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INSURANCE AGENCY AND BROKERAGE M&A TRENDS TO WATCH AMID THE COVID-19 PANDEMIC

BY THOMAS TRULLINGER

The COVID-19 pandemic has created challenges for many businesses across the globe, including the insurance industry. But so far, the insurance broker merger and acquisition (M&A) market has remained active even as the pandemic continues to unfold.

Before the pandemic, both property and casualty and employee benefits insurance brokerages and agencies emerged as prime acquisition targets for a multitude of different buyers. These insurance agencies have experienced steady growth over the past several years. Rising demand for insurance coverage in a hardening market has resulted in growing insurance premiums.

Considering most brokerages make their revenue from commissions, these rising premiums have positively impacted brokers' bottom lines.

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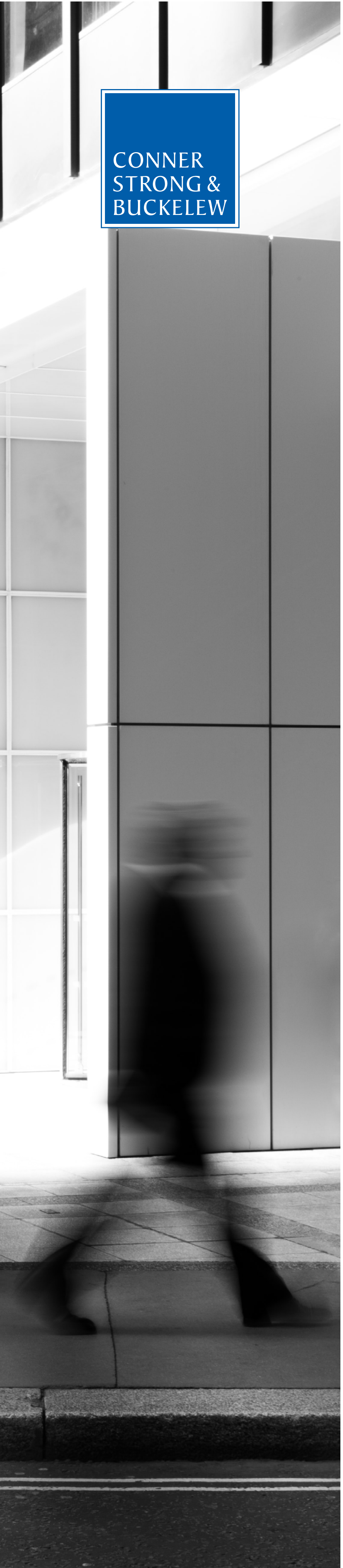
These dynamics caught the attention of both strategic and financial buyers looking to acquire businesses with strong cash flows and solid fundamentals. Because of this, competition for deals intensified over the last two to three years and agency valuations have also increased significantly. However, the pandemic has introduced some uncertainty into the market. Some brokers' clients may have business continuity issues and may not survive the pandemic, which could hurt the broker's valuation and attractiveness to a buyer. Because of this, valuations and multiples may flatten or drop slightly in the near term.

While it is still early to tell exactly how the pandemic will affect long-term demand for insurance broker and agency merger and acquisitions, the market for deals remains relatively active. As we move forward, there are several trends likely to affect merger & acquisition opportunities throughout 2020 and beyond. Here are a few dynamics to look out for in the months ahead:



1 HIGH VOLUME OF TRANSACTIONS

The number of transactions taking place in the brokerage sector is charting an upward trajectory. In fact, the total number of deals in the insurance brokerage space hit an all-time high in 2019 with 649 total transactions, up from 643 in 2018, according to Optis Partners LLC. This trend is likely to continue in the face of the novel coronavirus. It is even possible that the number of transactions will accelerate selling agencies' plans to pursue a deal given the need for diversification and scale as macroeconomic conditions begin to change.

2 EMERGENCE OF PRIVATE EQUITY BUYERS

One major driver of broker and agency M&A activity in recent years has been the emergence of private equity buyers in the market. According to the Optis Partners report, brokers owned by private equity firms or with some form of significant outside capital support were by far the most active buyers of insurance brokerages in 2019. These companies represented roughly 66% of all buyers last year. Looking ahead, the COVID-19 outbreak may decelerate the number of discussions taking place in the market in the near term.

However, private equity firms are still expected to be active buyers of insurance brokers in 2020.

With that in mind, sellers must take note: private equity firms may have the capital needed to fund a transaction. But they may not be able to provide the structure, resources, technology, industry relationships and expertise that a broker with decades of experience in the industry can.

3 GROWTH OF OVERALL M&A ACTIVITY

The merger and acquisition trend is not limited to the insurance brokerage industry.

According to Deloitte, more than $10 trillion in transactions have been announced across all industries in the U.S. since 2013.

Even amid a pandemic, many expect total deal volume to continue rising across the United States in 2020. This trend can present challenges for the insurance brokerage industry. Brokers can lose customers when those customers merge with another company that does business with a different broker.

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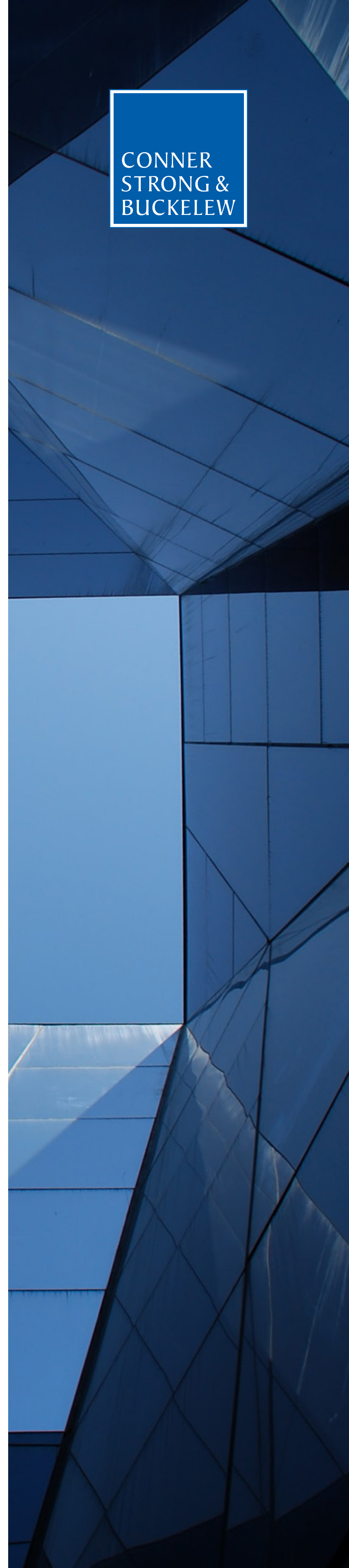

BUILDING A PLAN FOR THE FUTURE

As the amount of M&A activity continues to increase, brokers of all sizes must begin to think about formalizing their strategy. The economic uncertainty caused by the pandemic may begin to apply pressure to a broker's valuation, and many business owners considering a sale should begin to think about their options.

Larger, well-established brokers that can offer technology, expertise, and benefits of scale are the buyers behind many transactions. Now is a good time for smaller brokers to sell and reap these benefits.

Before doing so, brokers should first focus on finding the right cultural fit. For two businesses to integrate smoothly, a business owner must be sure their processes, procedures, and way of doing business align with the buyer's.

Brokers should also consider hiring an adviser. These individuals are well-versed in the insurance M&A marketplace and can guide business owners through the process. From start to finish, it may take a broker two to three years to find a buyer and finalize a transaction. A lot can change in that time, and advisors can help shorten and streamline this process.

Ultimately, brokers should partner with a company that will be able to provide them with the resources and support that enable them to grow and thrive in an evolving insurance landscape.

Right now, these buyers are in ample supply and have the capital required to make a deal. It all starts with a conversation.

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