Did Intact Financial Corporation Just Miss Out on a Big Deal?

Description

Privately held insurer Wawanesa Mutual Insurance Company made headlines on Thursday when it agreed to acquire two large insurance holdings of Desjardins, the Quebec-based financial services giant, for a total of $775 million.

The deal included Western Financial Group, which has grown to be one of central Canada's largest insurance brokerages. The High River, Alberta-based company has 157 locations across B.C., Alberta, Saskatchewan, Manitoba, and Quebec, employing a total of +1,700 employees.

Western Life Assurance provides life, critical illness, and other types of insurance for Western Financial's brokers.

Wawanesa is one of Canada's largest property and casualty insurers with $3 billion in annual revenues and total assets of more than $9 billion. It is a formidable force in the insurance market.

But it pales in size to Canada's largest property and casualty insurer, **Intact Financial Corporation** (TSX:IFC), which recorded $8.4 billion in revenue in 2016 and has nearly $23 billion worth of assets on its balance sheet.

Intact has been telling investors for years it intends to consolidate Canada's fragmented insurance market. So what happened here? Why wasn't it the one making headlines for making this deal?

The benefit of acquiring brokers

On first glance, the reason this deal didn't get done seems obvious. Intact is an insurer. The big prize was Western Financial, which is an insurance broker. While they're two similar businesses, an insurer buying an insurance broker is the equivalent of a mortgage lender buying a mortgage broker. It doesn't really make sense.

But I don't buy that logic. There are many different property and casualty insurers that operate in Canada. An average consumer with a good credit rating has plenty of choice. By buying insurance brokers, Intact can ensure its products are pushed over competing offerings. It's obvious Wawanesa saw the logic in doing this.

Besides, Intact already owns its own brokerage division, which includes both Brokerlink and Belairdirect. Intact's distribution income, which comes from its insurance brokerage division, came to $111 million last year. That pales in comparison to the company's underwriting and investment income — which were $375 million and $414 million, respectively, in 2016 — but it still matters. And, most importantly, it shows Intact knows the brokerage business already.

Why didn't Intact make the deal?

Ultimately, we don't know what happened behind the scenes. Maybe Desjardins never even approached Intact about these assets, and Intact's executives woke up this morning gobsmacked by the news.

I doubt it.

Intact is well known for wanting to consolidate the industry and make acquisitions. The company has made a number of big deals in the last few years, including a $2 billion deal to acquire AXA Canada in 2011 and a $143 million deal to buy Canadian Direct Insurance in 2015.

The real reason is probably pretty simple: Intact likely got outbid.

Shareholders have a couple of options at this point. They can either trust in management and assume that buying the Desjardins assets cost too much and they wouldn't offer a satisfactory return; or management simply decided Intact wasn't interested. One conclusion is acceptable. The other is troubling.

The bottom line

The good news for Intact shareholders is, the company is pretty attractively valued. Analysts expect Intact to earn $6.82 per share in 2017, putting it at just 14.2 times forward earnings. That's pretty cheap. But, then again, the company isn't expected to grow much either. The market in Canada is just too mature.

Many Intact investors own shares in part because they see consolidation potential. If Intact keeps letting these deals pass it by, it runs the risk of alienating shareholders. Keep that in mind if the company misses out on additional acquisition possibilities.

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