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OBSERVATIONS ON THE TRUMP TARIFFS AND THEIR IMPACT ON INSURANCE BROKERAGE M&A

OVERVIEW

President Trump's tariffs have been announced and they are more hawkish than most of the pundits expected. Over the past few weeks and especially post-announcement, global equity markets have been in free fall and the financial press is in panic mode. Despite the current chaos, we believe the tariffs will serve to be very positive for insurance brokerage M&A.

NO, THE SKY IS NOT FALLING

Over the last several years, the broker M&A market has continued to be robust, trading at peak multiples, despite high interest rates. With the dramatic interest rate rise beginning in 2022, we called for the advent of a more bearish market in insurance brokerage M&A in 2023. We proved to be completely wrong. Multiples on average actually increased slightly because the demand for targets remained strong among the 50+ active acquirers of insurance brokerages, most of whom were private equity sponsored, and because of the hard market's impact on premium inflation. In 2024, the market also remained resilient.

So why do we remain bullish on insurance broker M&A even though equity markets are down approximately 15.2% over the past few months and by over 10.0% last week? Here's our take on the situation.

1. President Trump had two paths with tariffs. The first was to go hawkish with high tariffs on all countries right out of the gate. The second was to go dovish – apply tariffs incrementally until enough pain is felt by our trading partners. He chose hawkish. The benefit of this approach is this could result in a quicker resolution of trade issues than a slow tariff build-up. We are the largest trading partner for many of these countries and if they don't immediately negotiate a resolution with us, the economic pain they will suffer is a multiple of ours. As a country and an economic powerhouse, we have all the leverage.

2. In our view, Scott Bessent, President Trump's Treasury pick, is one of the smartest and most economically savvy Treasury Secretaries in American history. Many don't know that Bessent was a partner with George Soros and Stan Drukermiller, who made one of the most brilliant and famous trades in history. They shorted the British pound and forced the British bank to intervene, making billions in the process.

3. Bessent has been vocal that the current financial trajectory of the US economy is unsustainable and he and President Trump are going to fix it. IF you have been following Bessent's comments, he has been clear on what he wants to do. He wants to bring the 10-year treasury down to 3% (down from 4.6% when President Trump was inaugurated). To do that, he needs to kill inflation. The approach the Administration is taking to dramatically reduce inflation has two principal elements:

1 Slow the economy by reducing spending via reducing the federal work force and implementing the policies of The Department of Government Efficiency.

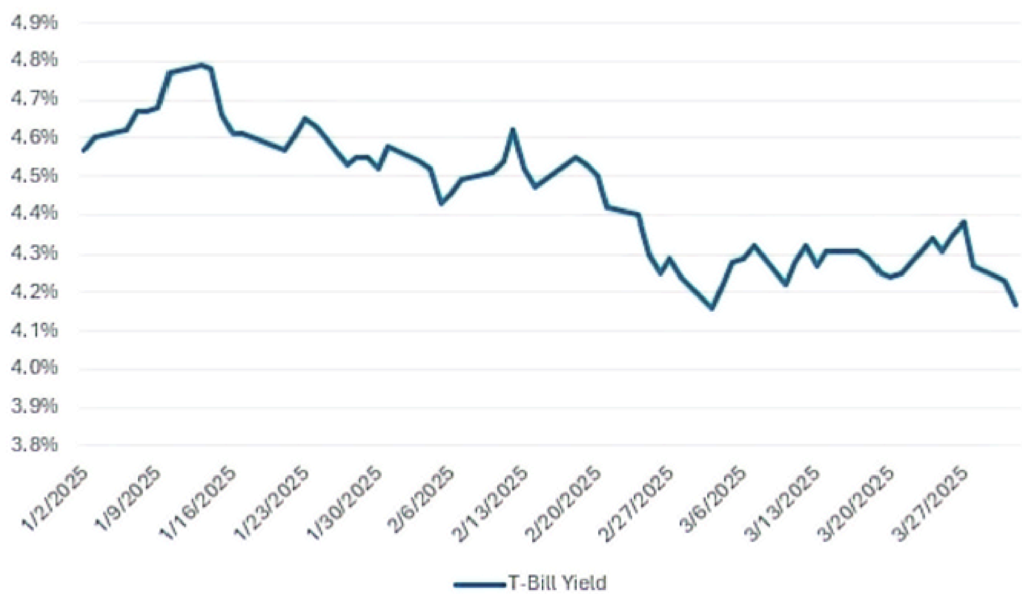
2 Implement a policy of significantly higher tariffs with all of our trading partners.

4. The Administration, and especially Secretary Bessent knew going into this what impact the tariffs would have on the market. They expected the negative impact on the stock market and are using this to their advantage. We believe Bessent has thought this through and felt the short-term pain was worth the long-term benefit.

5. So how does all of this affect the insurance brokerage M&A market? It is actually quite simple. Lower interest rates will lead to a more robust insurance brokerage M&A market. Here's why.

6. About 80% of all deal activity for insurance brokers is closed by private equity backed brokers. Across all transactions with an EBITA of over $1 million, the avg M&A multiple is about 11.5x – that multiple means a buyer can expect a return in excess of 20% normally. However, buying brokers at an average of 11.5x and expecting a return in the 20s while borrowing at extremely high interest rates is unsustainable. To date, the market has been resilient because of the sheer proliferation of private equity sponsored brokers, but eventually the high interest rates will catch up with it. We have already seen this happen in the Assured/AJG transaction (see case study here). It was a matter of time before it caught up to lower and middle market M&A.

7. In summary, lower interest rates will drive continued demand in insurance brokerage M&A. From Secretary Bessent's view, things are going to according to plan.



8. Broker borrowing rates are NOT pegged to the yield on the 10-year Treasury Note; rather, they are based on the 90-day Secured Overnight Financing Rate (SOFR), which is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. Typically, the SOFR yield is well below the 10-year Treasury yield. If Secretary Bessent can get to 3% on the 10-year Treasury yield, it is easy to extrapolate a 2% SOFR, which would save the current cadre of highly-levered brokers billions of dollars in interest expense by bringing rates down from the peak of approximately 3.4%. This would allow M&A multiples to remain at least at current peak levels, where they are unsustainable at the current high cost of borrowing. In fact, with over 50 potential acquirers looking to put capital – including considerable amounts of debt capital – to work, we may even see some multiple expansion.

9. If the trade war is prolonged, the two fears are deflation or inflation. Everyone has a different opinion, so lets look at both outcomes. In a deflationary scenario, insurance premiums may decline but interest rates will decline as well. If the Feds see any hint of deflation, they will cut low term rates (like SOFR) to zero. In general, insurance broker premiums are not affected directly by tariffs except as they affect GDP growth. As mentioned above, a decline in GDP will lead to a decline in interest rates. This is bullish for insurance broker M&A.

10. The other argument is that higher tariffs will lead to stagflation, meaning higher inflation and negative growth (similar to the Jimmy Carter years). In this scenario, insurance brokerage acquisitions can be the gift that keeps on giving. In a stagflationary environment, interest rates should go up with inflation, but our bet is they don't because the Fed will keep short term rates down to sustain the little growth there is. In other words, the Fed would accept higher inflation. In this scenario, higher inflation would lead to lower rates AND higher insurance premiums – all bullish for insurance broker M&A.

11. Obviously, neither deflation nor inflation is good for the country. But we believe Secretary Bessent is betting on a third outcome. And that is that our trading partners cave quickly. This would be a boost of the US economy and perhaps really lead to an American economic Gold Age. And this third scenario would also be bullish for insurance broker M&A.

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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 $19 billion in insurance agency and brokerage transactions since 2014. Sica | Fletcher has been ranked by S&P Global as the #1 insurance M&A advisory firm since 2017 in terms of total deals advised.

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