3rd Webinar on General Insurance
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Consolidation in Non-Life Insurance Industry

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Presentation Outline

- Evolution of Non-Life Sector in India
- Consolidation Curve (Four phases of consolidation)
- Consolidation Curve: Case Study: Indian Telecom Sector
- How consolidation happened in other counties in Non-Life Sector? Lessons from UK, US and China.
- Factors driving acquisitions
- Key M&As globally in Insurance
- M&A deals in Non-Life Sector in India
- Where do we stand on consolidation drive in India?
- Case Study: ICICI Lombard – Bharti-Axa Deal

Evolution of Non-Life Sector in India

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2000

- Insurance Regulatory and Development Authority Act (IRDA Act) of 1999 came into effect on 19th April 2000 which ended the monopoly of GIC and its subsidiaries and liberalized the insurance business in India.
- IRDA was incorporated as the statutory body to regulate and register private sector insurance companies.
- General Insurance Corporation (GIC), along with its four subsidiaries, i.e., National Insurance Company Ltd., Oriental Insurance Company Ltd., New India Assurance Company Ltd. and United India Assurance Company Ltd., was made India's national reinsurer.

2005

- De-tariffication of marine hull1

2007

- Till now all the segments of general insurance were tariffed and the premiums were decided by IRDAI. As on 2007, De-tariffication of all non-life insurance products except the auto third-party liability segment was done.
- Motor Third party pool was created wherein all the claims would be collected in this pool and would be divided amongst all the companies in their respective market share. This lead to adverse losses in the motor TP segment.

2012

- IRDAI dismantled Motor TP pool and set up a declined risk pool. This means that from here onwards the insurers could take the Motor TP policies on their balance sheets and thus manage their own motor TP policies.

2015

- The sector was once again opened up by Increasing FDI Limits to 49% from 26%.

2020

- Listing of private/ and public general insurance companies in during 2017-18
- Favourable regulatory changes around long term motor (3rd party) insurance, distribution through OEMs/ dealers, and compulsory personal accident cover.
- M&A – Apollo Munich and Bharti-Axa; more are on the block
- Entry of new age players like Acko

2001 - 2007: Tariffed Era

2008 - 2012: Readjustment phase

2012 - 2018: Growth with Profitability

Evolution of Non-Life Sector in India

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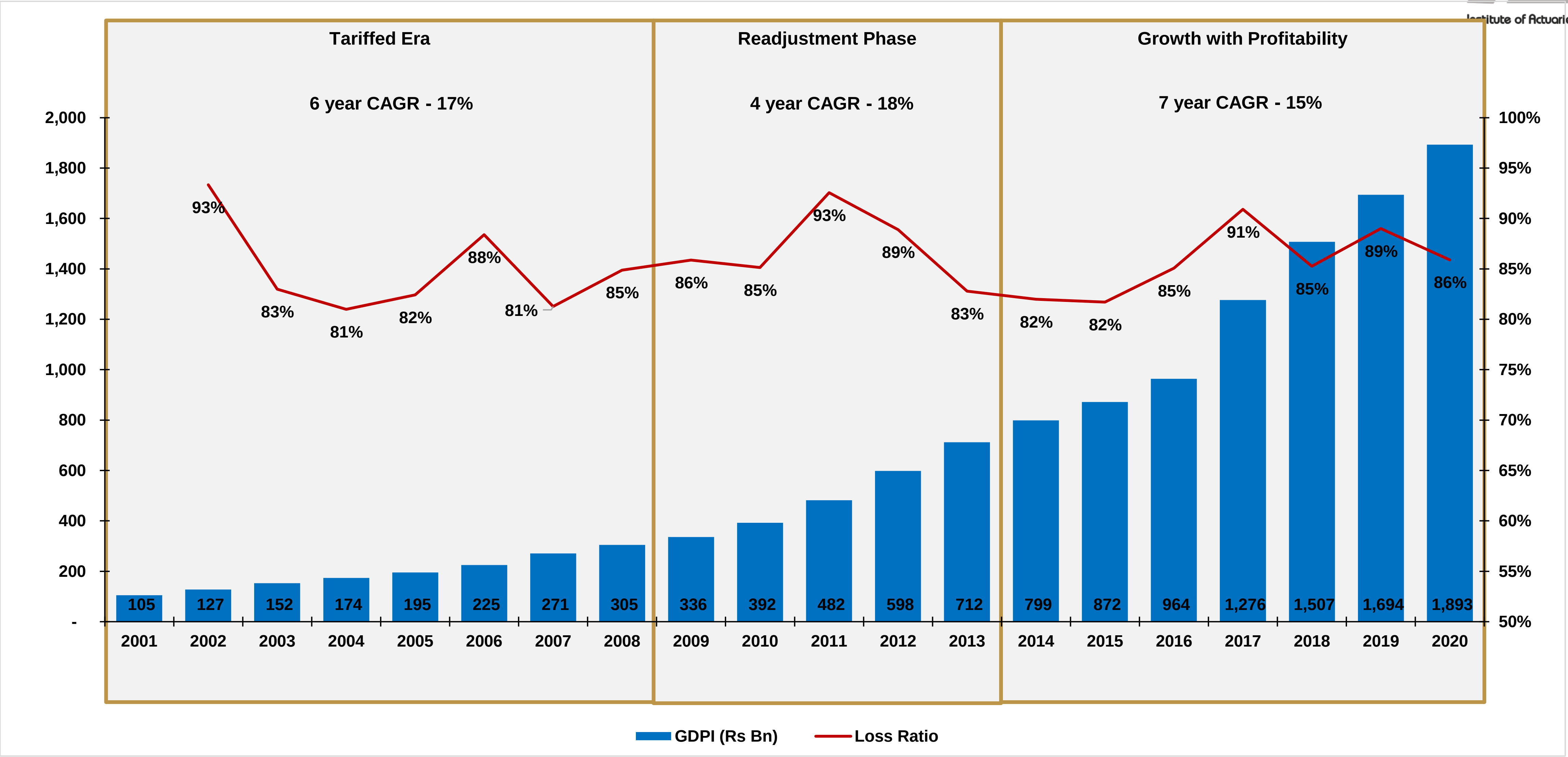
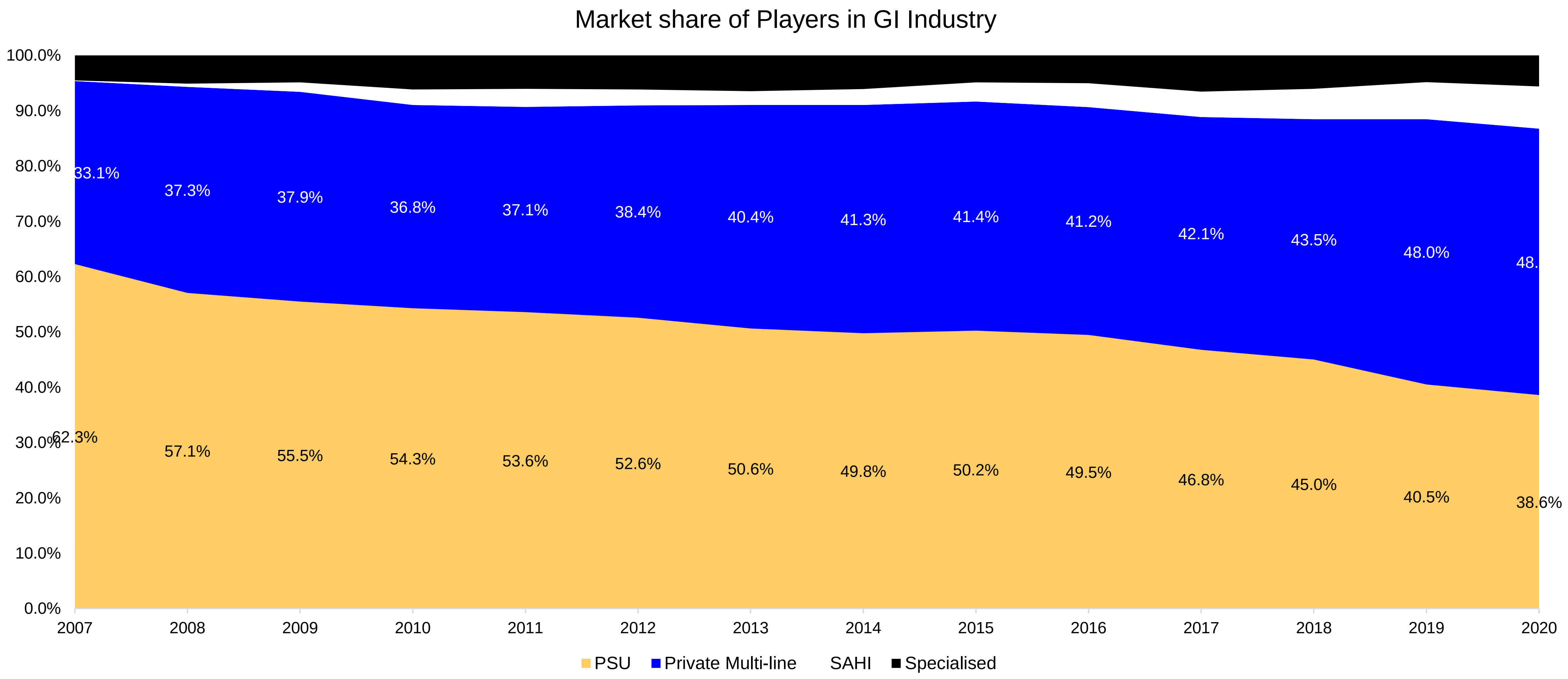


Evolution of Non-Life Sector in India



Consolidation Curve (Four phases of Consolidation)

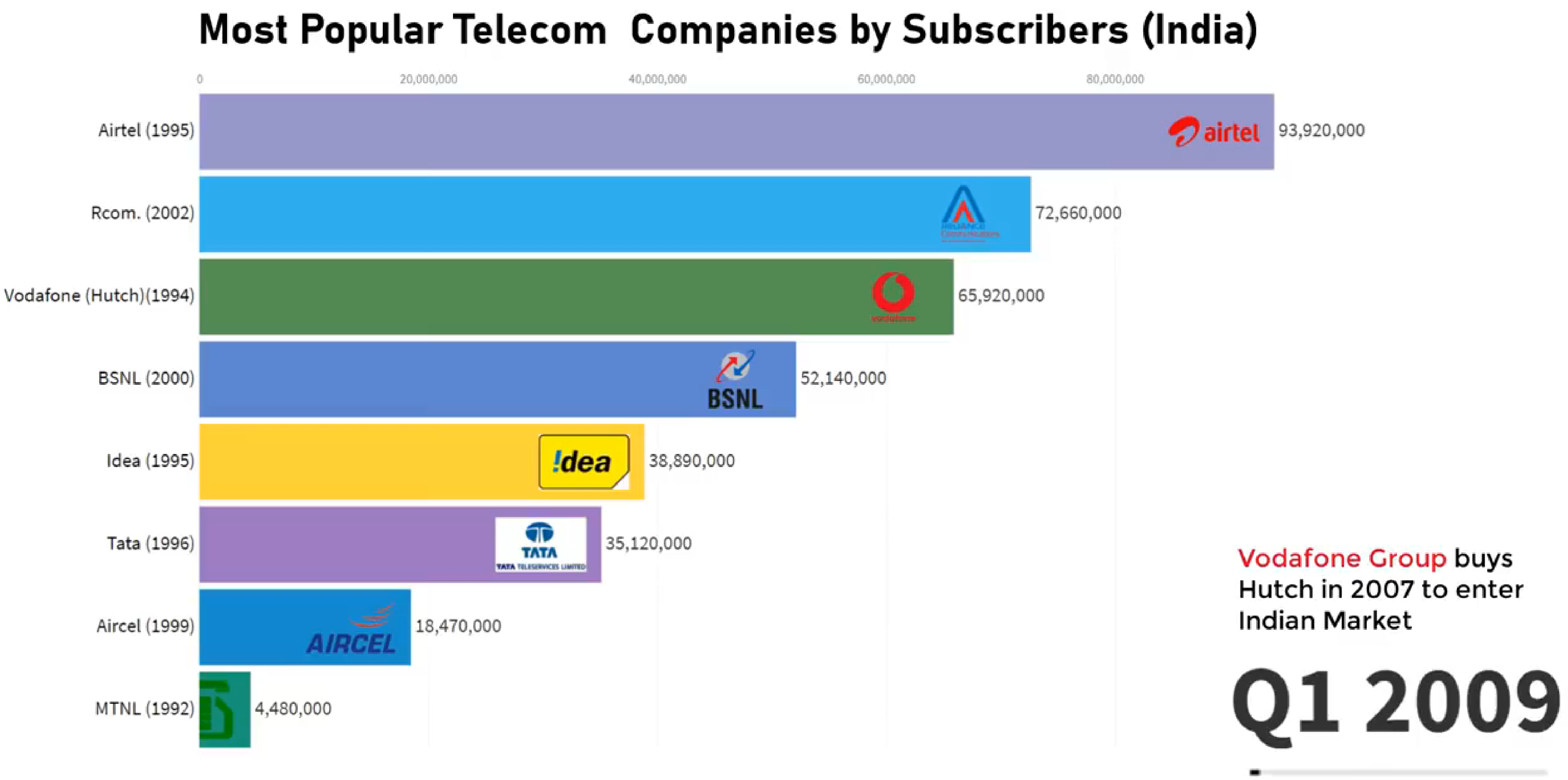
- Stage 1 – Opening
  - The first stage generally begins with a single start-up or with a monopoly just emerging from a newly deregulated or privatized industry.
  - But this 100% industry concentration quickly drops off. Soon, the combined market share of the three largest companies drops to between 30% and 10%, as competitors quickly arise to create the frontier of industry consolidation.
- Stage 2 – Scale
  - This stage is all about building scale. Major players begin to emerge, buying up competitors and forming empires.
  - The top three players in a stage 2 industry will own 15% to 45% of their market, as the industry consolidates rapidly.
- Stage 3 – Focus
  - After the ferocious consolidation of stage 2, stage 3 companies focus on expanding their core business and continuing to aggressively outgrow the competition.
  - The top three industry players will now control between 35% and 70% of the market. By this time, there are still generally five to 12 major players.
- Stage 4 – Balance & Alliance
  - The industry concentration rate plateaus and can even dip a bit as, at this stage, the top three companies claim as much as 70% to 90% of the market. Large companies may form alliances with their peers because growth is now more challenging.

Poll Question 1

Which of the following best describes Indian Telecom sector?

1. Monopoly
2. Duopoly
3. Oligopoly
4. Perfect Competition

Consolidation Curve: Case Study: Indian Telecom Sector



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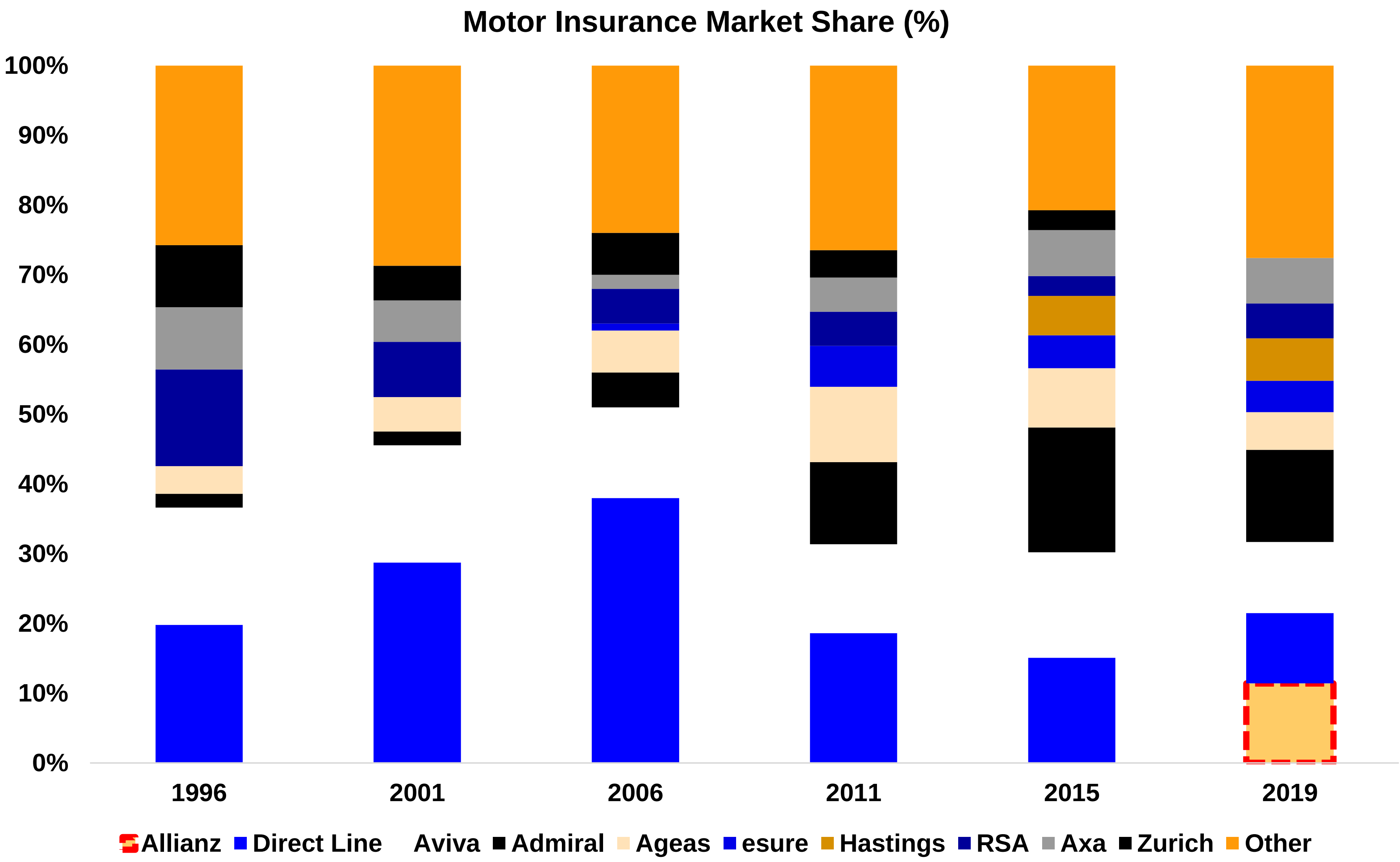
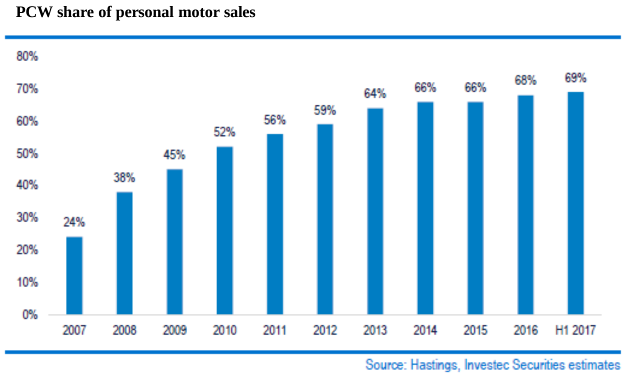
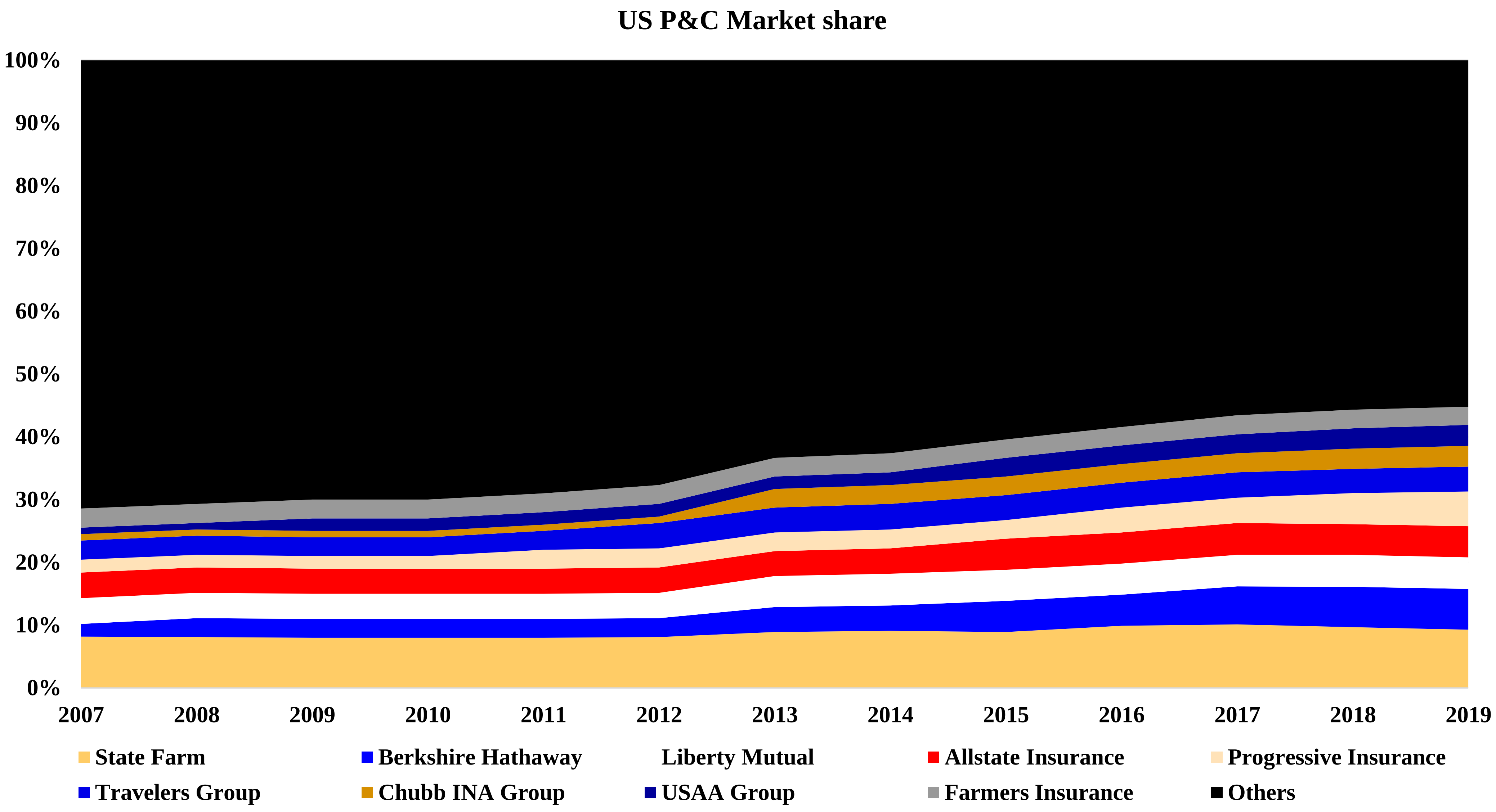
UK Motor Insurance – Why consolidation is not visible here?



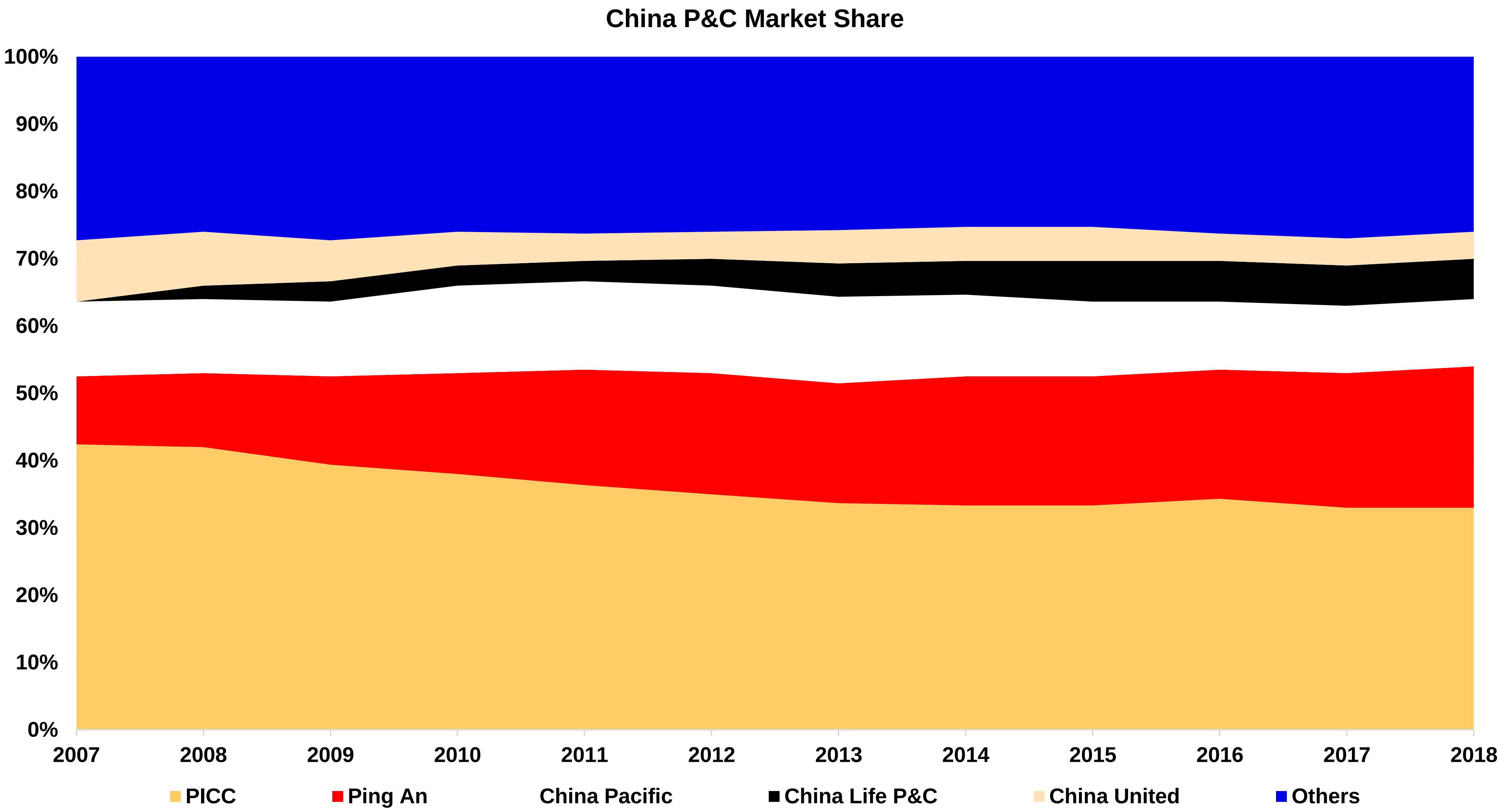
- Barriers to entry are low
- Business models changed; old players did not adapt to changes.
- Entry of Price Comparison Websites.



US P&C Insurance – Consolidation is happening at a slower pace



China P&C Insurance – No signs of consolidation

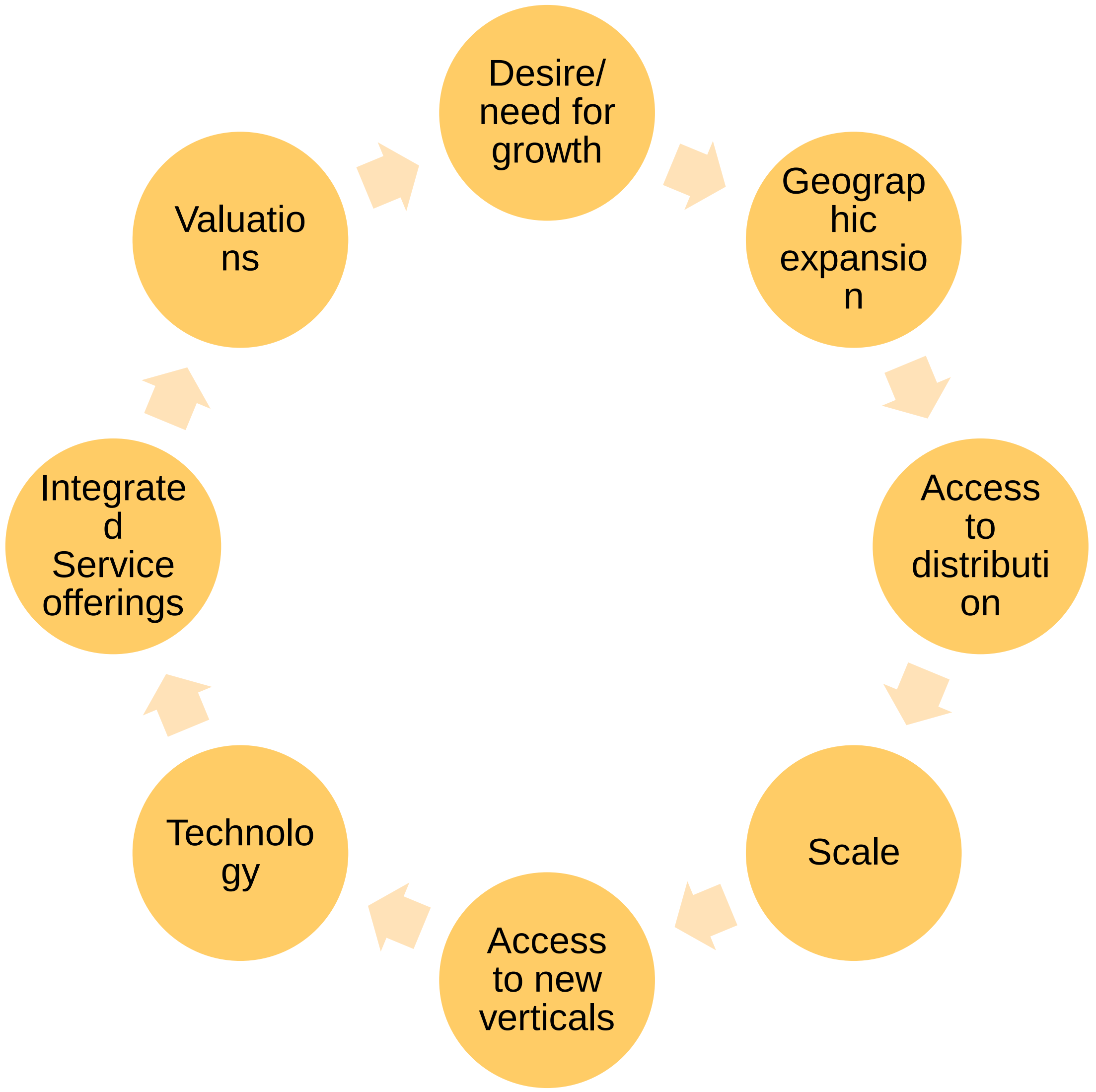


Reasons for slow or no consolidation in P&C industry

- Alternate distribution channels have scaled which benefited new entrants
  - Direct Channel
  - Price Comparison Websites
  - Online Channel
- Underwriting is more important than scale
  - Claims expenses form ~80% of expenses;
  - ~10% of expenses are variable;
  - Scale will provide little benefit here
  - Underwriting discipline is a culture and difficult to build inorganically
- Insurance cycle
  - P&C is a cyclical business
- P&C market is fairly segmented with niches (Consolidation is slowing down after Phase-2)
  - Small companies focusing on niche segments can build profitable businesses
  - GIECO operates with direct channel only
  - PURE insurance is US operates in affluent customer segment only

"Virtually all **surprises** in **insurance** are unpleasant ones.". – Warren Buffet

Factors driving acquisition (inorganic acquisition)



US P&C Insurance – Types of M&A deals

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Four main types of large M&A deals occupy the P&C insurance space.

P&C carrier deal activity, Europe and North America, 2013–18, deal value >$100 million

	Number of deals	Cumulative deal value, $ billion	Average deal value, $ billion
European and North American carriers with desire for increased scale and diversification	~80	~100	~1
Access to new capabilities or expertise	~5	~1–2	<1
Asian carriers seeking growth in Europe and North America	~5	~20	~4
Private-equity transactions	~40	~40	~1

Key M&A deals globally

- Tokio Marine acquired Privilege Underwriters in 2019
  - Privilege Underwriters owns a P&C company in USA which is based on model of Reciprocal Exchange. It caters to HNI customers.
  - It offers insurance for homes with a rebuild value of more than one million dollars, automobiles, watercraft, jewelry, art and other collections, personal excess liability (umbrella), and flood.
  - This gave access to Tokio Marine to US markets and diversifies its business.

- Allianz UK acquitted LV= & L&G in 2019
  - The acquisition of LV= & L&G positioned Allianz as the number two players in P&C sector in UK.
  - The deal rationale is to build scale in UK and gain market leadership position.

Two-third of M&As do not work out

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- “Most **acquisitions** go awry. Not only are the synergies to which so many executives pay lip service seldom realised; more often than not the result is catastrophic. Frequently the executives of the acquired companies leave. In their stead remains only a shell and some devalued capital equipment. More important, acquisitions, even little ones, suck up an inordinate amount of top management’s time, time taken away from the main-line business.” Thomas Peters, In Search of Excellence
- "I will tell you a secret: **Deal-making** beats working. Deal-making is exciting and fun, and working is grubby. Running anything is primarily an enormous amount of grubby detail work . . . *deal-making is romantic*, *sexy*. That's why you have *deals that make no sense*." Peter Drucker
- “*Two thirds* of **acquisitions** *don’t work*. Ours work because we don’t try to do **acquisitions** — we *wait for no-brainers*.” Charlie Munger
- “You always have these things that the investment banker will tell you will produce synergy and all that. Most times that doesn’t work.” Buffett

Poll Question 2

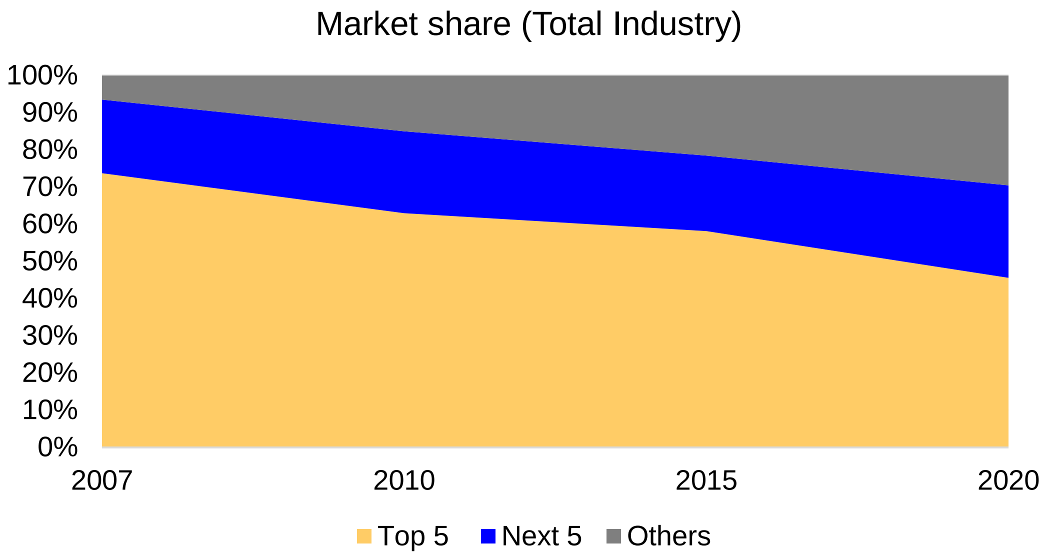
Has India non-life sector consolidated in last ten years?

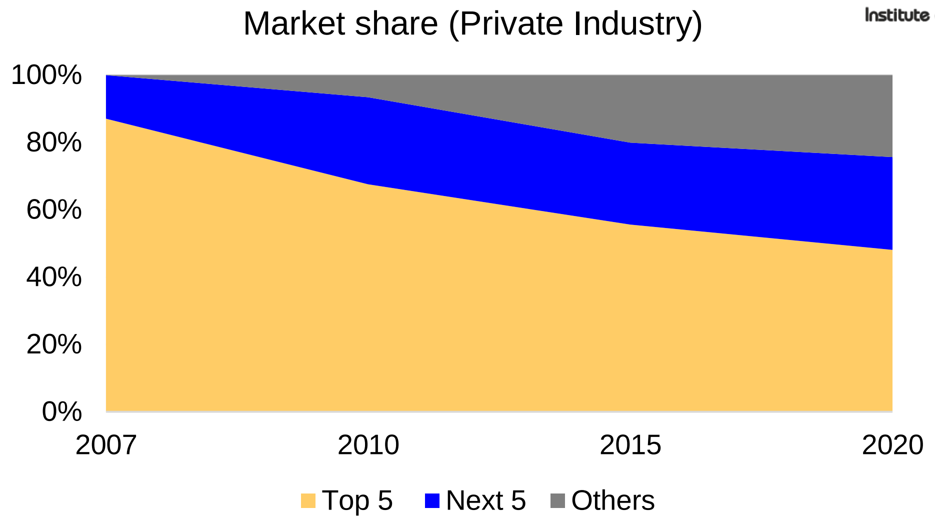
a. Yes

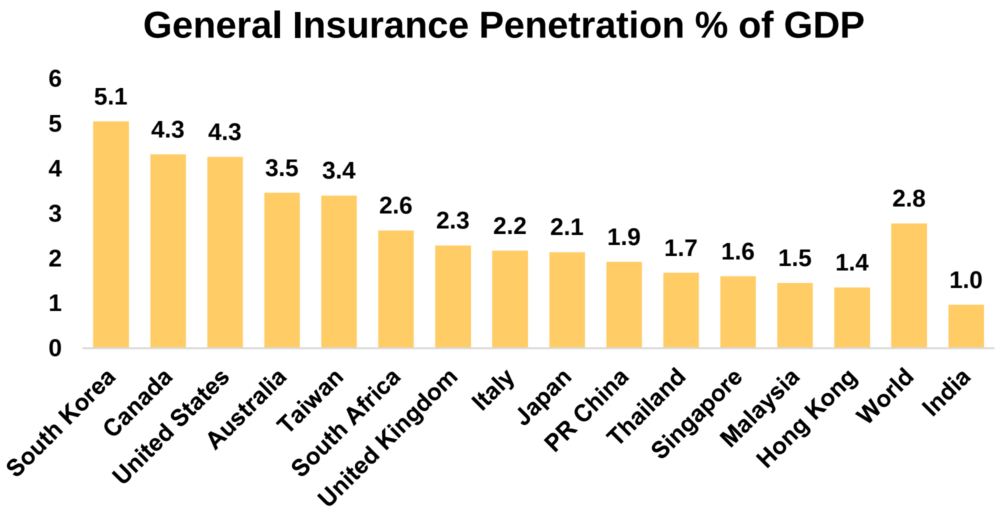
b. No

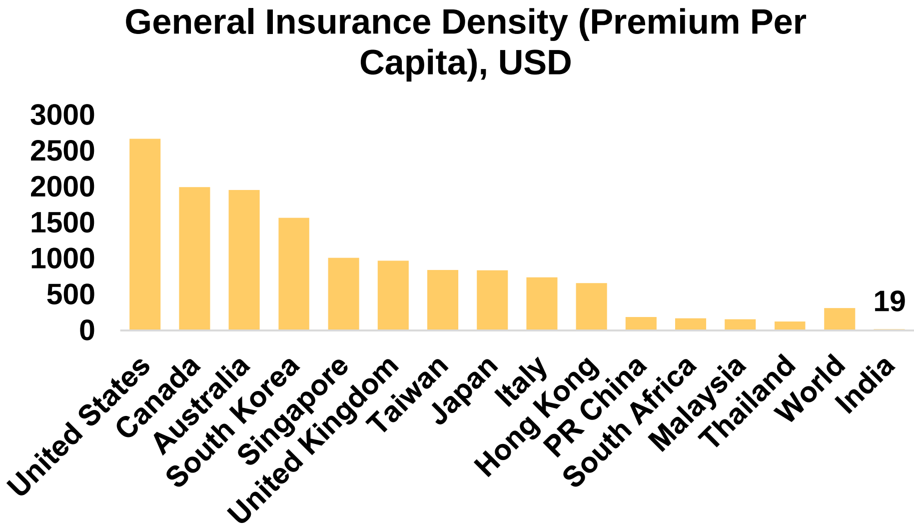
c. Can’t Say

India – Non-Life sector is becoming more fragmented

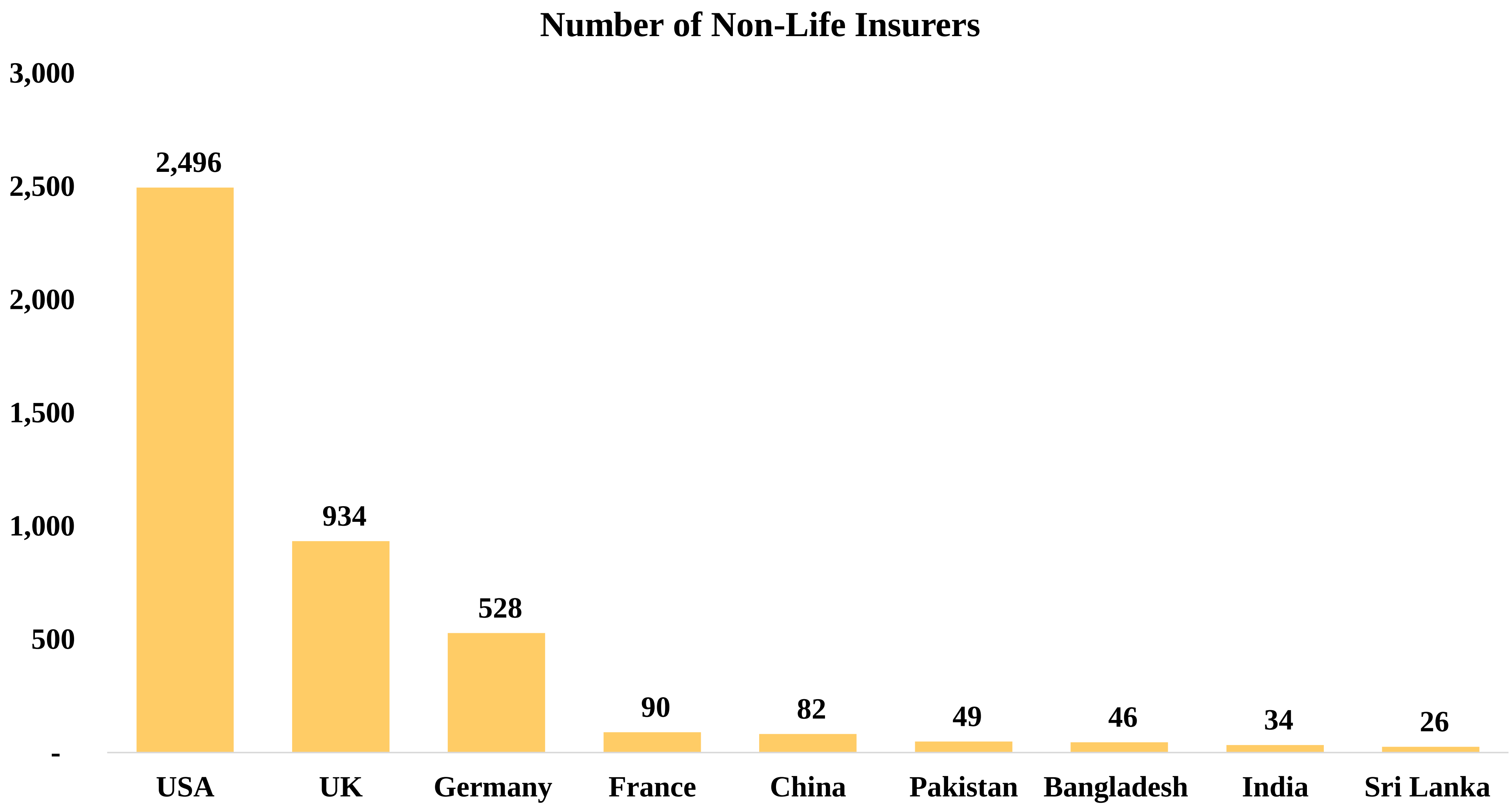




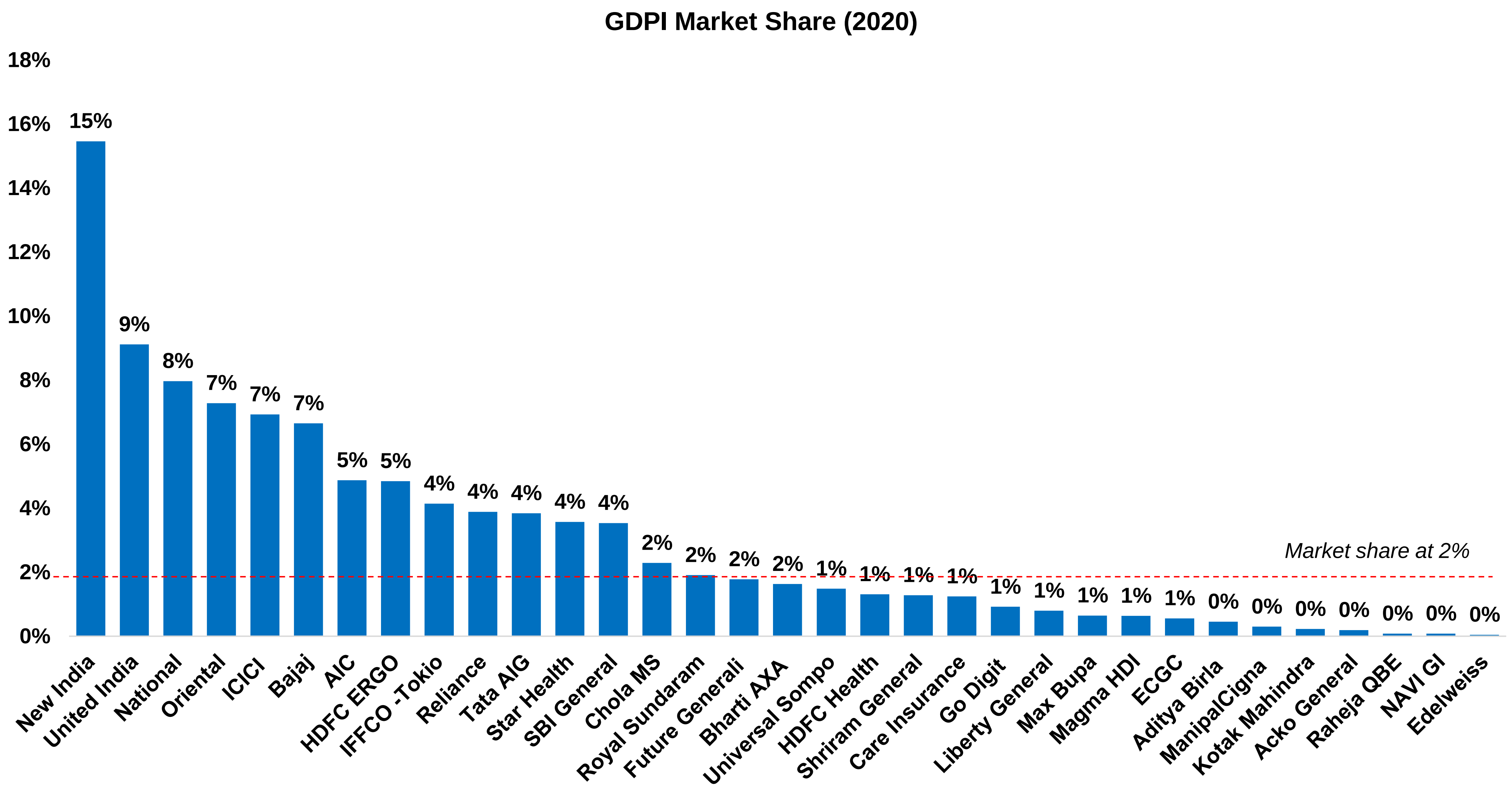




India has scope for more number of non-life insurance companies



India has a long tail of companies which will need capital for survival



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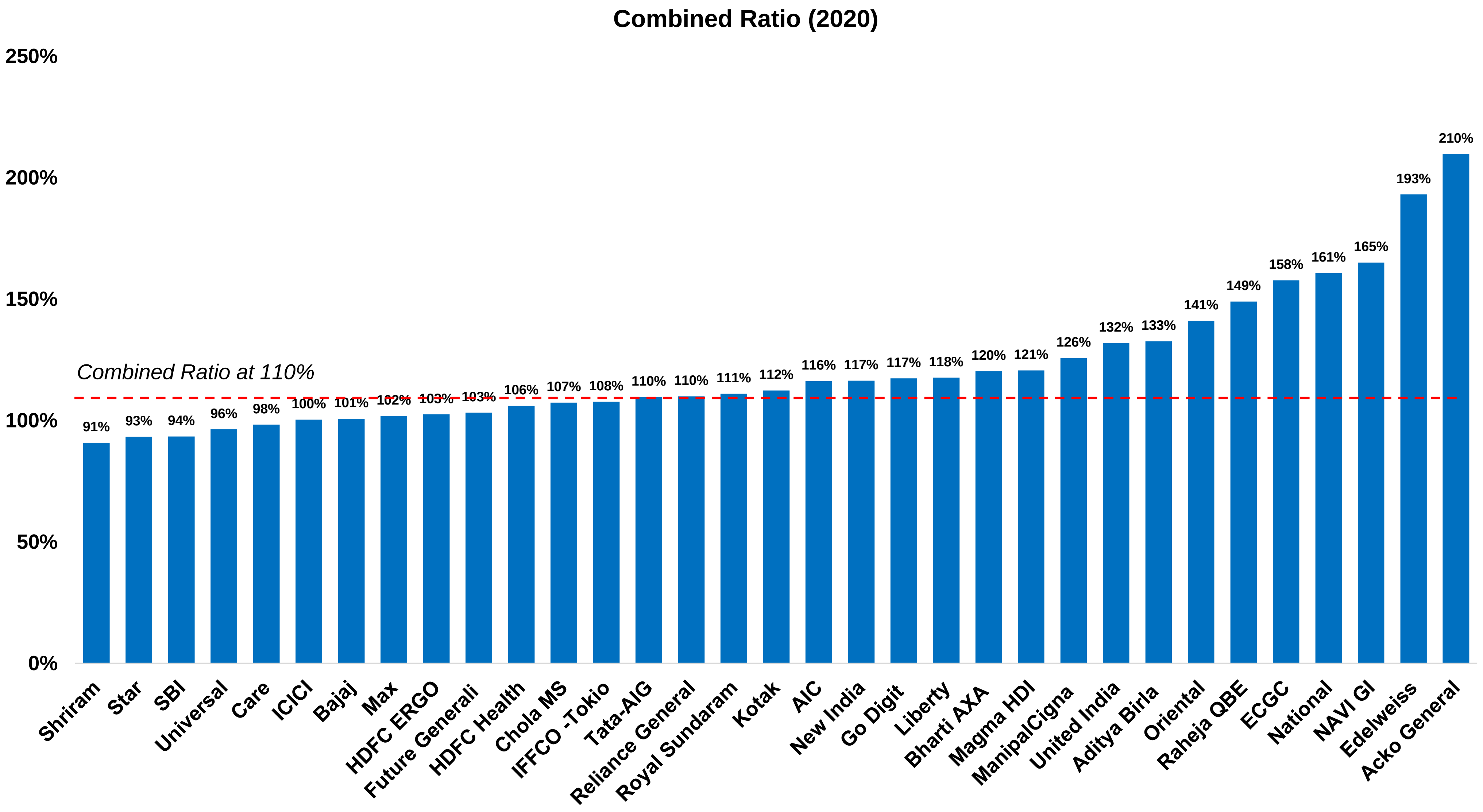

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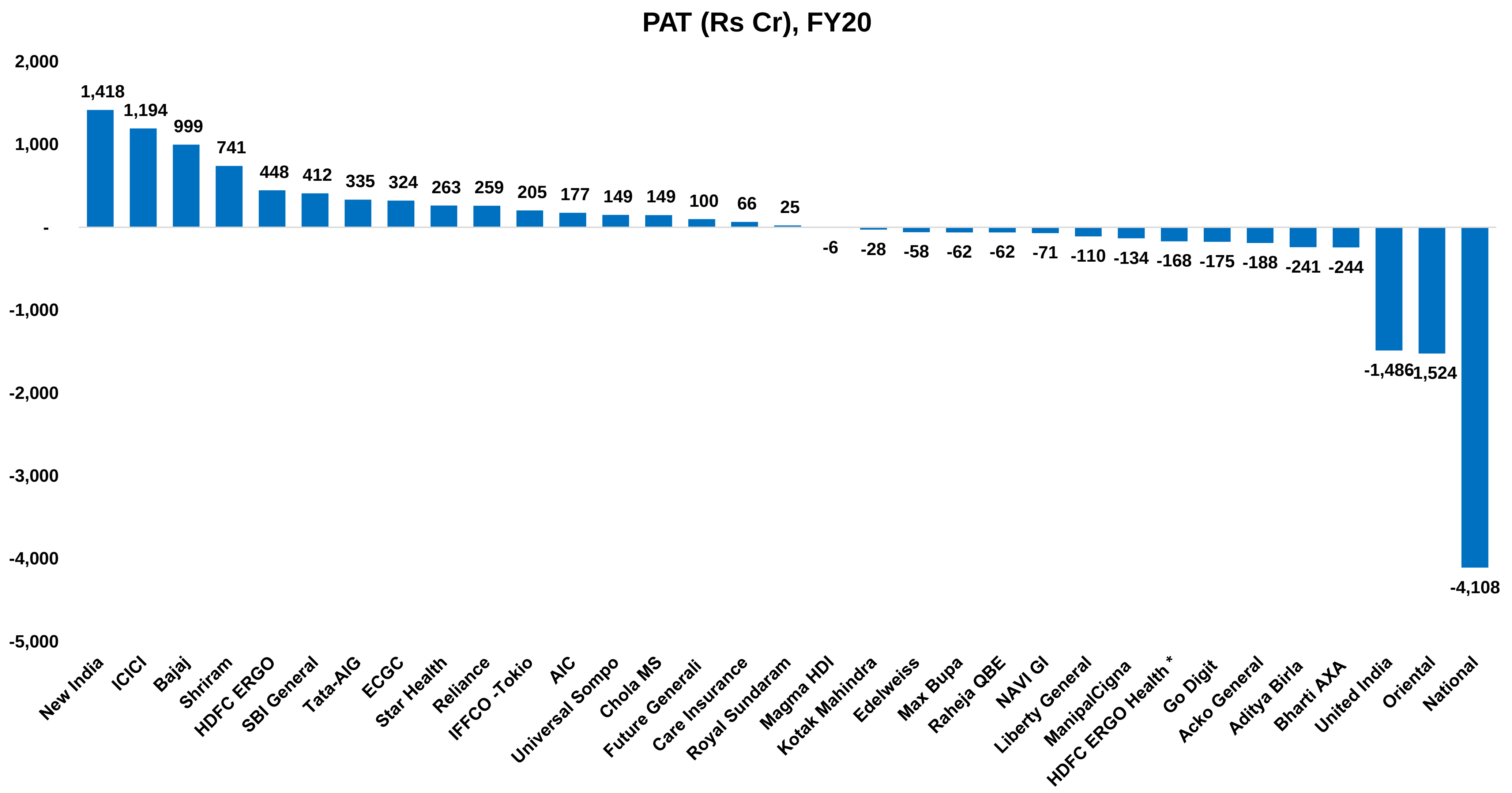

Drivers of consolidation in India

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- Capital
  - Capital constraints faced by small and mid size players
- Profitability
  - Skewed towards top players
- Economies of Scale
  - Benefits to large players
- Technology
  - Market share gains by players with strong tech platforms
- Distribution
  - Companies with strong distribution will continue to gain market share

Drivers of M&A in India

- Scale
  - HDFC + L&T General
  - ICICI Lombard + Bharti Axa
- Capital constraints
  - Bharti-Axa
- Promoters’ priorities
  - Bharti-Axa, L&T General, Apollo Munich
- Entry in new segments
  - HDFC acquisition of Apollo Munich
- Technology
  - ICICI Lombard acquisition of Auto Ninja
- Distribution
- Valuation
  - ICICI Lombard + Bharti Axa

Valuation as driver for M&A

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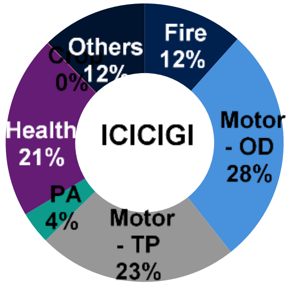
- M&A could be attractive depending on the valuation of deal
- There are two ways to make a deal look attractive
  - Buying businesses at cheap valuation
  - Buying businesses with expensive stock

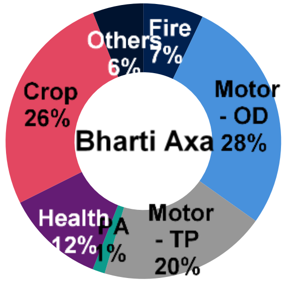
	Company A	Company B	Merged Entity	Merged Entity with Synergies
Net Worth	100,000	10,000	110,000	110,000
PAT	20,000	1,000	21,000	22,000
RoE	20%	10%	19%	20%
Combined Ratio	100%	105%	101%	100%
No of Shares	100	100	105	105
P/B	6.0	3.0	5.7	6.0
Valuations	600,000	30,000	630,000	660,000
Share Price	**6,000**	**300**	**6,000**	**6,286**
EPS	200	10	200	210

Case Study – ICICI Lombard – Bharti Axa acquisition

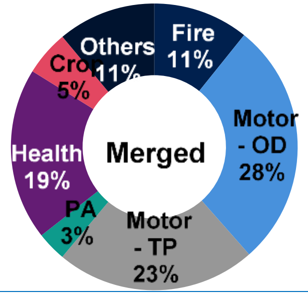
Product mix of ICICIGI and Bharti-Axa



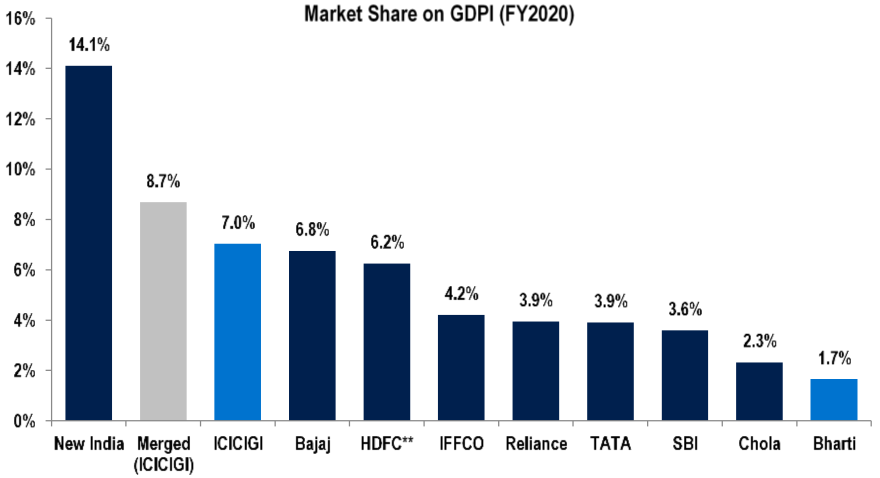
Source: Investec Securities estimates



Source: Investec Securities estimates

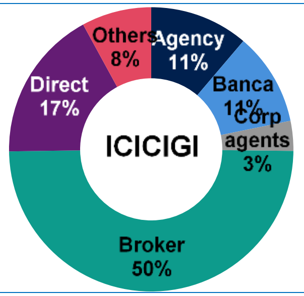


Source: Investec Securities estimates

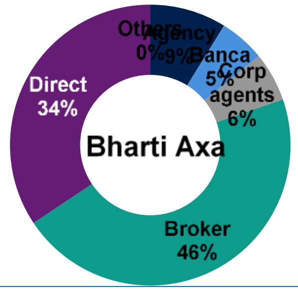


Source: **HDFC market share includes Apollo Munich, Investec Securities estimates

Distribution mix of ICICIGI and Bharti-Axa



Source: Investec Securities estimates



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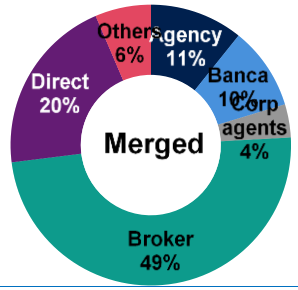

Source: Investec Securities estimates

Case Study – ICICI Lombard – Bharti Axa acquisition

Figure 1: Merged entity RoE of 20% is possible subjected to cost synergies

	ICICIGI	Bharti Axa	Merged	Comments
A. Claims ratio	72.9%	78.3%	73.8%	Loss ratio of merged entity will increase marginally
B. Opex/NEP	**28.3%**	**46.1%**	**31.2%**	**Bharti Axa Opex ratio are high where should be cost synergies**
C. Underwriting Margin (C = 1 - A - B)	-1.1%	-24.5%	-4.9%	
D. Expense Ratio/NWP	27.6%	42.1%	30.1%	
E. Combined Ratio (E = A + D)	100%	120%	103.8%	CR may be contained if cost synergies play out
F. Investment return	8.4%	9.0%	8.5%	
G. Average Investment/NEP	2.6	2.4	2.5	
H. Investment return/NEP	22%	21%	22%	
I. Other expenses/NEP	-2%	-10%	-4%	Bharti made provisions on investments which should not recur.
J. PBT/NEP (J = C + H + I)	18%	-13%	13%	
K. PAT/NEP	13%	-13%	8%	Tax rate may reduce to 20% as Bharti has accumulated losses.
L. NEP/Avg Net worth	1.6	3.1	1.8	
M. RoE (M = K*L)	21%	-41%	15%	
N. Investment Leverage	4.3	7.2	4.6	

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Case Study – ICICI Lombard – Bharti Axa acquisition

Figure 1: ICICIGI-Bharti-Axa deal valuations are in line with past deals in the industry

Company	Seller	Buyer	% stake sold	Valuation	Trailing PAT	Trailing BV	P/E	P/B	Date
HDFC ERGO	HDFC Ltd	Ergo International AG	22.9%	49,000	1,040	10,237	47	4.8	Dec-15
Chola MS General	Tube Investments	Mitsui Sumitomo	14.0%	63,048	2,997	8,670	21	7.3	Mar-16
ICICI Lombard	ICICI Bank	Fairfax	9.0%	172,250	5,356	31,795	32	5.4	Oct-15
Royal Sundaram	RSA	Sundaram Finance	26.0%	17,308	220	5,498	79	3.1	Jul-15
ICICI Lombard	Fairfax	Warburg Pincus	12.2%	203,000	7,019	44,038	29	4.6	Jun-17
SBI General	SBI	Premji Invest & Axis MF	4.0%	120,500	3,957	15,481	30	7.8	Sep-18
Royal Sundaram	Sundaram Finance	Ageas	40.0%	38,000	833	10,245	46	3.7	Nov-18
Star Health	Promoter	West Bridge, RARE	93.3%	65,000	1,702	9,596	38	6.8	Jun-18
Apollo Munich	Apollo Hospitals	HDFC	50.8%	29,232	112	4,361	261	6.7	Jan-20
Max Bupa	Max India	True North	51.0%	10,000	228	2,559	44	3.9	Feb-19
Religare Health	Religare Enterprises	Kedaara	6.39%	41,831	436	5,499	95.9	7.6	Jun-20
Raheja QBE	Prism Johnson & QBE Austrailia	Paytm	100.0%	5,680	(621)	1,485	NA	3.8	Jul-20
Bharti AXA	**Bharti Enterprises, Axa**	**ICICI Lombard**	**100.0%**	**46,000**	**(2,440)**	**7,503**	**NA**	**6.1**	**Aug-20**

How can one value Bharti-Axa at 6x P/B?

Because ICICI Lombard was valued at 9.6x P/B

Case Study – ICICI Lombard – Bharti Axa acquisition

Management team of Bharti-Axa

Name	Designation	Bharti AXA - Joining date	Comment
Sanjeev Srinivasan	**Chief Executive Officer & Managing Director**	**Aug-16**	**He was heading marketing and bancassurance at ICICI Lombard for 6.6 years.**
Rahul Ahuja	CFO	May-20	Earlier CFO of Max Bupa Health.
Banashree Satpathy	Actuary	Jan-17	No experience with Lombard
Rohit Kohli	Senior Vice President - Customer Services and Operations	Jun-16	Never worked in Lombard. Spent large part of career in Max Bupa.
Arif Syed	**Senior Vice President of Technology (CTO)**	**Oct-17**	**He has spent nine years at ICICI Lombard.**
Milind V Kolhe	Chief Underwriting and Reinsurance Officer	Apr-19	Not worked in Lombard.
Saurav Jaiswal	**Chief Distribution Officer - Retail Business**	**Jan-17**	**He spent 12 years at ICICI Lombard and was heading retail and direct channel.**
Jignesh Sangoi	**Chief Risk Officer**	**NA**	**He spent ~5 years at ICICI Earlier he was AVP – Management reassurance at Lombard**

Poll Question 3 & 4

What is NOT a rationale for acquiring Bharti-Axa?

a. Access to technology

b. Scale

c. To ward of competitors to gain scale in Motor Insurance

d. Cultural fit as top management from Bharti-Axa is from ICICI Lombard

Is ICICI Lombard acquisition of Bharti-Axa justified?

a. Yes

b. No

Food for thought

- P&C industry in other countries is not consolidating much
- India needs many more companies to expand the penetration
- In short term, P&C industry may consolidate as tail is getting weaker and promoters are not willing to infuse capital. Acquired or Perish!
- Which of India's M&A deals make sense?
- M&A activity is likely to accelerate, though ICICI Lombard has made M&A difficult for others by raising the bar.
- Overtime, we expect new players to enter who will disrupt the sector either through tech or new products.