Insurtech Deals Market Insights 2021

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Content

Foreword

Insurtech is here to stay. How are businesses, and more specifically (re)insurers, leveraging M&A to accelerate their digital transformation and improve the experience of their end consumers? Is this hindered or helped by other market entrants such as private equity and venture capital ('VC') funds, which are competing for access to the same, promising market?

In this first edition of our Insurtech Deals Market Insights we take a look at Insurtech transactions globally through September 2021, with a specific focus on the increasing interest by European investors in this segment, the areas of the (re)insurance value chain that are attracting the most capital, and the respective challenges that investors need to consider when valuing such businesses.

A deep dive following our Insurtech Deals Market Insights will subsequently be published in Q1 2022, with a focus on Swiss-headquartered (re)insurers and their digitalisation journeys, as well as their approaches to partnering with Insurtechs to access promising technologies and capabilities.

First, a word from our FS Deals leader in Switzerland

"We have seen Insurtech investments propel companies ahead while accelerating their digitisation journey. Ensuring that you have the right strategy and access to opportunities in the deal markets is critical to successfully staying ahead in today's ever-evolving digital age."

Christoph Baertz
Financial Services Deals Lead Partner

Key takeaways

Insurtechs aim to generate value by reinventing or supplementing a part of the (re)insurance value chain.

We take a look at the different parts of the (re)insurance value chain, and provide examples of how Insurtechs seek to add value to them.

The global rise of Insurtech transactions observed over the past 6 years is poised to continue in 2022 and beyond.

We look at the interest in Insurtech, not only from traditional (re)insurers but also from more broadly generalist investors, private equity and venture capital funds, which has significantly increased the competitive landscape.

European investors show a strong affinity to investing in US-based targets, as well as in the UK, Germany and France.

We analyse the regional reach of Insurtech transactions by European investors over the last 6 years.

About 80 % of Insurtech transactions from European investors were in the form of venture capital (‘VC’) investments.

We analyse other characteristics by deal type and value chain area of Insurtech transactions over the last 6 years.

The valuation of Insurtech companies is more comparable to Fintechs than mature insurance industry peers.

We review the significant price tags attached to some Insurtech companies, and how to stay grounded amidst the high expectations.

1. How did we get here?

'Insurtech', often considered the younger sibling to its well-known technology industry peer 'Fintech', continues to receive more and more attention. Insurtech is helping to redefine how business and, more specifically, (re)insurers operate. But how? What is Insurtech, and why should you care?

The term 'Insurtech' was originally coined in early 2010, as large technology companies started to vastly expand into new industries and provide different service offerings to their rapidly expanding customer base.

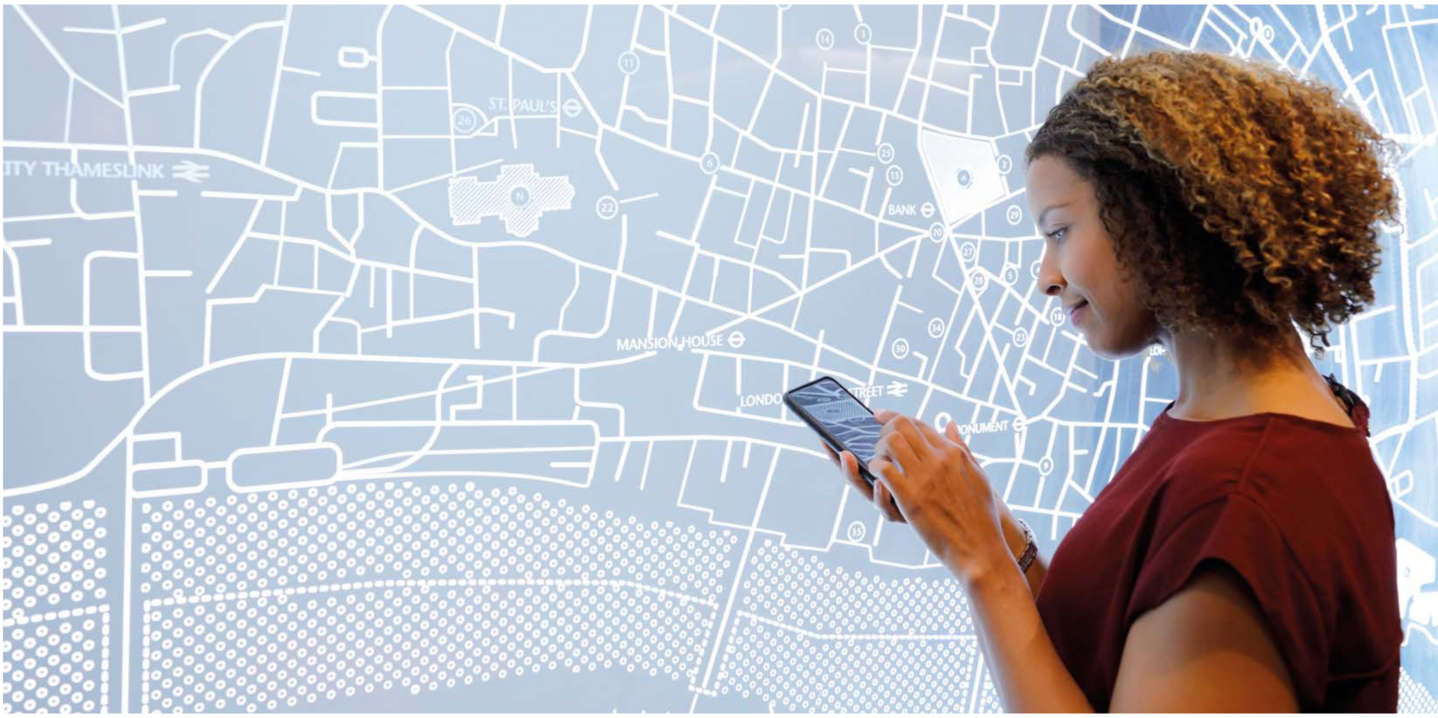
The industry has shifted over time from seeing Insurtechs as pure disrupters trying to take market share away from established carriers to a more collaborative approach, where the focus is centered on partnering with Insurtechs to augment or establish new capabilities across the (re)insurance value chain to increase operational efficiency and improve client servicing capabilities.

The COVID-19 pandemic has impacted society in an unprecedented manner. It has altered the way individuals work, shop, socialise and, ultimately, live. This drastic change and the need for digitalisation has led to increased M&A activity into Insurtechs, as businesses seek to digitalise their customer experience to stay competitive.

First things first – defining Insurtech

Today, the line between what is considered tech and non-tech can easily be blurred. It is therefore important for us to start by setting our definition of Insurtech as we see it in the current environment. We have defined Insurtech[1] as any type of technology-enabled solution, company, platform or application that focuses on digitising the broader (re)insurance industry or any part of the (re)insurance value chain. This can broadly be to:

- enhance the customer experience across their (re)insurance journey; or
- improve the management of risk by enabling a more effective assessment, mitigation, and recovery of loss; or
- yield higher efficiencies for operations, internally and across the value chain.



1 Definition only for the purposes of this Insurtech Deals Market Insights 2021

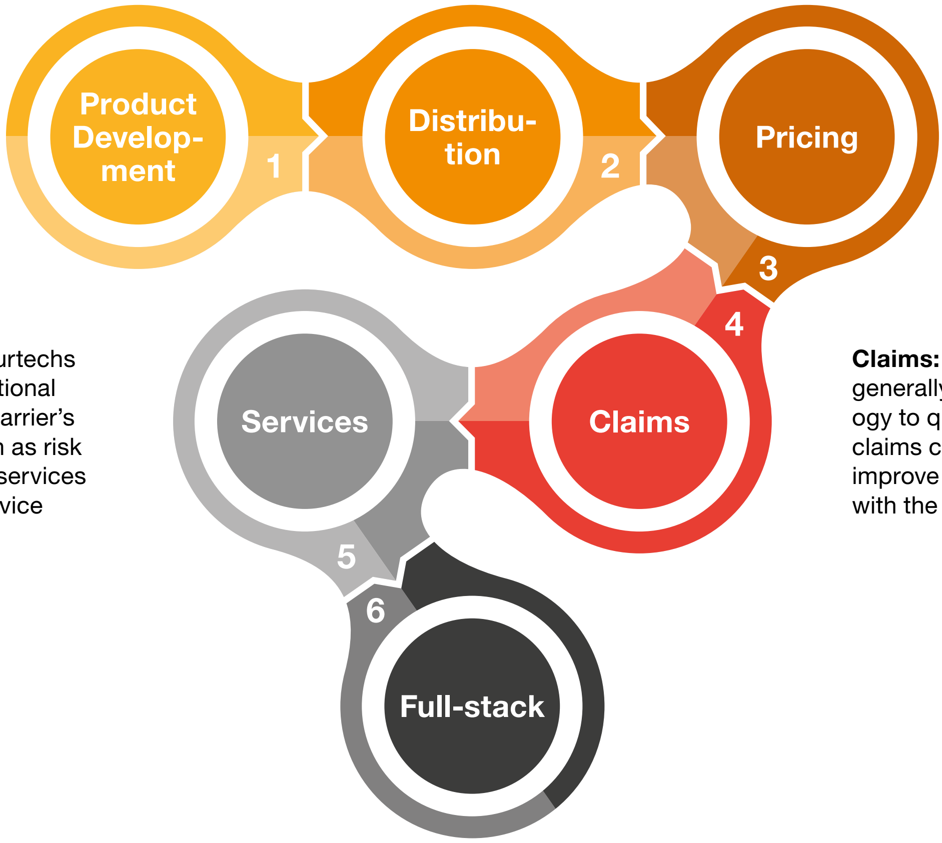
2. Insurtech and the (re)insurance value chain

Taking a deeper look into the (re)insurance value chain helps to understand where Insurtechs are focusing their efforts. We have said that Insurtechs aim to generate value by reinventing or supplementing a part of the (re)insurance value chain. We have therefore broadly segmented the value chain into six main areas.

Product development: Insurtechs create modern and customer-focused products by designing products for emerging segments (e.g. gig economy and freelance workers) or attaching insurance to other product sales

Distribution: Insurtechs seek to improve the customer experience at the point of sale by aggregating quotes, providing tailored advice or offering more streamlined contracting

Pricing: Insurtechs often use big data, AI and IoT devices to improve the accuracy of policy pricing

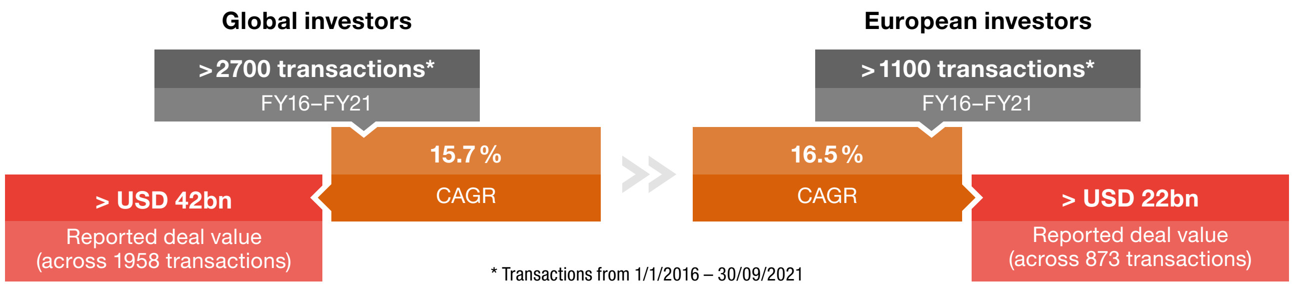


Services: Insurtechs can offer additional benefits to a carrier's insureds, such as risk management services or financial advice

Claims: Insurtechs generally use technology to quicken the claims closure rate and improve communication with the claimant

Full-stack: Insurtechs are developing solutions that extend across the entire value chain

3. Global rise of Insurtech transactions[2] poised to continue in 2022 and beyond



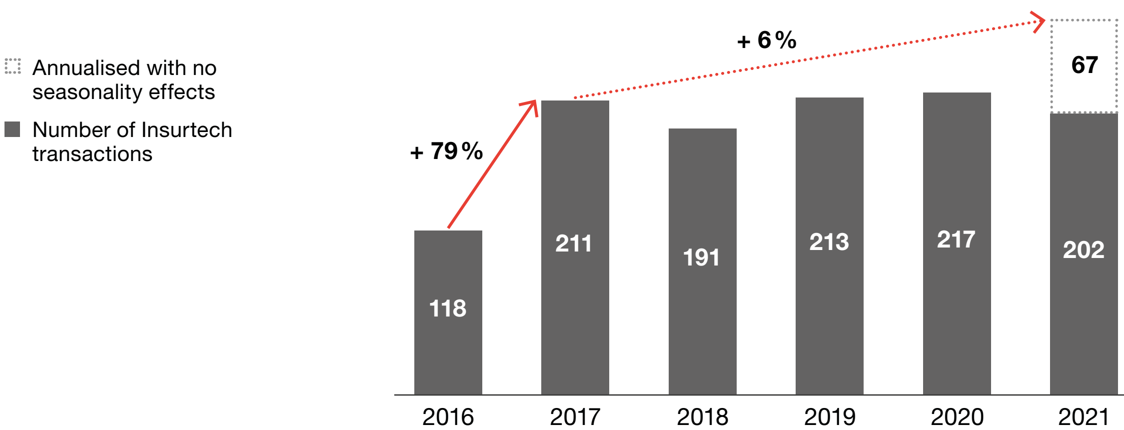
* Transactions from 1/1/2016 – 30/09/2021

Globally, Insurtech investments have been on the rise year-on-year with over **2700 transactions reported since 2016,** resulting in a CAGR of 15.7 % for the five-year period through 2020. These are expected to grow by an additional 18 % through Q4 2021, assuming an annualised growth rate with no seasonality effect. This development shows the **current strong trajectory** of Insurtech transactions, with many top (re)insurance executives and industry experts expecting the trend to continue into 2022 and beyond. This market growth is fueled by the eagerness of most incumbent carriers to digitise all areas of the value chain, as well as new market players and entrants taking advantage of the current innovation in the market to get a foot in the door.

European investors are following the global trend

Similar to what we are observing globally, Insurtech investments by European investors[3] are expected to double in volume in 2021 compared to 2016, with 269 transactions (118 in 2016) expected to be closed. In total, **over 1100 transactions** were observed over the past six years (Graph 1) with **USD 22.3bn** in total **Reported Deal Value**[4].

Graph 1: Development of Insurtech transactions from European investors – 1/1/2016 – 30/09/2021



	2016	2017	2018	2019	2020	2021
Total number of transactions	1152					
Reported deal value (in USDm)	1232.8	1917.7	3661.4	4672.6	4018.7	6803.7
Total reported deal value (in USDm)	22,307					

2 This paper represents a data-driven analysis of Insurtech deals transactions over the past six years from various sources including most notably providers CB Insights, S&P Capital IQ and Mergermarket. These include investment transactions where either a majority or minority stake was taken into Insurtech targets globally. It does not reflect other types of transactions such as IPOs, loans, convertible notes, bridge funding, grants taken out or incubator, accelerator and business plan competition participation by Insurtech companies.

3 We focus on Insurtech transactions where the investor is headquartered in Europe, whereas the Insurtech target can be located globally. Data from 1 January 2016 to 30 September 2021 (referred to as the 'review period') was analysed.

4 Total Reported Deal Value is comprised of the published aggregated transaction value of 873 transactions (out of the 1152 observed transactions linked to European investors) over the review period.

Strong affinity for US and European targets

European investors show a strong affinity to invest in companies located in Europe and North America, with 48 % and 31 % respectively (Visualisation 1). In Europe, targets were mainly based in the UK, France and Germany.

Looking at individual countries, however, the US leads overall, with 29 % of all reported transactions and 48 % of reported deal value (USD 10.7bn) (Table 1). This is not surprising, given that a number of very successful Insurtech start-ups have originated in and gone on to list in the US, including the likes of Lemonade, Oscar, Doma Holdings, Duck Creek Technologies DCT and others.

The US is followed by the United Kingdom, with 17 % of total transactions constituting USD 3.3bn reported deal value, and thereafter France and Germany, with ca. 7 % of total transactions each with a reported deal value of USD 1.4bn and USD 1.7bn respectively.

Please note that the regional focus is limited to European-headquartered investors only.

Visualisation 1: Continental split of Insurtech transactions from European investors – 1/1/2016 – 30/09/2021

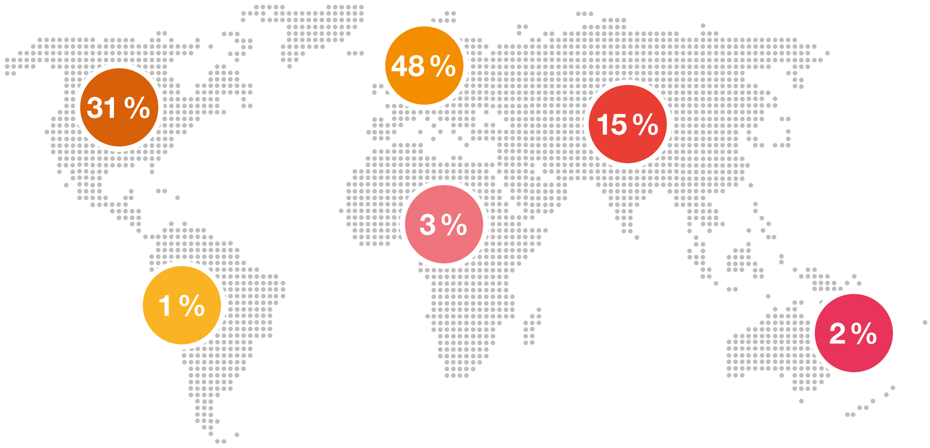


Table 1: Country split of Insurtech transactions from European investors – 1/1/2016 – 30/09/2021

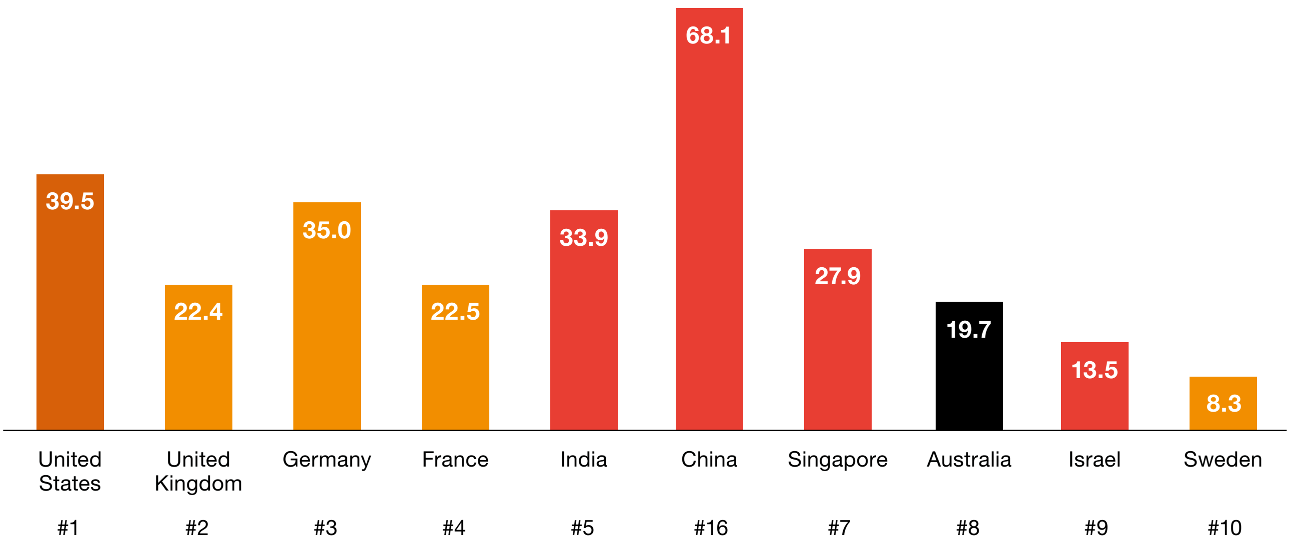
Continent	Country	Top 10 Ranking by total reported deal value	Number of trans-actions	% of total trans-actions	Number of transac-tions with reported deal value	Reported deal value (in USDm)	% of reported deal value to total deal value	Reported average deal value (in USDm)
Europe 48 %	United Kingdom	#2	199	17 %	148	3321.1	15 %	22.4
	France	#4	80	7 %	64	1438.7	6 %	22.5
	Germany	#3	78	7 %	48	1681.1	8 %	35.0
	Sweden	#10	37	3 %	31	258.5	1 %	8.3
	Spain		30	3 %	26	163.8	1 %	6.3
	Switzerland		25	2 %	9	35.3	0.2 %	3.9
	Other Europe		108	9 %	76	481.2	2 %	6.3
North America 31 %	United States	#1	334	29 %	271	10,708.0	48 %	39.5
	Canada		16	1 %	13	51.4	0.2 %	4.0
	Mexico		8	1 %	5	16.9	0.1 %	3.4
Asia 15 %	India	#5	52	5 %	41	1389.3	6 %	33.9
	Singapore	#7	30	3 %	23	642.1	3 %	27.9
	Israel	#9	30	3 %	22	296.3	1 %	13.5
	China	#6	18	2 %	12	817.0	4 %	68.1
	United Arab Emirates		14	1 %	12	69.0	0.3 %	5.8
	Other Asia		31	3 %	22	467.7	2 %	21.3
Rest of the world 6 %	South Africa		20	2 %	17	46.5	0.2 %	2.7
	Australia	#8	17	1 %	16	315.7	1 %	19.7
	Kenya		6	1 %	5	12.8	0.1 %	2.6
	Chile		5	0.4%	5	91.5	0.4 %	18.3
	Nigeria		4	0.3%	2	0.5	0.0 %	0.2
	Other Rest of the world		10	1 %	5	2.7	0.0 %	0.5
Total			**1152**	**100 %**	**873**	**22,307.0**	**100 %**	**25.6**

Target companies in the US lead overall investment from European investors

US-based Insurtechs were not only involved in a large number of the transactions with European investors, they also generated the second-largest average deal value of USD 39.5m per transaction over the last six years (Graph 2). China-based Insurtech transactions, which have the sixth-largest total reported deal value of USD 817.0m, had the highest average deal value of USD 68.1m[5]. This was largely driven by a single target company, Waterdrop, a technology platform dedicated to insurance and healthcare services. Waterdrop had multiple investment rounds, with an average deal value of USD 105m for a total investment of USD 630m, which drove up the average deal value for China.

Furthermore, it should also be noted that the average deal value has increased significantly from USD 12.8m in 2016 to USD 44.2m in 2021, demonstrating the growing interest in and maturity of the sector.

Graph 2: Average deal value of Insurtech transactions from European investors by target countries in USDm – Top 10 by total Reported Deal Value – 1/1/2016 – 30/09/2021



	United States	United Kingdom	Germany	France	India	China	Singapore	Australia	Israel	Sweden
	#1	#2	#3	#4	#5	#16	#7	#8	#9	#10
Reported deal value (in USDm)	**10,708.0**	**3321.1**	**1681.1**	**1438.7**	**1389.3**	**817.0**	**642.1**	**315.7**	**296.3**	**258.5**
Number of transactions with reported deal value	271	148	48	64	41	12	23	16	22	31
	81 %	*74 %*	*62 %*	*80 %*	*79 %*	*67 %*	*77 %*	*94 %*	*73 %*	*84 %*
Total number of transactions	**334**	**199**	**78**	**80**	**52**	**18**	**30**	**17**	**30**	**37**

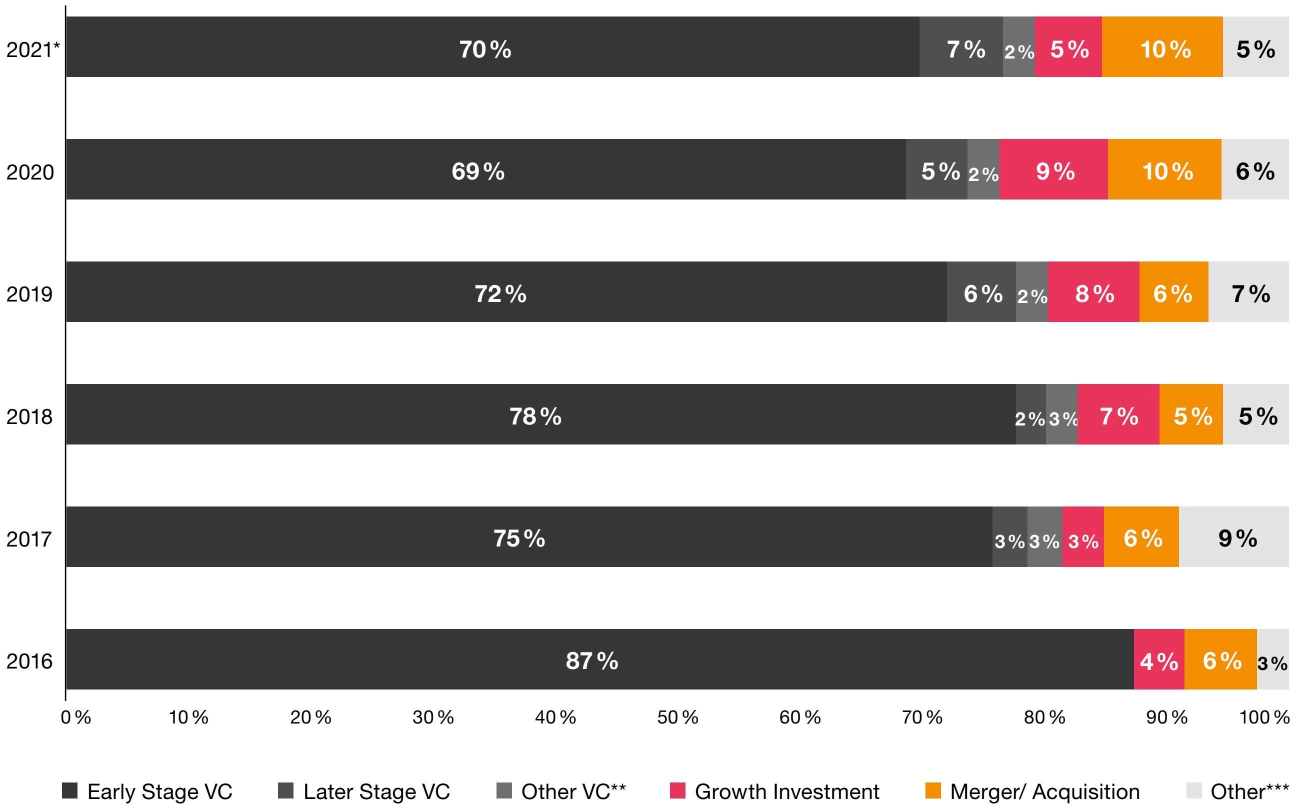
5 We highlight that the average deal value by country and other parameters (e.g. value chain components) may be distorted by outliers due to a limited number of disclosed transactions (for example, for China only 12 transactions out of 18 disclosed the relevant deal value).

About 80 % of Insurtech transactions from European investors were in the form of venture capital ('VC') investments (Graph 3)

Given the nature and maturity of most Insurtechs, the majority of Insurtech transactions by European investors from 2016 through 3Q 2021 were VC investments, both early and later stage. As a result of competition and the risk of becoming obsolete or being left behind, investors are scrambling to engage with Insurtechs early on, whether through incubators or other programmes. This pattern of supporting the development of future technology capabilities from the beginning can also be seen within the broader Fintech space.

However, we also noted an increasing share of growth investments from 4 % in 2016 to 9 % in 2020 and majority investments (i.e. Mergers & Acquisitions) from 6 % in 2016 to 10 % in 2020, which reflects a stronger commitment and interest by investors in Insurtechs whose underlying technology is more mature.

Graph 3: Insurtech transactions from European investors by deal stage and year – 1/1/2016 – 30/09/2021



*YTD 30/09/2021
**Other VC are transactions backed by venture capital investors for which the stage of the transaction was unknown
***Other includes crowdfunding and secondary market transactions, among others

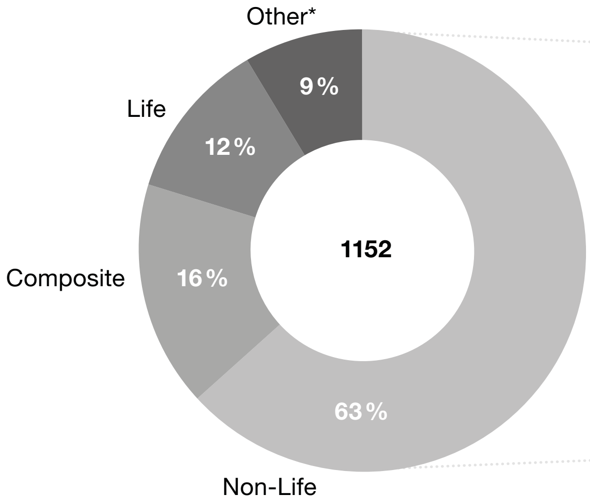
The majority of targeted Insurtechs are active in the non-life space, aiming to add value by way of services along the value chain

European investors mainly targeted Insurtechs in the non-life sector, with over 60 % of all transactions during the review period geared towards P&C or non-life companies.

Taking a closer look at these investments in Insurtechs in the non-life sector and which part of the value chain they support, we noted that roughly 50 % of all transactions were in the Services area. Services is where Insurtechs try to offer additional benefits to a carrier's insureds, such as risk management services or financial advice. Investments in areas such as Distribution and Full Stack followed, with 18 % and 15 % of total Insurtech transactions respectively.

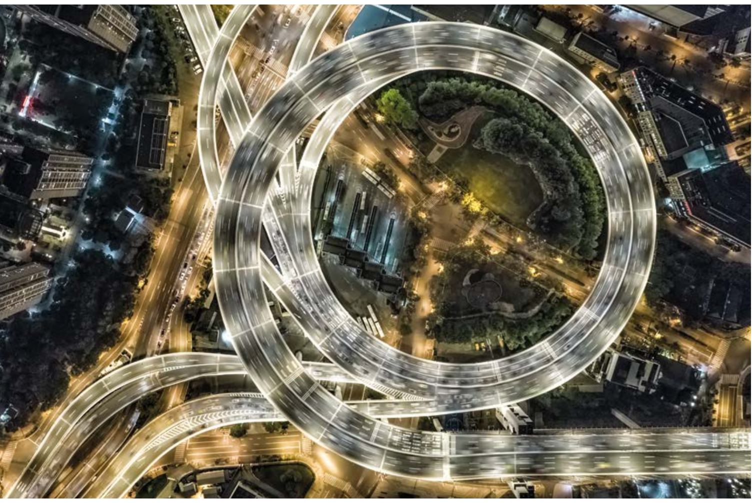
We see a relatively similar picture in the life segment, with more than half of all transactions focused on enhancing the Services area of the value chain, driven by the need to increase client-facing service capabilities.

Graph 4: Target Insurtech companies from European investors by subsectors – 1/1/2016 – 30/09/2021



Services	51 %
Distribution	18 %
Full Stack	15 %
Pricing	12 %
Claims	3 %
Product Development	0 %

*Other includes technology companies that focus on various financial services (incl. insurance-related aspects), among others

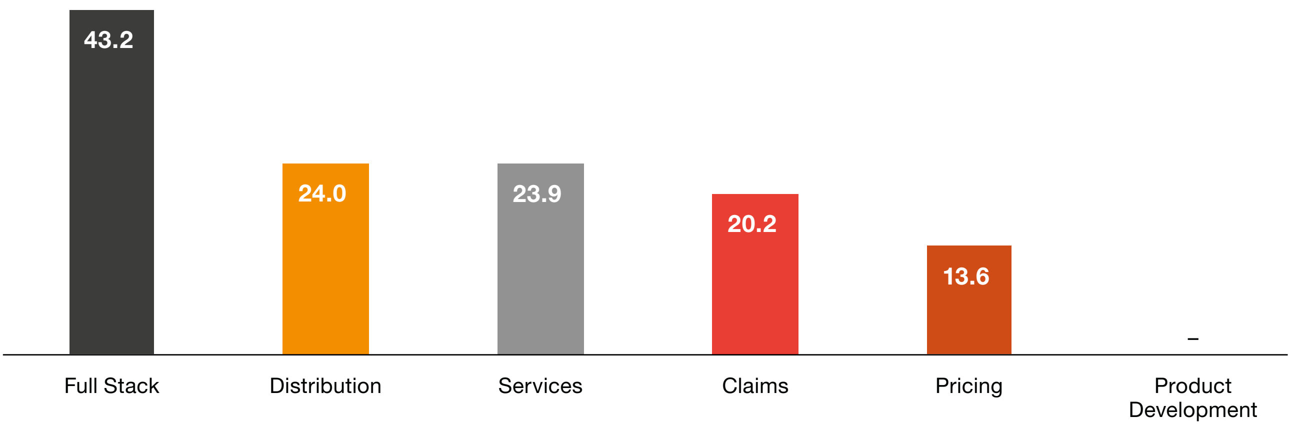


Full Stack Insurtechs achieved the highest average deal values reflecting their larger end-to-end offering

It should be further noted that whilst most transactions were made in the non-life sector, the average deal value for reported transactions was higher for target companies in the life segment (USD 38.3m life vs. USD 25.5m non-life).

The highest average deal values were for full-stack Insurtechs (i.e. fully operational digital insurance companies), which reflects the larger end-to-end offering these companies provide.

Graph 5: Average deal value of Insurtech transactions from European investors by value chain in USDm – 1/1/2016 – 30/09/2021



Number of transactions with reported deal value

131	167	446	30	99	0

Total number of transactions

178	**211**	**584**	**40**	**139**	**0**

Take away

Despite a turbulent year worldwide arising from the COVID-19 pandemic, the market for Insurtech deals has remained buoyant. Driven by the growing interest from (re)insurers to build or augment their capabilities across the (re)insurance value chain, European investors, including traditional (re)insurers, have shown increasing interest in Insurtechs. This has led to the number of Insurtech investment transactions by European investors from 2016 to 3Q 2021 more than doubling and average deal value increasing. The majority of investments has focused on US-based Insurtechs, followed by the UK, France and Germany, and has predominantly been in the form of VC investments.

Insurtechs which are active in the non-life space and focus on the Services segment along the insurance value chain receive the most interest from investors. The competition for Insurtechs that offer a differentiating proposition is likely to stay strong for the foreseeable future.

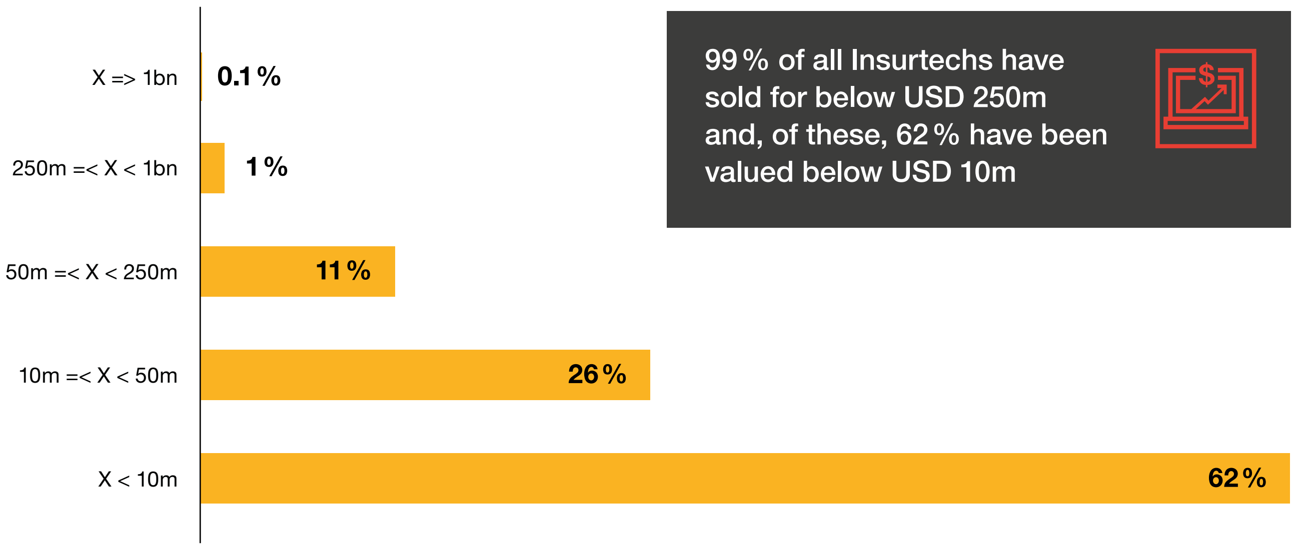
4. Valuing Insurtechs and staying grounded amidst high expectations

Looking at the global rise of Insurtech transactions and the emerging hype around future expectations, there can be no doubt that valuation is a critical topic. However, similar to Fintechs, the valuation of Insurtechs can sometimes be challenging as the characteristics are usually not comparable to traditional, established companies which are often much larger. Insurtechs are primarily young businesses leveraging their technology to either disrupt the conventional (re)insurance industry or to enhance a certain part of the value chain.

99 % of all Insurtechs have sold for below USD 250m and, of these, 62 % have been valued below USD 10m (Graph 6[6])

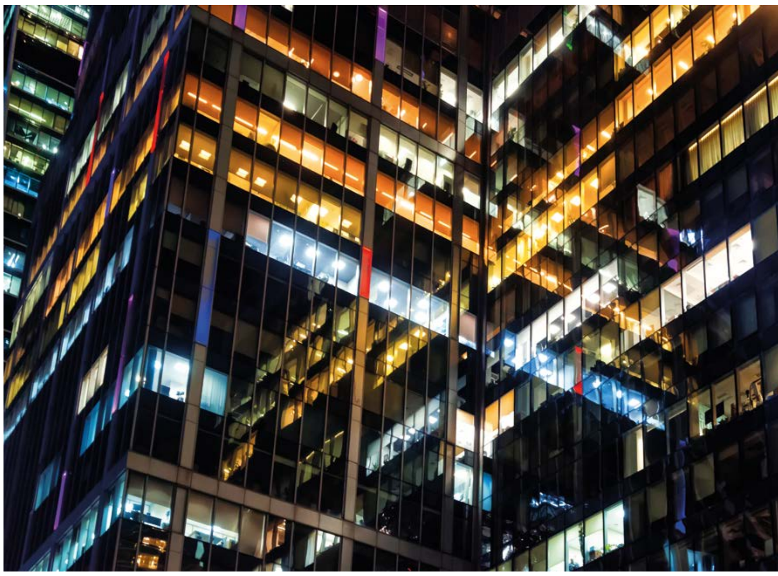
This is more likely an indication of their early-stage start-up nature rather than the success they are expected to achieve in the future. Subsequent funding round valuations or IPOs often result in significant valuation jumps.

Graph 6: Share of transactions by valuation (in USD) – 1/1/2016 – 30/09/2021



99 % of all Insurtechs have sold for below USD 250m and, of these, 62 % have been valued below USD 10m

Given the nature of Insurtech businesses, they cannot be valued in the same manner as more mature companies, and their valuations require further considerations. Typically, traditional (re)insurance companies are valued using the dividend discount model ('DDM') or in combination with a trading multiples approach of comparable companies, while considering adequate levels of capital to fulfil regulatory requirements.



6 Graph 6 shows the distribution of post-money valuations for Insurtech transactions observed over our period of review from 2016 – Q3 2021.

Insurtechs are more comparable to technology or other start-ups than mature (re)insurance companies

The basic principle of valuing Insurtechs aligns more to the valuation methodology for technology start-ups rather than traditional (re)insurance companies. Most Insurtechs are at an early stage in their development lifecycle, and exhibit high revenue growth potential combined with negative profit margins as a result of the large initial expenditures needed to ramp up the business. Some Insurtechs are still in their conceptional phase, and may require some time until they start generating their first revenues.

The stage of the development lifecycle which the Insurtech is in strongly influences the uncertainty of future cash flows.

Due to capital requirements, Insurtech valuation methods depend on the activity (underwriting vs. technology)

Insurtechs that underwrite their own (re)insurance business are usually valued with the dividend discount method (DDM), as the relevant cash flows correspond to the net income distributable to the equity holders while maintaining regulatory capital requirements, whereas Insurtechs that are technology users or providers to different participants in the (re)insurance industry are usually valued by the discounted cash flow model (DCF).

Elements such as whether the Insurtech expects to under-write its own policies and the pursuant capital requirements, as well as assessing the appropriate cost of equity, are vital in establishing the valuation.

Sufficient years of planning are often required to reach positive levels

For young Insurtechs, near-term free cash flows or earnings are often negative due to no or low revenues and high initial capital needs, which is why the business plan needs to comprise sufficient years to ensure that cash flows or earnings reach positive levels before transitioning to the terminal value year. That is often why a transition phase between the detailed planning phase and the terminal value is considered.

Determining the risk-adequate required rate of return is challenging

A particular challenge is determining a risk-adequate required rate of return (cost of equity) to discount the cash flows of the Insurtech. Due to their high inherent risk of business failure, the application of the standard or expanded Capital Asset Pricing Model (CAPM) is not suitable, as it will certainly underestimate the required rate of return. Hence, the cost of equity derived by the CAPM needs to be adjusted upwards by factoring in the annual probability of default of the Insurtech. Another way to derive a reasonable cost of equity for start-up valuations is the consideration of required rate of returns from venture capital/private equity firms depending on the company's stage of development. PwC uses an internally developed scorecard model to derive a company-specific risk premium, which is then added to the cost of equity derived based on the CAPM.[7]

The transaction multiples approach determines the value of the Insurtech based on multiples of comparable companies that were the subject of recent transactions (e.g. mergers/acquisitions, private placements or public offerings). A key advantage of values derived by transaction multiples is that they factor in actual prices paid by independent parties. The applied multiples for estimating the value of the Insurtech depend on the operational niche of the Insurtech. For self-underwriting Insurtechs, Price/Premiums, Price/Earnings and Price/Book multiples are usually considered, whereas for non-underwriting Insurtechs, Enterprise Value/Revenue, Enterprise Value/EBITDA and Enterprise Value/EBIT multiples are applied to initially derive the enterprise value of the Insurtech. Subsequently, the net debt is subtracted from the enterprise value to arrive at the equity value.[8] One major condition for properly applying the transaction multiples approach is to select recent transactions of companies with similar characteristics

7 The derivation is based on 16 questions, covering both qualitative and quantitative aspects from four categories. The company receives points for each question, depending on its performance. The risk premium results from the total score. The higher the total score, the lower the resulting risk premium.

8 Note that for (re)insurance companies, the separation between financing activities from their core business operations is practically not possible and high leverage is part of the (re)insurance business, which is why no distinction between enterprise and equity value is normally made for the purposes of valuing (re)insurance companies.

to the valuation subject, which might not always be available. As Insurtechs are generally early-stage companies, the application of trading multiples is usually inappropriate as listed peers are likely at a more mature stage.

The Venture Capital (VC) method is another common approach to value startup companies, and hence is also suitable for most Insurtech valuations. The basic principle is that venture capitalists realise the majority of their return with a liquidity event in the future (i.e. exit of the investment), for which they expect a certain rate of return given the specific level of risk attached to their initial investment. This approach requires the estimation of future expected revenues or earnings (typically in 2-5 years) and the estimation of an exit multiple (e.g. Enterprise Value/Revenues or Price/Earnings). The estimated future exit value is discounted back to the present at an adequate rate of return that captures both the perceived risk of the business and the likelihood of the firm not surviving (i.e., similar to the income approach). Hence, the key to appropriately applying the VC method is a reliable estimation of future expected revenues or earnings and the exit multiple, which is usually challenging due to the high uncertainty of the Insurtech's business success.

In practice, further valuation approaches exist such as the cost and asset approach. The premise behind the cost approach is that a buyer is unlikely to pay more for a company than it would cost to replicate it, whereas the asset approach determines the value based on the company's net asset value. The net asset value is derived by subtracting the market value of total liabilities from the market value of total assets. These approaches are usually not appropriate for valuing Insurtechs fairly, as most of them are technology startups with low capital levels that are mainly valuable due to their proprietary and innovative technology or other intangibles (e.g. workforce, management, stakeholder relationships). Hence, the results from the cost and asset approach in the context of valuing Insurtechs indicate minimum values.

Take away

As Insurtechs are heterogeneous and often early-stage ventures with a high degree of uncertainty regarding their future business development, the evaluator should apply different valuation methods and also conduct sensitivity and scenario analyses to get a comprehensive understanding of the main value drivers. The results of these different valuation methods might not align perfectly, but the primary goal should be to derive an overall acceptable bandwidth. Ultimately, valuing start-ups or Insurtechs is more like an art form, and is subject to negotiation instead of being an exact science.

Last words

Traditional (re)insurers, as well as more broadly generalist investors, private equity and venture capital funds have shown a growing interest in Insurtechs, driven by carriers' need to develop new capabilities or narrow existing gaps across the value chain to remain relevant in the market and offer their customers a digitally enhanced experience. Traditional and non-traditional European players are expected to maintain and grow their interest in this sector, with a large share of their investments (largely early stage) oriented towards US-based Insurtechs, particularly those focused on developing services capabilities.

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