



BRYAN, GARNIER & CO

NEWSLETTER

PROJECTIONS

BET ON INSURANCE SOFTWARE



February 2017

AN INDUSTRY ON THE VERGE OF DEEP TRANSFORMATION

'Insurtech' is no longer a neologism. Many start-ups have already begun revolutionising how insurance policies are offered, priced and distributed. So far, however, insurers' internal IT systems have been largely disregarded by sector analysts and blue-chip industry players. **This is about to change.**

THE CLOUD AND INSURANCE-SPECIFIC PLATFORMS ARE THE CATALYSTS

Specialist insurance software vendors began by offering more agile and modern client-facing interfaces. Today they offer complete and robust P&C and Life platforms, enabling insurers to efficiently manage the policy lifecycle from initial sale through to CRM, compensation, back-office administration and internal compliance. Two factors have combined to catalyze this transformation: the increasing adoption of Cloud-based solutions to serve business-critical applications; and insurance-specific platforms that allow for easier and faster migration.

THE SALES CYCLE HAS BEGUN AND IS ACCELERATING

Third-party banking core system vendors such as Temenos and Sopra recently paved the way for a major IT refresh in the banking industry. Today, insurance software providers seem to be following their lead. We are seeing accelerating sales growth driven by the regional subsidiaries of multinational insurance groups. And we believe that very large contracts will be on the market soon, now that existing solutions are proven. Recent aggressive moves from well-informed strategic acquirers and PE funds further support our theory.

KEY DATA POINTS

TAM: \$10.0bn
yearly annual license
and
service revenue

10%
third-party vendor
penetration rate








+6.5% CAGR
in insurers'
IT spending

#2
in terms of IT spend
after financial
services

THIBAUT DE SMEDT

Partner | Bryan, Garnier & Co

TRADING PEERS VALUATION BENCHMARKS

Companies	2016 EBITDA margin	EV / Sales		EV / EBITDA	
		2016e	2017e	2016e	2017e
 GUIDEWIRE	3.9%	7.0x	6.2x	n.a.	n.a.
 EBIX	14.8%	7.8x	7.2x	n.a.	18.9x
 SAPIENS	38.0%	2.9x	2.5x	19.7x	16.8x
 MAJESCO	11.8%	1.6x	1.3x	n.a.	14.5x
Average Insurance Soft.	17.1%	4.8x	4.3x	19.7x	16.7x
 TEMENOS	35.6%	5.4x	4.9x	12.8x	11.3x
 ORACLE FINANCIAL SERVICES	42.3%	2.5x	2.4x	9.1x	8.0x
 D+H	27.9%	2.7x	2.4x	16.9x	14.1x
Average Banking Soft.	35.3%	3.6x	3.3x	12.9x	11.1x

SELECTED LANDMARK TRANSACTIONS

Date	Target Company	Country	Acquirer	EV (€m)
Dec-16	ISCS	USA	Guidewire Software	153
Aug-16	FirstBest Systems	USA	Guidewire Software	31
Aug-16	Relay Software	UK	Applied Systems	5
Jun-16	AgencyPort Insurance	UK	Apax Partners	n.a.
May-16	Vertafore	USA	Bain Capital ; Vista Equity Partners	2,368
Apr-16	Duck Creek Technologies (60% Stake)	USA	Apax Partners	n.a.
Mar-16	EagleEye Analytics	USA	Guidewire Software	38
Dec-15	Xchanging	UK	CSC	695

A LARGELY GREENFIELD MARKET WITH MANY DRIVERS FOR GROWTH

Insurers' core systems have always been considered mission-critical. This made it difficult for third-party vendors to penetrate the market, and it also lengthened sale cycles despite the disruptive new solutions on offer. However recent structural and cyclical trends are now putting pressure on insurers to refresh their in-house core systems. Decades old, these systems are expensive to maintain, offer low productivity and lead to customer dissatisfaction.

We believe that with its combination of low third-party penetration and long lifetime value, insurance software is one of the largest and most long-term growth opportunities in the enterprise software space.

- The start of a large IT refresh cycle in the European insurance industry is a major opportunity for specialized insurance software vendors

20%+ of a typical insurer's cost base is made up of IT expense

- Aging IT infrastructure and the growing scarcity of experienced employees has resulted in both increased business risks (customer churn, fraud etc.) and a critical need for fast replacement

45% of P&C insurers are replacing or planning to replace a policy administration system

- Limited market penetration will support longstanding and fast revenue growth in one of the software spaces with the highest customer retention rate

10% Estimates suggest that the insurance software market is less than 10% penetrated

- Changing customer expectations around device-based interaction and omnichannel services are leading to the creation of insurtech startups - this is increasing the need for P&C insurers to migrate to suites

DESPITE THE COMPETITION, WE BELIEVE PURE-PLAY INSURANCE SOFTWARE VENDORS WILL EVENTUALLY WIN THE RACE

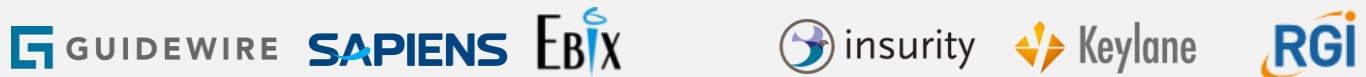
INSURANCE SOFTWARE COMPETITION MATRIX

	Cost-efficient	Cloud-based	Full-suite	Omni-channel	User-friendly
Internally developed software	✗	✗	✓	✗	✗
IT services firms	✗	✗	✗	✗	✓
Pure insurance software vendors	✓	✓	✓	✓	✓
Horizontal software vendors	✗	✓	✗	✓	✗
Start-ups & regional players	✓	✓	✗	✗	✓

Over the past few months, insurers have increasingly been moving away from custom and "green screen" in-house solutions, showing a strong preference for complete core systems suites from third-party vendors. Compared with legacy mainframe systems that are organized around policies, the best-in-class third-party solutions are customer-centric. And they offer agile front-end capabilities coupled with big data analysis, features that are critical both to address the new ways that customers are using systems, and to support omnichannel distribution (e.g. metasearch, direct sales, etc.)

The third-party insurance software space is getting more crowded every year. Vendors are diverse in terms of their profiles, product offerings and integration capabilities. There are three main categories: regional leaders; small niche specialists; and upcoming challengers that combine scalable, full-suite offers with deep knowledge of local market specifics.

- **Large regional leaders** were the first to arrive, offering best-of-breed solutions. They now face increasing competition from agile new challengers
- **Local niche specialists** offer tailored modules and customized pieces of core insurance systems, addressing local players' specific needs



- **“Glocal” challengers offering front-to-back suites** will probably benefit from the strongest growth in the coming years thanks to substantial barriers to entry, agile solutions dedicated to the insurance sector and captive cross-selling opportunities (i.e. a module-by-module sales strategy)

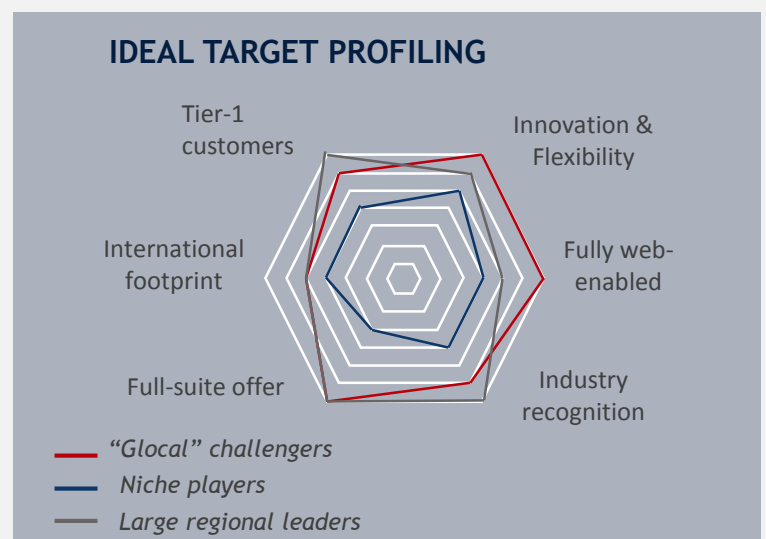


Three factors create substantial barriers to entry in the insurance software space: understanding insurance-specific IT challenges; developing either full front-to-back suites or agile best-of-breed solutions that are easy to deploy and integrate; and building relationships with Tier 1 insurers. In our view, this favors specialist vendors over niche players and large, diversified software providers. “Green-screen” core systems are now part of the industry’s history.

SOFTWARE MARKET LEADERS AND PE FUNDS DRIVE CONTINUOUS M&A AND FUNDING ACTIVITY

As a large, rich industry undergoing deep IT transformation, insurance is attracting growing focus from both strategic buyers and private equity players:

- **horizontal and financial software vendors** target acquisitions to improve time-to-market and broaden their product offering
- **regional software insurance leaders** mostly target additional footprint, a broader client portfolio and new technologies
- **private equity firms** are conducting buy-and-build strategies around small/medium size players. They are attracted by best-in-class vendors with high potential to become “Glocal” market leaders.



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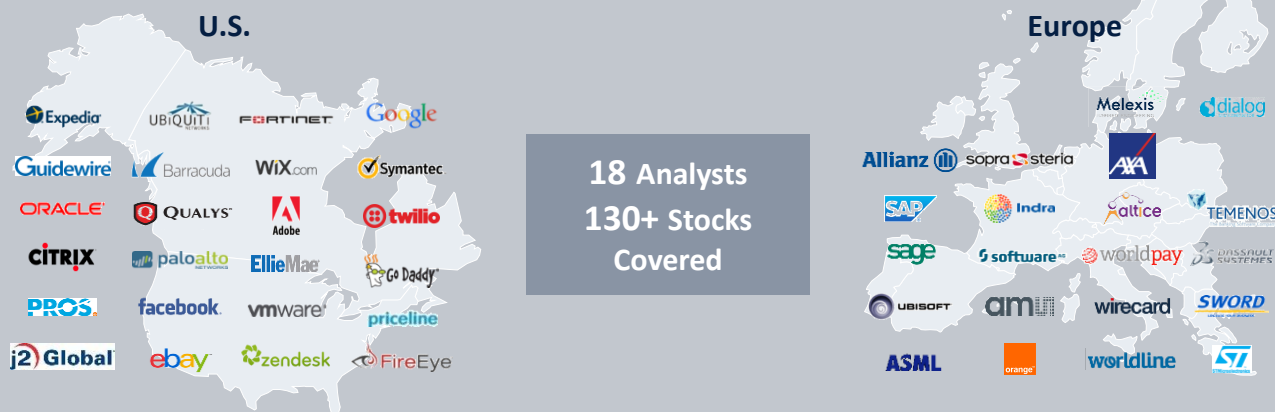
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JMP BRYAN GARNIER EQUITY RESEARCH COVERAGE

In November 2016 Bryan, Garnier & Co formed a partnership with JMP Securities LLC (NYSE : JMP) to create JMP Bryan Garnier, a full-service transatlantic investment banking alliance for technology and healthcare companies.



BRYAN, GARNIER & CO SELECTED CREDENTIALS



Investment by

KEENSIGHT

Undisclosed

Advisor to the Buyer



Acquired by

THL Thomas H. Lee Partners

Undisclosed

Sole Advisor to the Sellers



Acquired by

Reed Elsevier

Undisclosed

Co-Advisor to the Sellers



Acquired by

TEMENOS

Undisclosed

Advisor to the Buyer



Acquired by

CAPITAL MANAGEMENT

€38 000 000

Advisor to the Seller



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