EXPERT Q&A

Apogem Capital's Bill Kindorf, co-head of sponsor coverage, and David Kelly, managing director in private credit, explain why insurance and financial services represent a hot sector for lending activity





Positioning for success in the insurance sector

Q How would you describe the dynamics in the insurance and financial services space, and what makes it such an appealing market for lenders?

Bill Kindorf: It is a very active space right now, particularly compared to when we started doing these deals over 20 years ago. We think about our book in three broad categories: insurance distribution and services; wealth management and asset management; and related financial services. The common themes we look for across all those categories are that the businesses have strong recurring revenues, attractive cashflow dynamics, established market valuations and limited balance sheet requirements.

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Since our inception in 2001, we have lent to more than 100 insurance-related platforms and over 40 wealth and asset management-related platforms, and in our experience, businesses in this sector can exhibit less cyclicality and their cashflow dynamics can provide additional resilience. Those attributes do not eliminate risk, however, and the complexity of these businesses makes disciplined underwriting and structuring particularly important.

Q How have you seen the lending opportunities evolve over time in the sector?

David Kelly: We have seen the direct lending market become much more active in this sector. What started with a relatively limited set of sponsors and lenders doing insurance and financial services has broadened significantly over the past few years.

Certain types of transactions have become more frequent in nature, such as sponsors executing consolidation strategies in insurance distribution, wealth management and, more recently, in accounting services. As these strategies become more established, we have seen more sponsors and lenders participating, so the terms and structures have become more competitive over time.

Beyond these recurring deal types, the core financial services-orientated sponsors continue to invest in complex

businesses such as managing general agents or active investment managers. This is where industry experience for lenders to appropriately underwrite and structure the financing is key, and we have seen more limited competition.

Q What are the attributes of successful lenders in the insurance and financial services sector?

BK: There is often more nuance to these transactions than may appear at first glance, so experience in addressing that is very important. Structural complexity is fairly common. Within wealth management, for example, that is often around regulated entities, such as broker dealers or trust companies. Within insurance, we see businesses that have regulated risk-bearing entities, indirect underwriting risk assumption or business viability that is reliant on favourable underwriting results.

In other words, you almost have to view some businesses that are not directly taking underwriting risk as if they are, because the underwriting results will dictate their ability to grow and, in some instances, to remain viable.

Scalability has also become essential for lenders in this space. There is often some element of non-organic growth that the sponsor and management team want to pursue. That requires the ability to upsize the facility to support M&A, team acquisitions, earn-outs, forgivable loans or other mechanisms.

Compared with the average deal outside financial services, you may end up with a sub-optimal collateral package just by virtue of the fact that you have a regulated entity. That is just a factor of lending to this sector.

Q How have borrowers responded to periods of economic disruption and how important is M&A in the space?

DK: The attractive attributes of the sector have helped to insulate these businesses, to an extent, from periods of broader economic disruption. The underlying businesses tend to benefit from less cyclical demand and they generate recurring revenues with low capital investment requirements.

That said, we have seen various factors affect certain sub-segments of the market, such as sudden changes in interest rates and variations in the frequency and severity of catastrophic loss events. In these instances, borrowers respond by managing costs, adapting business models and pursuing strategic opportunities, including M&A.

M&A is a significant part of the insurance and financial services landscape, whether that is a high-volume roll-up strategy, a platform seeking expansion into adjacent service lines or geographies, or a business pursuing a transformative acquisition. Almost all borrowers in our insurance and financial services portfolio are active in the M&A markets and experienced lenders are important partners in that, providing capital, flexibility and certainty of execution for sponsors as they build their platforms.

Q What is your perspective on how AI is likely to impact insurance and financial services companies?

DK: We believe AI will create several tailwinds. We're already seeing companies in our portfolio incorporating AI into workflows to become more operationally efficient. We have seen, and expect to increasingly see, companies using AI to optimise decision-making, such as speciality insurance underwriters leveraging their own proprietary data and broader industry data to price policies.

We spend a lot of time considering the potential for AI to disintermediate these people-centric businesses. Our view is that human judgment and trusted relationships remain critical to delivering advisory services, helping clients to navigate complex markets.

BK: In our wealth management deals, a common refrain we hear from sponsors, owners and management teams is that salespeople are biased towards selling what they know. That means they favour products that they have always sold at the expense of other products that may be more appropriate for the portfolio.

AI may allow firms to become better equipped to evaluate and introduce products that are newer or more complex, potentially broadening the solutions available to clients and helping advisers operate more effectively.

Q Finally, how do you think the private credit opportunity will evolve moving forwards?

BK: In most financial services subsectors, valuations remain elevated by historical standards. There continues to be opportunity, but execution following a very focused strategy is key.

It is probably unwise to have your investment thesis rely solely on market multiple expansion on the overall platform. Similarly, the opportunity for purchase price multiple arbitrage has narrowed significantly, making that approach more difficult to execute than historically. Instead, we see the need for more speciality expertise. Our sponsors are more frequently deploying operating partners and tapping into industry contacts.

But we believe there is good reason for valuations to be where they are: these are generally good businesses with core characteristics that private equity desires. We consistently see new teams spinning out of larger consolidators and new specialities emerging.

Sponsors and lenders need to have experience and the knowledge base to evaluate deals quickly and put their best foot forward because these processes are often expedited. Sellers are getting better sellside advice. The highest bids do not always prevail. Sellers are seeking partners that understand their businesses and are going to be best positioned to help them execute on a strategy over time. ■