COVID-19 and Credit: Debt Market Volatility and Insurance Brokerage M&A

We are all painfully aware of the impact the coronavirus pandemic has had on our investment and retirement portfolios. As someone recently joked, in the darkest hours of this pandemic, it seemed as though our 401(K)'s were turning into 101(K)'s. What is generally less understood is the impact of the pandemic on the debt markets. What is going on in these markets could potentially have significant implications for insurance brokerage M&A, and we want you to understand why.

While we can't predict the future, our certainty level regarding the impacts on insurance brokerage M&A has increased over the past several weeks. To provide you with some color on what has happened, a little recent history is in order.

Many PE-backed Insurance Brokers Secured Sizable Loans Immediately Prior to the Crisis

Over the past several years, the demand for high yield debt issued by private equity (PE) backed insurance brokers has been extremely strong. As a result, the top tier of these companies has had ready access not only to equity provided by PE firms, but also to highly inexpensive debt. This trend continued unabated at the start of 2020, at least until the economic impact of the pandemic hit.

As you can see from the chart below, four of the twelve leading brokers in the SF Index (Assured Partners, Alera Group, NFP Corp. and Acrisure) secured large loans between January 31 and February 11 of this year. In total, these four companies successfully borrowed $7.8 billion at yields between 5.1% and 5.9%:

Date Priced	Issuer	Size	Spread	Maturity	At Issue Ratings: CCR	At Issue Ratings: Tranche	At Issue: QID	At Issue: Yield
11-Feb-20	AssuredPartners	$2,122	L + 350	2027	B2 / B	B2 / B	99.75	5.38%
7-Feb-20	Alera Group	697	L + 400	2025	B3 / B	B2 / B	100.00	5.88
4-Feb-20	NFP Corp	1,850	L + 325	2027	B3 / B	B2 / B	99.50	5.24
31-Jan-20	Acrisure	3,175	L + 350	2027	B2 / B	B2 / B	99.75	5.41

Sources: Bloomberg, Goldman Sachs, S&P Global.
Note: Amounts in USD millions unless otherwise noted.

Impact of the Pandemic

As markets began to absorb the economic and social ramifications of the pandemic, the impact on trading markets was sudden and significant. There was a flight to "safe haven" - less risky assets. You felt this in your investment and retirement accounts, and the debt markets were dramatically affected as well.

We can see the impact in the debt markets very clearly. The loans which had been raised by the PE-backed brokerages trade on secondary markets together with other issues of high yield debt. As you can see from the chart below, in the month following February 21, the yield on these loans as priced by the debt markets nearly doubled, from an average of 5.3% to 10.0%.

	Issuer	Issue Date	Amount	Spread	Maturity	20-Mar-20 4yr Yield	21-Feb-20 4yr Yield
Insurance Brokerage	Acrisure	Jan-20	$3,175	L + 350	Feb-27	10.20%	5.18%
	Alera	Aug-18	697	L + 400	Aug-25	10.20	5.65
	Alliant	Apr-18	2,086	L + 300	May-25	9.17	0.00
	Alliant	May-19	530	L + 325	May-25	9.41	4.92
	AmeriLife	Feb-20	390	L + 400	Feb-27	9.70	5.65
	AmWINS	Jan-17	1,811	L + 275	Jan-24	8.78	4.33
	AssuredPartners	Feb-20	2,122	L + 350	Feb-27	9.20	5.20
	BroadStreet Partners	Jan-20	1,111	L + 325	Jan-27	9.37	4.91
	Confie	Oct-16	665	L + 475	Oct-21	19.76	7.59
	Confie	Oct-18	220	L + 850	Nov-25	17.20	12.93
	EPIC	Jan-19	969	L + 425	Sep-24	6.86	6.05
	Hub International	Apr-18	3,210	L + 300	Apr-25	9.45	4.75
	Hub International	Oct-19	1,270	L + 400	Apr-25	9.74	5.52
	NFP Corp	Feb-20	1,850	L + 325	Feb-27	9.70	5.03
	OneDigital	Oct-18	669	L + 400	Oct-25	10.20	5.61
	USI	Apr-17	2,610	L + 300	May-24	9.29	4.73
	USI	Nov-19	550	L + 400	Nov-26	9.08	5.66
	1LTL Mean		**$1,482**	**L + 359**		**10.01%**	**5.34%**
	1LTL Median		**$1,191**	**L + 350**		**9.43%**	**5.19%**
	2LTL Mean		**$220**	**L + 850**		**17.20%**	**12.93%**
	2LTL Median		**$220**	**L + 850**		**17.20%**	**12.93%**

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

Note: Amounts in USD millions unless otherwise noted.

And it was not just insurance broker debt whose yields nearly doubled; the same thing happened to the bonds issued by these PE-backed insurance brokerages:

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

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

Note: Amounts in USD millions unless otherwise noted.

From looking at these two charts, the impact of the coronavirus pandemic is very clear. The public markets have substantially increased the implied yields on both loans and bonds issued by these brokerages, typically repricing the debt to imply yields in the high single digits or low double digits. One outlier is Confie Seguros, whose loans were priced to yield close to 20%. Confie has traditionally focused on the non-standard auto market, and perhaps the concern is that their demographic may be the first to stop paying their insurance premiums.

Implications of the Data

The good news from this data is that the top tier of PE-sponsored insurance brokers had secured their debt financing at highly attractive terms before credit markets were substantially affected by the coronavirus. This is one of the key reasons that the deals we have in our pipeline are getting done on the same terms and conditions as before, and most of the large strategic players are telling us it is "full steam ahead," as they have the capital and desire to continue to acquire. The parties involved are working around the logistical obstacles presented by the virus, mostly by teleconferencing.

Having said that, we are now dealing with a more uncertain future that will only resolve itself with time. While we cannot predict what will happen, this data raises interesting questions.

Here are some of the questions we ask ourselves:

- Will the debt markets continue to demand a risk premium reflected in higher yields over the upcoming months? To the extent that new capital has become more expensive, how will this affect transaction pricing over time?
- Would these insurance brokers be better off buying their own loans at discounted pricing rather than using this capital to acquire other agencies?
- To the extent that there is long term damage to GDP and economic growth, how will this affect insurance brokerage revenues and margins? And in turn, how will this affect insurance brokerage M&A pricing and terms?

We certainly hope that you and your loved ones stay safe and well and that your business continues to flourish. If you would like to have a discussion about your strategic options in these uncertain times, please reach out to us. 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.