group Ltd. for \$4.2 billion, and Axis Capital Holdings Ltd. and PartnerRe Ltd. have agreed to an \$11 billion merger to create one of the world’s largest reinsurers. We expect the deals momentum in this space to continue through 2015.
- **Technology** – The insurance industry historically has lagged behind other industries in adapting to and leveraging new technology. Over the last few years, many insurance companies, particularly in the P&C carriers, have been investing heavily in upgrading existing and/or deploying new systems. This has helped them improve their operational effectiveness and efficiency, thanks to new-found abilities to more accurately analyze trends and risks to the business and thereby improve underwriting. Over the last few years, we have seen potential acquirers seek to leverage the technology of target companies. Moreover, technology can have a significant impact on valuations as companies seek strategic acquisitions to upgrade their systems.

Implications

- After several years of slow deals activity, 2014 saw a noticeable increase in deal volume and size. 2015 already has been similarly active and we believe the remainder of the year will follow suit.
- We expect non-US companies to be active players in the deals market and likely drive up valuations if they remain willing to pay a premium for access to the US market.
- Private equity will remain a major driver of insurance deals activity, especially as it relates to MGAs and MGUs. Increased regulatory scrutiny and risk management concerns make these kinds of deals especially appealing to many private equity investors.
- Thanks in large part to a soft market and limited organic growth opportunities, we expect to see continued consolidation in the P&C reinsurance industry.
- Insurers that have upgraded or replaced their core systems are increasingly becoming the target of potential acquirers. Improved technology usually makes carriers more operationally efficient, and potential acquirers often use strategic acquisitions as a way to upgrade their systems.

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