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M&A in Australia's insurance sector

Positioned for growth

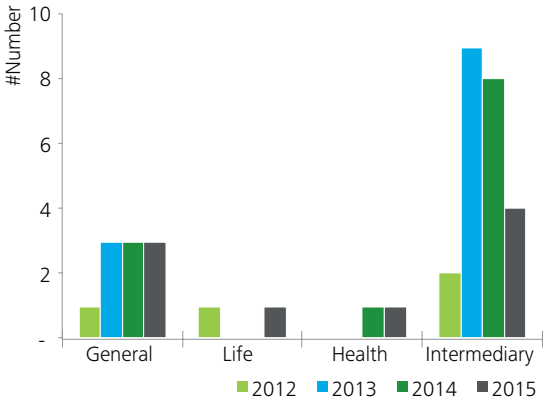
Overview

There are a number of factors aligning to position the Australian insurance sector for increasing levels of merger and acquisition (M&A) activity. These include:

- Slowing organic growth opportunities for general insurers
- An assessment by the major banks on whom the natural owners are for life insurance manufacturing versus distribution operations
- The strong competition between intermediaries for limited targets of size
- An environment where the regulator continues to increase capital requirements which indirectly encourages consolidation, particularly at the smaller end of the market.

Some of this parallels significant activity in Asia where the distribution aspects of deals, especially around bancassurance, are driving forces of deal strategy and value. We explore these themes and more herein.

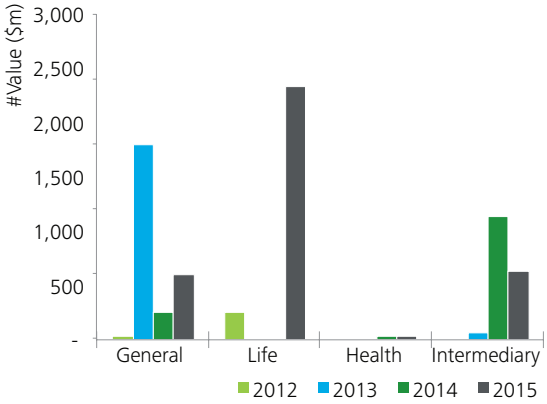
Insurance M&A Deal Volume (by Sector by Year)



Source: Mergermarket (1 Feb 2016)

As illustrated in the chart above, M&A activity across the Australian insurance sector has been relatively stable (in terms of transaction volume) over the past three years, with strong growth in 2013 following a relatively subdued 2012. Insurance intermediary transaction volume has also remained strong although numbers are declining from their peak in 2013. The life and health insurance sectors have in the past seen lower deal volumes due to a limited number of life insurance acquisition opportunities coming to market and limited appetite by private health insurance (PHI) businesses to sell. However, recent sector activity (such as the divestment of 80% of the insurance business of MLC by NAB and the acquisition of Transport Health by Primary Health Care) indicate a potential pick-up in activity over the short to medium term in both sectors.

Insurance M&A Deal Value (by Sector by Year)



Source: Mergermarket (1 Feb 2016)

There have been significant landmark transactions within each sub-sector (except for health insurance). The chart above sets out the total sum deal value by sector in each year 2012–2015, however some of the landmark transactions include:

- General (2013): IAG acquired Wesfarmers Insurance Underwriting operations in Australia and New Zealand ($1.8bn)
- Life (2015): Nippon Life announced the acquisition of 80% of the life insurance business of MLC Limited (from NAB) ($2.4bn)
- Intermediary (2014): Arthur J Gallagher acquired Wesfarmers insurance brokering business, OAMPS ($1.0bn)
- Intermediary (2015): Steadfast acquired Underwriting Agencies Australia and CHU and strata broker BCB from QBE ($522m).

Note that not all M&A announcements include the value of the transaction; therefore the chart above only includes the transactions for which the transaction value has been disclosed.

See Appendix 1 for a list of the 15 largest insurance M&A transaction announcements between 2012 and 2015.

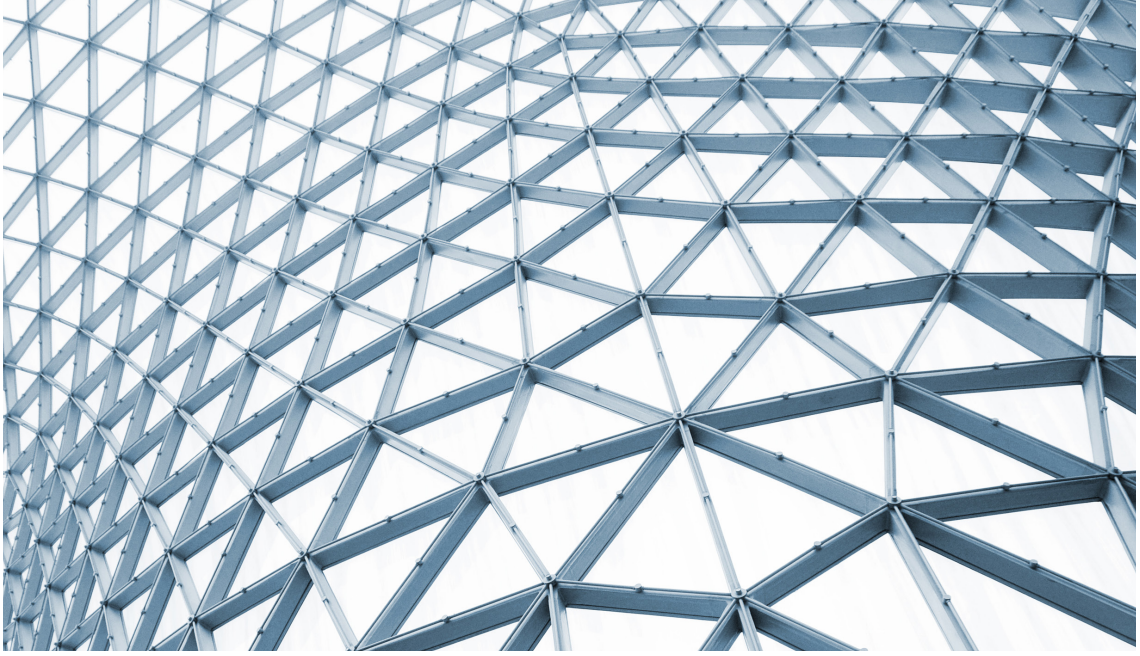
In addition to the M&A activity discussed above, there has been some capital market activity within the insurance sector across each sub-sector, most significant of which was the $5.7bn IPO of Medibank Private, Australia's largest health insurer, $591m sell-down of 34% of Genworth Mortgage Insurance Australia by its US-parent, $521m IPO of Cover-More Group, an Australian-based travel insurance provider and $334m IPO of Steadfast Group.

See Appendix 2 for a list of the insurance IPO's (with a market capitalisation of over A$75m) between 2012 and 2015.

Below we discuss the M&A landscape for each insurance sub-sector.

General Insurance

- Organic growth opportunities for general insurers are limited within Australia, with the soft insurance market (particularly in commercial lines) driving weak and slowing growth. General insurers may therefore look to M&A as one option for top-line growth, either domestically or in Asia
- There have been a number of M&A transactions in the general insurance sector, with highlights of 2015 including the investment into IAG by Berkshire Hathaway (and entrance into a corresponding reinsurance agreement), and the acquisition of AssetInsure by CBL Corporation, who then subsequently listed the combined group on the ASX and NZX. Global consolidation, such as the Ace acquisition of Chubb, is also changing the competitive landscape in Australia with the new combined groups becoming significant local players
- Privatisations drove some of the M&A activity in 2014 and 2015, led by the NT Government's privatisation of the Territory Insurance Office (TIO) which was acquired by Allianz. The SA Government also recently entered into an agreement for a group of general insurers to provide cover for the SA Motor Accident Commission's front-book from 1 July 2016 onwards (the SA Government is still holding the back book, but this could be sold in the near-future). We would expect state governments to continue to consider potential privatisations of Compulsory Third Party and Workers Compensation insurance schemes
- Expansion (or further expansion for some) into Asia may be appealing, to capitalise on the growing middle class and transfer skillsets developed in Australia, but is not without concern from Australian institutional investors, especially as in some countries control is not available to foreign insurers. IAG recently announced it was looking at a significant acquisition opportunity in China, however after investor concerns were expressed, IAG later announced the termination of that potential opportunity. Asia still presents an enormous opportunity for Australian general insurers who can navigate the regulatory, cultural and competition hurdles to grow their business



- Another area which general insurers may focus on in the near-term is financial technology (fintech), whether it is for distribution, claims handling/reporting or other ways to engage with their customer base and also reduce overhead / back-office costs. There is also an increasing trend of incumbents buying fintech players (or using incubators) as a cheaper option to developing financial technology in-house.

Life Insurance

- The Australian life insurance sector has seen three significant recent transactions. First was the acquisition of TOWER Australia by Dai-Ichi Life in 2011 (rebranded TAL), the acquisition of ClearVew Wealth by Crescent Capital in 2012 and most recently Nippon Life's acquisition of 80% of the life business of MLC Limited (from NAB)
- In recent years, structural issues in retail insurance around business retention, disability income claims experience and pricing of group insurance caused profitability issues for a number of Australian life insurers and reinsurers. Actions have been taken on some of these factors, improving the outlook for the sector, at least in the short to medium term
- Anticipated to be a hot sector in the short-to-medium term, driven by banks and private equity disposals. Firstly banks, where we anticipate that the big 4 (as well as Macquarie and some of the major regionals) will look to divest some or all of their life insurance operations. This is partially driven by two major factors:
  - An assessment of who is the natural owner of a life insurance business, dividing distribution versus manufacturing of life insurance products, and the potential sale of the life insurance manufacturing operations. The Nippon Life / MLC transaction demonstrates that a big 4 bank can divest its life insurance business; it just takes patience and expertise
  - The level of capital tied up in these business units and the bank's desire to increase their return on equity from less capital intensive and higher margin operations, such as mortgage lending. It has been specifically rumoured that both ANZ and Macquarie may look to divest their life insurance businesses
- It has also been rumoured in the press that Crescent Capital (an Australian private equity fund) will divest its majority interest in ClearView Wealth which it acquired in 2012 and potential buyers may take the opportunity to try and acquire the rest of the business from minority shareholders and management
- An increased appetite for growth by major global life insurers who have been looking to Australia for global expansion
- The Australian Securities and Investment Commission (ASIC) recently began an investigation into consumer credit insurance (CCI) and in Oct-15 fined one of the big 4 banks for misselling. Some CCI insurers may look to exit this business line and sell their operations, however it is likely that the market appetite for this product line is limited and a seller may be required to retain the conduct/litigation risk associated with legacy CCI practices. Until there is further clarity on the matter, it could be a waiting game for M&A activity.

Health

- The Australian health insurance sector continues to be dominated by Medibank Private and BUPA, who collectively hold c. 55% market share. These majors are followed by three medium-sized national or regional players (HCF, NIB and HBF) who hold c. 27% market share while the balance is held by a long tail of small (typically non-profit) participants
- While the sector enjoys favourable demographic characteristics and a generally supportive structural and regulatory environment, the following key factors are challenging the future performance outlook for the sector: Competitive rivalry and online comparison engine marketing activity giving rise to elevated customer churn levels
  - Voluntary downgrading of coverage levels by policyholders in response to significant policy price increases in recent years
  - The increase in governance costs to be imposed by APRA starting in June 2016
  - A lack of growth in market niche segments in which some funds operate
  - Increased political reluctance to allow a continuation of recent policy pricing trends given the sector's relatively buoyant earnings (which are highly predicable compared to other insurance segments)

- Despite there being a number of small insurers who are struggling to achieve growth and sustainable profitability in this climate, participants continue to be shielded by strong excess capital positions and therefore have little external pressure to drive the long anticipated sector consolidation. This merger reluctance has arguably been exacerbated by social factors such as:
  - The reluctance of mutuals (which dominate by number of insurers) to change the status quo
  - Ability for non-profit players to leverage the shared Hospital & Medical Benefit Systems (HAMBS) and joint buying power of the Australian Health Services Alliance, reducing the cost advantages available from consolidation
  - The effective niche marketing strategies of some of the smaller funds
  - Logistical challenges faced by large insurers seeking to achieve meaningful market share growth through small acquisitions
  - A strategic focus by larger insurers to diversify into complementary direct healthcare services
- Despite the factors above there have been some notable exceptions in recent years, including:
  - The acquisition of health.com.au by GMHBA, providing GMHBA with an additional brand to operate under alongside its existing stable of online health funds including frankhealthinsurance.com.au
  - Primary Health Care's expansion into private health insurance (PHI) through the acquisition of Transport Health, providing an initial platform for an attempt at long-tail consolidation in response to future regulatory changes
- Australia's PHI market has long been positioned for significant consolidation and activity, but has lacked a true catalyst to kick-off meaningful transaction volumes. Perhaps 2016 is the year in which a combination of intense competition, margin pressure and regulatory change finally sets the wheels in motion for a modernisation of this market.

Intermediaries

- Intermediary M&A activity has been strong for a number of years. This was no exception in 2015, with 5 deals announced and an aggregate deal value of approx. $700m, led primarily by Steadfast
- We do not anticipate a slow-down in M&A activity in 2016, given the pressure on commissions (correlated to general insurance premiums) and limited organic growth opportunities, intermediaries will continue to look for growth through M&A. However, the challenge for intermediaries is increasingly the ability to source acquisition targets of scale, as it is time consuming to grow your top-line by single-digit millions at a time with small bolt-on deals. We expect strong competition among the major players for any large brokerage firms coming to market
- The key pressure point in intermediary M&A has been pricing, with significant pricing expectation gaps between the buyers and sellers. This may lead to more sellers undertaking 'auctions' or similar non-exclusive transactions, to bid up the price through a competitive M&A process. This is exacerbated by the IPO of PSC Insurance Group, an insurance broker, authorised representative network and underwriting agency at a high forward earnings multiple (partly on the basis of acquisition expectations – some of which have begun to unfold in early 2016). Depending on a vendor's reason for exiting, this could lead to more brokerage IPOs in the short-medium term. However if succession planning is the key M&A driver, a capital market exit is unlikely
- Competition is also fierce in the comparison site market following the entrance of the UK's Compare the Market into Australia. This has put pressure on Australia's largest listed comparison site iSelect
- One notable potential M&A opportunity space in this sector (which is rumoured to be out in the market) is Greenstone, a personal lines direct distribution player which develops and distributes its own branded products (Real Insurance, Pet Insurance etc.), white label products (for Woolworths and RSPCA) and has its own comparison site (Choosi) where it's shareholders are rumoured to be looking to sell down a 40% stake.

Conclusion

While the number of deals has been small in recent times, some very large transactions have occurred, marking a change in appetite of specific buyers and sellers. It has been many years since any of the industry segments saw numerous sizeable transactions in a short period of time. However, we are beginning to see the impact on M&A of underlying drivers of changing customer behaviour, value-chain economics between distributors and manufacturers and regulatory change. These could all be converging to create a very active M&A environment in the next few years.

Appendix 1

Top 15 Australian Insurance M&A Announcements (2012-2015)

#	Target	Acqurier	Sub-Sector	Date Announced	Value (A$m)
1	MLC Limited (80% Stake)	Nippon Life Insurance Company	Life	27/10/2015	2,400
2	Wesfarmers Limited (Australian and New Zealand insurance underwriting operations)	Insurance Australia Group Limited	General	16/12/2013	1,845
3	Wesfarmers Insurance Investments Pty Ltd	Arthur J. Gallagher & Co.	Intermediary	06/04/2014	1,010
4	Underwriting Agencies of Australia Pty Ltd; CHU Underwriting Agencies Pty Ltd; Corporate Underwriting Agencies Pty Limited	Steadfast Group Limited	Intermediary	16/02/2015	522
5	Insurance Australia Group Limited (3.69% Stake)	Berkshire Hathaway Inc.	General	16/06/2015	500
6	ClearView Wealth Limited	Crescent Capital Partners Management Pty Ltd	Life	12/07/2012	263
7	Territory Insurance Office (Insurance operations)	Allianz SE	General	24/11/2014	236
8	CKA Risk Solutions Pty Ltd.	Willis Australia Ltd.	Intermediary	20/08/2015	95
9	World Nomads Group Pty Ltd	nib Holdings Limited	General	08/07/2015	95
10	Calliden Group Limited	Steadfast Group Limited	Intermediary	27/08/2014	94
11	health.com.au Pty Ltd.	GMHBA Limited	Health	27/07/2015	46
12	Assetinsure Pty Ltd	CBL Corporation Ltd	General	31/08/2015	42
13	National Credit Insurance (Brokers) Pty Ltd	Steadfast Group Limited	Intermediary	28/06/2013	41
14	Calliden Insurance Limited	Munich Re	General	27/08/2014	40
15	IC Frith NZ Limited; ICF (Australia) Pty Ltd	Steadfast Group Limited	Intermediary	16/02/2015	30

Source: Mergermarket, 1 February 2016

Appendix 2

Insurance IPOs (with a market cap > A$75m) between 2012 and 2015

Company	Listing Date	Capital Raised (A$m)	Market Cap (A$m)	Performance since IPO
ASX Listed				
iSelect Ltd	6/24/13	88.1	479.3	(38.9%)
Steadfast Group Ltd	8/2/13	334.6	576.1	35.7%
Cover-More Group Ltd	12/19/13	521.2	635.0	10.5%
Genworth Mortgage Insurance Australia Ltd	5/20/14	591.5	1,722.5	4.2%
Medibank Private Ltd	11/25/14	5,673.0	5,673.2	7.5%
PSC Insurance Group Ltd	12/15/15	43.0	225.0	54.0%
Dual-listed NZX/ASX (balances presented in NZ$)				
CBL Corporation Ltd	10/13/15	125.4	340.0	n/a

Source: Thomson Reuters

Note: Performance since IPO is through to 31 December 2015

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