

Mergers and acquisitions in property/casualty insurance

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Mergers and acquisitions (M&A) can prove to be a beneficial tool in the future success of insurance companies in the property and casualty field. Through M&A's, two individual entities can combine to make a single more profitable and efficient entity. This transaction could prove to be very beneficial to the parties involved. Likewise, when there is an opportunity to make large gains, there is an equal risk of experiencing equally devastating losses from unforeseen risks and liabilities not accounted for when the M&A took place. P&C firms can benefit from both situations. P&C firms can benefit by from increased profits and efficiency through an M&A with another entity or by insuring the risk of unforeseen liabilities in an M&A between two separate entities.

Before we continue, what exactly is an M&A? A merger is a situation when two firms combine to form one new single company instead of being individually owned and operated. Likewise, an acquisition is a situation when a company takes over a target company and establishes itself as the new owner. After an acquisition, the target company ceases to exist. The difference between a merger and acquisition lies in the fact that the target company ceases to exist after an acquisition.

The main idea of an M&A is that the combination of two entities creates a separate entity that is more valuable and cost efficient than the sum of the two individual companies. This new and improved entity is a result of the synergies that occur in an M&A. Synergies are the positive effects due to the combination of two individual entities, such as staff reductions, economies of scale, acquiring new technology, and improved market and industry visibility. A firm in P&C industry will benefit most from improved market reach and industry visibility. By merging or acquiring another insurance company, the new company will benefit by obtaining the target companies clients, as well as expanding their business into areas where the target company had prior control over. The new entity can also

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experience benefits from groundbreaking ideas or unique technology owned by the target company.

Before going into an M&A transaction, a company must value the target company. The target company can be valued through comparative ratios, such as the price-earnings ratio, or the enterprise-value-to-sales ratio, replacement costs, which is where an acquisition is based on the cost it would take to replace the target company, or through discounted cash flow, where a company's current value is determined by its estimated future cash flows. After valuing the target company, it must be determined if the potential synergies of the M&A transaction outweighs the amount of premium needed for the transaction. If the synergies do not outweigh the amount of premium needed, a company should not undergo an M&A transaction.

P&C insurance companies can benefit from other companies undergoing M&A transactions. Since there is always risk in an M&A transaction between two parties, an insurance company can insure that risk. Risk in an M&A transaction are often high and unknown when the transaction occurs. These risks come in the form of environmental liabilities, management liabilities, political risks, and fiduciary and benefit liabilities. An insurance firm can benefit from the premium earned by insuring this risk, and the companies undergoing an M&A transaction can eliminate some of the risk through such an insurance policy.

P&C firms can benefit from M&A transactions in many different ways. They can benefit from the synergies experience through an M&A transaction such as increased market presence and through the sharing of unique ideas and technologies. Also, P&C firms can benefit by insuring the unexpected risks between two companies undergoing an M&A transaction.