Property Casualty 360

Specialty Lines Spice Up M&A Deals

Niche business is key to latest wave of P&C deals; MGAs enjoy higher values

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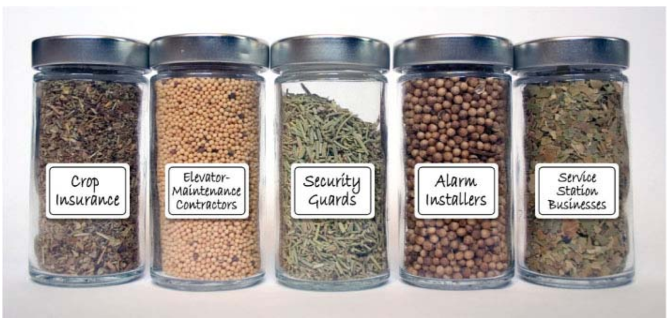
As in past soft property and casualty markets, insurer appetite for mergers and acquisitions is strong today. But what distinguishes the current wave of deals is strategic buys of specialty-flavored books that focus on lines like inland marine, slices of medical professional liability, crop insurance and even elevator-maintenance contractors.



Although specialty books of business are typically smaller than potential standard-lines acquisition targets, what makes them so appealing is that some run at combined ratios below 90, says Jerry Theodorou, vice president of insurance research & publications for Conning in Hartford, Conn. Firms with those sorts of numbers became very attractive in 2010, says Theodorou, author of Conning's annual report on insurance M&A trends released in March.

"M&A is typically a creature of the soft market," he tells *NU*. "When you can't grow your way out of the doldrums, you try to buy somebody else," he says, adding that sagging investment returns and soft-market prices pressuring loss ratios make standard-lines writers—with combined ratios north of 100—unattractive targets.

Representative deals involving specialty insurers include:

- The purchase of Vanliner Insurance, a moving and storage specialist by National Interstate Group.
- The deal completed by ProSight Specialty Insurance Holdings to acquire NYMAGIC, the ocean and inland-marine specialist.
- The deal which saw Travelers buying a stake in a surety writer in Brazil.

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SLIM PICKINGS DRIVE HYBRID DEALS

For carriers looking to acquire specialty books of business, however, there is a problem: not a lot of standalone specialty insurers are out there to buy. That has led a number of risk-bearing entities to adopt an alternative strategy.
"They are looking at distribution plays," opting to buy managing general underwriters and agencies, Theodorou says, pointing to deals like ACE Limited's $1.1 billion purchase of MGA Rain & Hail last year; and to a similar deal this year by Everest Re to buy Heartland Crop Insurance.

Theodorou, who identified these "hybrid deals" that bring specialty distributors and carriers together as an underlying theme of many recent deals, spoke to *NU* before this year's biggest transaction so far—the just-announced merger agreement valued at $3.2 between specialty-insurer Allied World and specialty-reinsurer Transatlantic Re.

WHOLESALE ALSO RISING

While specialty books are the belle of the current M&A ball, wholesaler prices also are up, according to Richard Kahlbaugh, CEO of Jacksonville, Fla.-based Fortegra Financial, the insurance-services firm which acquired wholesaler Bliss & Glennon (B&G) in 2009.

Kahlbaugh, who is actively seeking to buy regional wholesalers, contends that Ryan Specialty Group—the most active acquirer in the wholesale space, which is headed by Patrick Ryan, the former chair on Aon—"has inflated expectations."

Estimating that wholesaler-deal prices are up 10-25 percent since his B&G deal "wouldn't be a stretch," Fortegra's CEO says.

Participants in that pending deal are mainly touting the benefits of a combined $8.5 billion capital base, as the well as the flexibility of the worldwide specialty enterprise to allocate capital to highest-return geographies and to hardening lines of business, such as property-catastrophe reinsurance.

OPPORTUNITY KNOCKS FOR NICHE MGAS

Chris Hughes, director of insurance distribution for Merger & Acquisition Services in Hartford, says that insurers are not the only potential buyers aggressively competing for specialty MGAs. Referring to a deal for Trafalgar, a recreational-marine MGA, he notes that while "all the main marine [carrier] competitors" put fair valuations on the business, strategic program managers with 20-30 non-marine programs delivered enhanced valuations. So did generalist wholesalers, Hughes says, noting that the MGA ultimately went to Arrowhead General Agency, a California-based program manager.

In these types of deals, there are "a lot of people seeing a stronger strategic value than just combining top lines and maybe cutting some expenses," says Hughes, who notes that valuations for some niche deals are being bid up to levels like 6- to 8-times EBITDA (earnings before interest, taxes, depreciation and amortization). In contrast, he says, while demand continues for wholesale-broker acquisitions, value for those are more like 4.5- to 6-times EBITDA.

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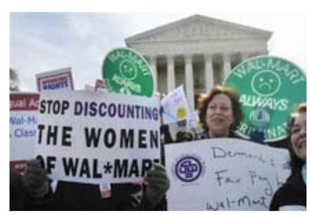

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