April 10, 2020

Quincy Analytics

Where is InsurTech headed as COVID-19 peaks?

POSITIONING FOR THE REBOUND

Opportunities

+ Deals still happening
+ Angel & seed prospects still bright
+ Over $270bn in venture capital dry powder
+ Fundamentals still strong; segment still attractive to investors
+ Uptick in M&A likely
+ New or expanded opportunities in cyber; self-service; DIY; mobile and virtual
+ Gains made by female founders continue

Challenges

- Minimal deal activity through Q2 2020
- Downturn in deals by 25%+ bottoming in 2-3 quarters and rebounding to a “new normal” by mid-2021
- Downturn in investment dollars of up to 50% bottoming in early 2022 and not fully recovered until late 2023
- Smaller deal sizes by up to 20%
- Near-term failures for InsurTechs low on cash and highly exposed to economic shutdown

Where is InsurTech headed as COVID-19 peaks?

As COVID-19 peaks and the world begins to think about life after lockdown and a global economic awakening, InsurTech entrepreneurs, innovators, and investors are pondering some key questions:

- How long will the current freeze and coming investment downturn last?
- What will the post-crisis investment environment look like?
- What impact will a COVID-19 induced recession have on established, fledgling, and nascent InsurTechs?
- Who will be the post-pandemic “winners” and “losers”?

These questions are particularly acute for the earliest stage InsurTech entrepreneurs who may not have the “runway” to survive a prolonged downturn or investment hiatus – or even the opportunity in the current investment environment to get up and running.

The InsurTech Bonanza

For the past 10 years, InsurTech has been on a tremendous roll globally. From 2012-2019, investment and deals in the InsurTech sector outperformed all venture capital (VC) by roughly 2:1 (Figure 1).

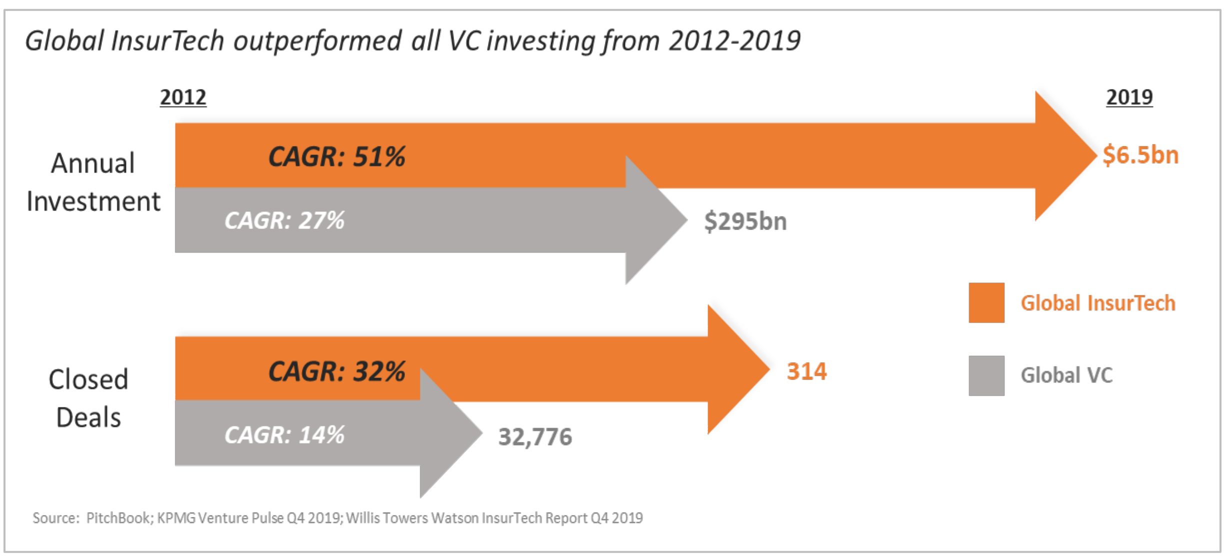


Figure 1 VC and InsurTech investment and deals closed 2012-2019

While worldwide VC investing had already been feeling the effects of the WeWork debacle and lackluster performance of other “unicorn” IPOs by the end of 2019, InsurTech investments were showing resiliency. Global VC investment and deal counts were down 12% and 6% respectively from 2018 to 2019 (excluding the SoftBank infusion into WeWork), while global InsurTech investing and deals were *up* 53% and 22% (Figure 2). The quarter-over-quarter results are even more dramatic: while global VC investing dropped 18% from Q4 2018 to Q4 2019 (excluding WeWork), InsurTech capital investment hit an all-time high at $2bn for the quarter, up 25% from Q4 2018.

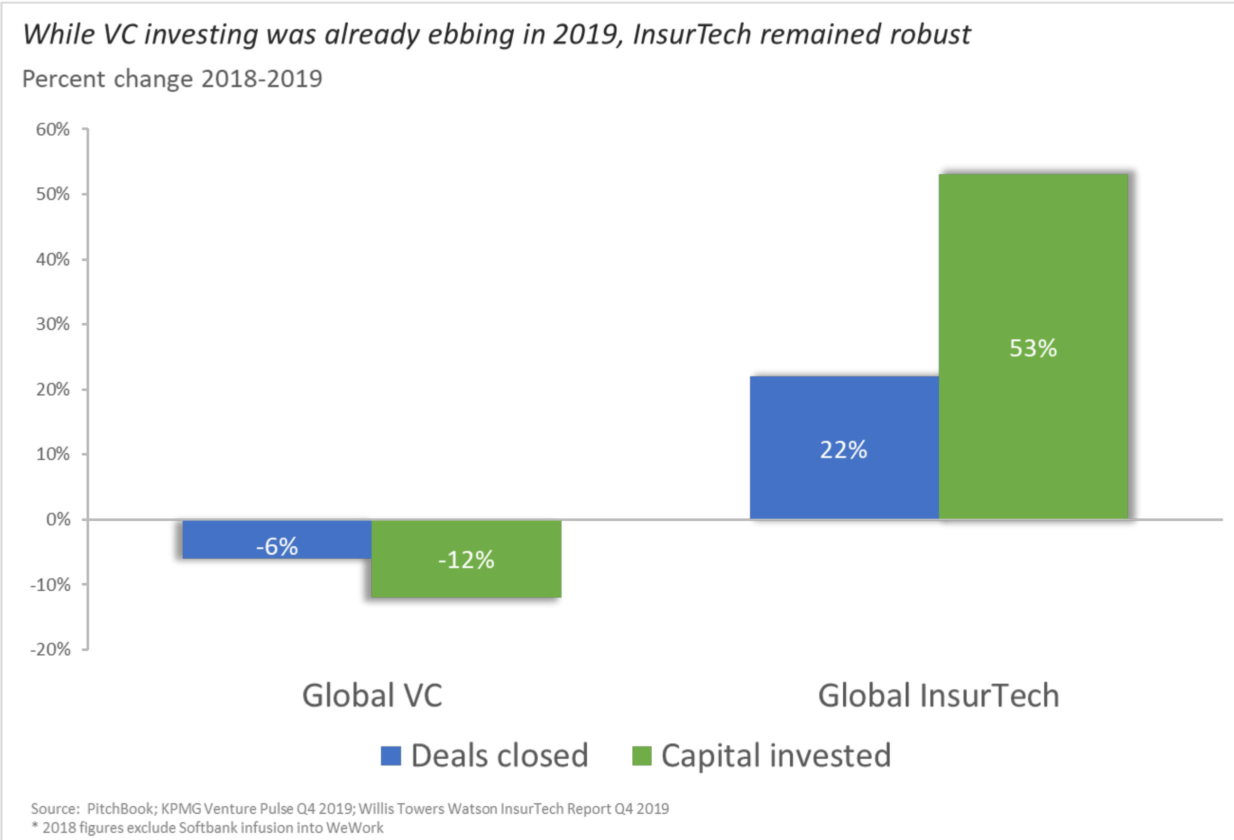


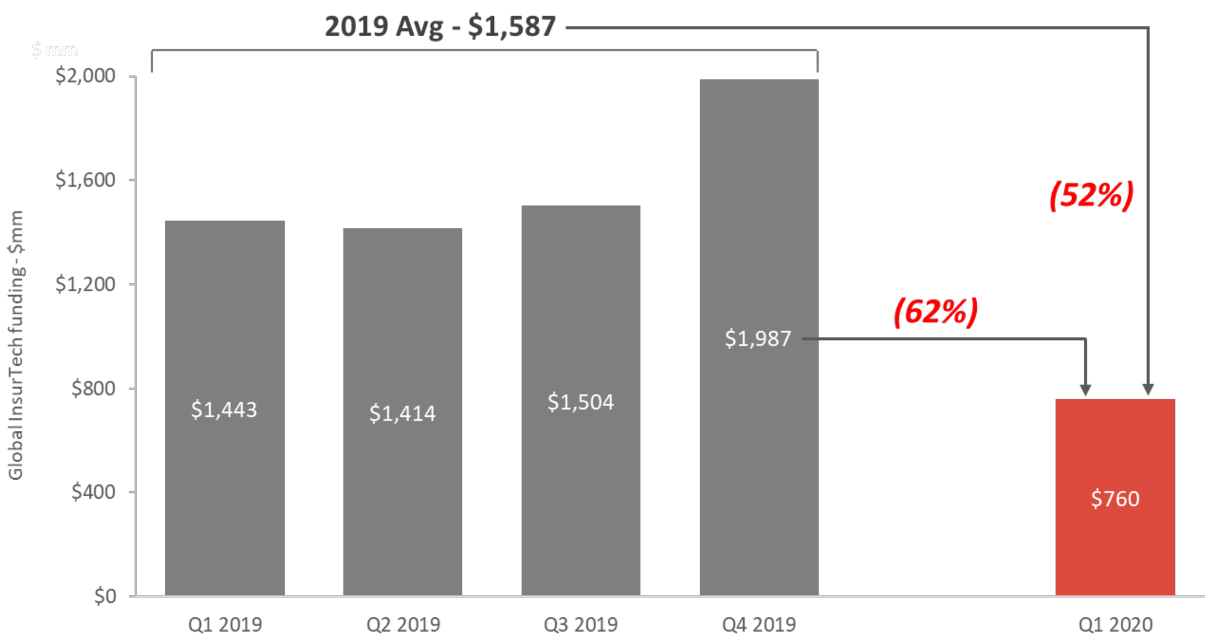
Figure 2 Global VC and InsurTech activity 2018-2019

Enter the Global Pandemic

But InsurTech is not immune to COVID-19. Anyone working in or with VC or PE firms knows that capital is already tightening up, deals are being re-examined or put on hold, and attention spans of investors have been understandably diverted elsewhere. While we all adjust to lockdowns, working from home, and general ennui, VC and PE teams have shifted to crisis management as they hunker down in war rooms attempting to help existing portfolio companies simply survive. While much of this may be short-term if the economy recovers quickly, other impacts will be lasting, ultimately affecting VC and PE firms' investment theses, risk appetites, and perspectives on where and how much their future bets will be.

This is already evident in InsurTech investment numbers (Figure 3). Q1 2020 InsurTech investment dollars were down over 50% from 2019 and over 60% from the Q4 2019 all-time high. Q2 is certain to be worse since many of the deals that closed in Q1 were VCs concluding investments already in the pipeline.

InsurTechs globally are already feeling the impact of COVID-19 as Q1 2020 investment drops precipitously from 2019 highs



Source: Preqin; PitchBook; Willis Towers Watson InsurTech Report Q4 2019

Figure 3 Global InsurTech investing, Q1 2019 - Q1 2020

Obviously, the longer the COVID-19 virus continues, the more reluctant investors will be to fund new ventures. Opinions on how long and pervasive this downturn and rebound will take abound. Optimists hope for a "rubber band" effect where deal-making and investing snap back very quickly. The darkest pessimists foresee a downturn akin to the Great Depression − a crisis that lasted 10 years. Perhaps the IMF (and others) have a more realistic view: “The International Monetary Fund said it expects a global recession this year [2020] that will be at least as bad as the downturn during the financial crisis more than a decade ago, followed by a recovery in 2021.”[1] With that in mind, it is instructive to look back at VC trends during that period to get some clues as to what to expect in an upcoming COVID-19 downturn.

What Does the Data Suggest?

It is no surprise that long-run InsurTech deal volume and capital investment track very closely with overall VC investment, especially "early-stage"[2] InsurTech deals (Figure 4). The particularly close correlation with just VC investing (versus all private equity) makes sense given

[1] *Fortune*, “Coronavirus economic impact ‘will be severe,’ at least as bad as Great Recession, says IMF,” March 23, 2020
[2] Early stage includes angel, seed, Series A and B rounds

the smaller and more nascent nature of the InsurTech space, and the implication is clear: as the broader VC market goes, so goes InsurTech.

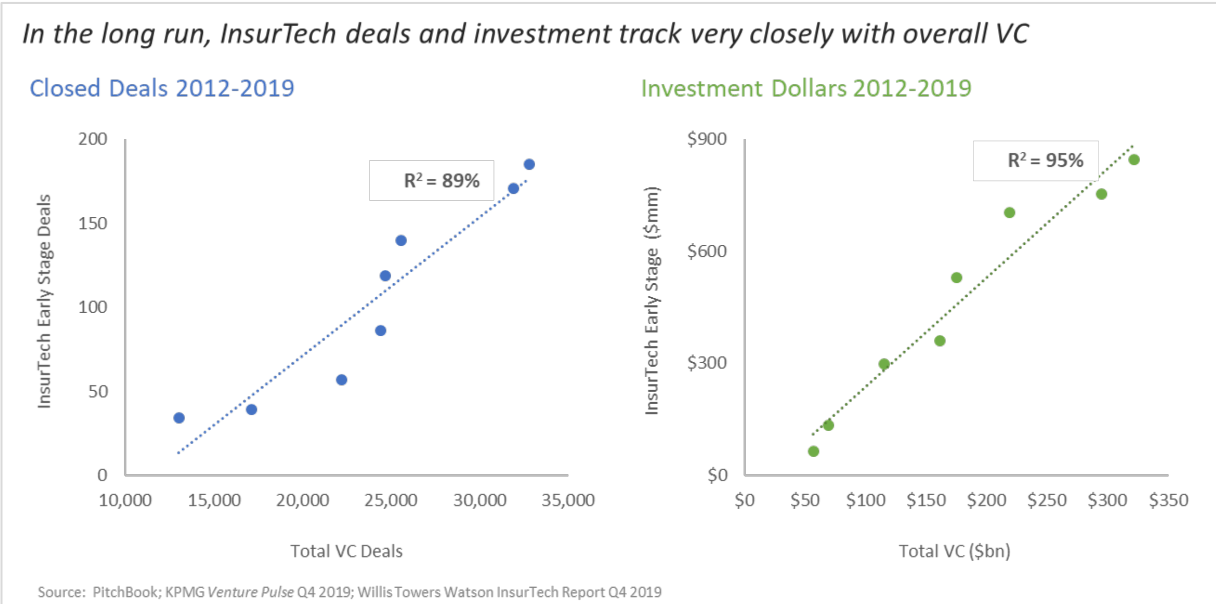


Figure 4 VC versus early stage InsurTech deals and investments (2012-2019)

This observed relationship is also very helpful because while what is now called InsurTech wasn't tracked separately during the Great Recession of 2007-2009, aggregate VC investing was. Looking at VC deals and investments during that period "peak-to-trough-to recovery" could be representative of what startup and early-stage InsurTechs can expect during and after a similar COVID-19 induced recession.

Figure 5 shows quarterly US VC deal volume and investments from Q1 2006 to Q4 2010. The "official" [3] duration of the Great Recession is shaded gray. VC investing dropped 44% from its peak 3 quarters before the official start of the Great Recession to the VC bottom in Q1 2009, one month before the official end of that recessionary period. Deal volume dropped 28% from peak to trough.

But the time from peak to bottom is less helpful than the time it took to get "back to normal." While VC investment dollars went on a steady 9 quarter decline from peak in Q1 2007 to trough, they did not return steadily to pre-recession levels until Q1 2011 (16 quarters after the fall started and 7 quarters after the bottom). The deal cycle downturn and recovery was more compressed: 4 quarters from peak in Q1 2008 to trough in Q1 2009, and 8 quarters from peak to pre-recession normalcy.

[3] According to the U.S. National Bureau of Economic Research: December 2007 − June 2009

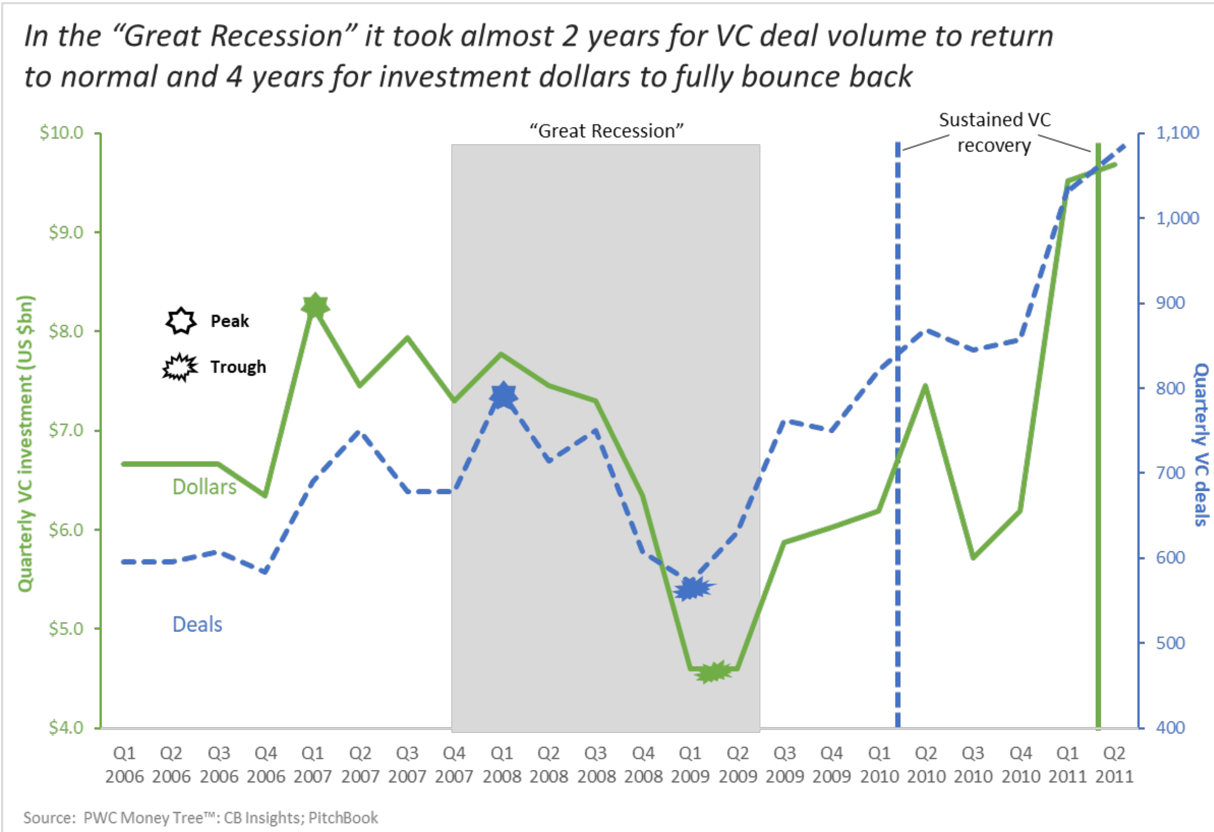


Figure 5 Quarterly VC deal and investment levels pre and post the Great Recession

Given that InsurTech investing hit its peak in Q4 2019 and assuming the COVID-19 recession begins in Q1 2020, the data imply a likely InsurTech deal downturn could last through 2020 with a return to "normalcy" by mid to late 2021. The investment dollar downturn could be more protracted, not bottoming until Q1 2022 and not fully rebounding until late 2023.

Two significant factors may mitigate this dreary forecast. The federal government's swift intervention with at least $2TN of stimulus and the Federal Reserve's immediate quantitative easing was sooner than (and may well surpass) actions taken during the 2007 financial crisis. Additionally, private capital markets – especially venture and growth capital – have significantly more uncalled capital ("dry powder") on hand than at any point in the past 20 years. A recent study by Bain[4] showed that overall private equity dry powder was 38% higher at the end of 2019 than the average for the prior 5 years and twice as high as the average for the 2007-2009 recession. For venture capital alone, the relative difference is even larger (Figure 6).

[4] Bain & Co., "Global Private Equity Report," February 2020 (data provided by Preqin)

While the swift reaction by governments globally and the significant amount of VC dry powder on-hand suggest a possibly shorter investment downturn than in the Great Recession, InsurTech investors, innovators, and entrepreneurs need to prepare for a near term deal "freeze" and a return to "normal" that may take multiple years.

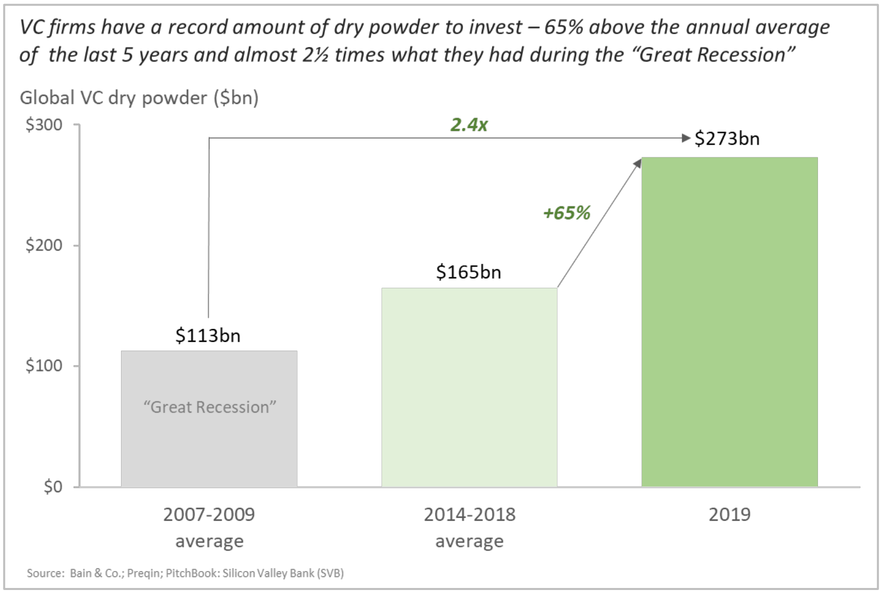
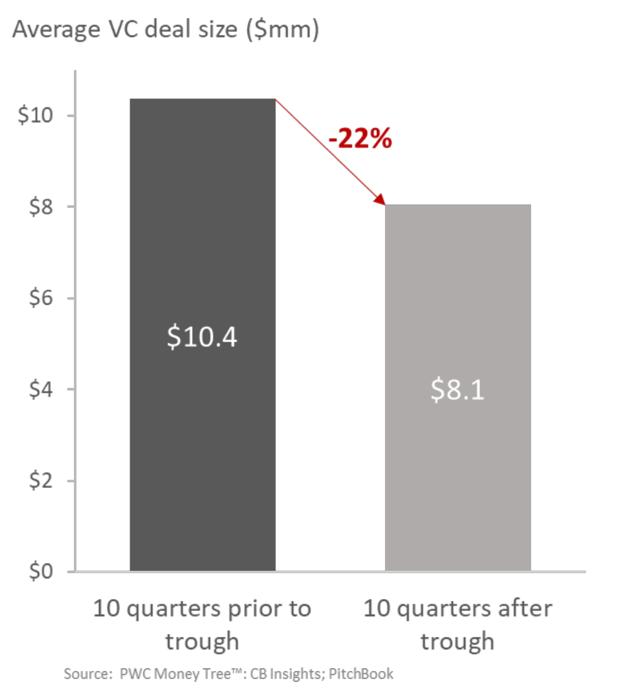


Figure 6 Global VC uncalled capital

If trends from the Great Recession repeat, the "new normal" for InsurTechs post COVID-19 will likely be much smaller deal sizes. Looking at the periods two and half years prior to and post the Great Recession VC investment bottom, average deal size dropped over 20% (Figure 7). According to data from PitchBook, median declines were even more dramatic. And while deal

We can expect drastically lower deal sizes, but deal activity may be flat for angel & seed entrepreneurs



VC activity during the "Great Recession" by stage

DEAL COUNT	2007	2008	2009	DECLINE FROM PEAK
Angel & seed	792	930	1,246	(did not decline)
Early stage	2,130	2,291	1,860	-18.8%
Late stage	1,431	1,566	1,452	-7.3%

MEDIAN DEAL SIZE($M)	2007	2008	2009	DECLINE FROM PEAK
Angel & seed	$0.8	$0.6	$0.5	-33.3%
Early stage	$4.0	$3.8	$3.0	-25.6%
Late stage	$9.6	$8.0	$6.2	-34.9%

Figure 7 Venture capital deal size and count pre and post the Great Recession

volumes for the earliest ventures (angel & seed) increased, early-stage (Series A/B) deal volumes were particularly hard hit, down almost 20%.

What Will Investors be Looking for Post COVID-19?

For the very near-term, VC and PE firms will be focused on the survival of existing portfolio companies and largely distracted from new deals. Deals that were very far along in the process in early Q1 2020 will likely close but could be delayed, perhaps into Q3 or Q4 of 2020. Regardless of how long the coming downturn in deals and investment dollars lasts, investors will likely refocus on basics going forward:

- **Cash is king; not trash:** back in January, Ray Dalio, the billionaire hedge fund manager, proclaimed at the World Economic Forum in Davos that “cash is trash” in a not-so-subtle swipe at Warren Buffett and his $128bn cash hoard at Berkshire Hathaway. That notion may be very passé in a post-pandemic world. VC and PE firms having just painfully scrambled to keep their portfolio companies’ lights on will have a re-found appreciation for *cash* – not just EBITDA. Going forward, cash – once again – will be king, and InsurTechs with demonstrated or clear paths to strong cash flow will benefit.

- **Prove it:** investors will be even more keenly focused on mitigating risk. Business plans and models with the slightest whiff of “fake it ‘til you make it” will not fly. Tangible use cases, proven technology and business model efficacy, and real (and realistic forecast) revenue and EBITDA will be more important than ever. Unicorns and IPOs based on dubious business models and long time horizons to profitability were already out of favor before the COVID-19 crisis; the pandemic will only heighten that aversion and increase the scrutiny and selectivity of potential InsurTech investments.

- **Show me the money − FAST:** investors are also apt to favor technologies and business models with faster near-term payoffs and paths to profitability. This will bode well for models leveraging known, effective, and successful technologies (e.g. SaaS, RPA, Big Data, and to an extent IoT and AI/ML) while far-off, albeit promising, applications (e.g. AI deep learning and neural networks, Blockchain, etc.) may face challenges securing funding.

InsurTech Winners and Losers

A breakdown of the various P&C and L-H InsurTechs by business model is shown in Figure 8. While full-stack carriers like Oscar, Clover Health, Root, Lemonade, Next, and Metromile account for only 14% of InsurTech companies, their higher capital needs (and promised growth and revenue prospects) have garnered them the largest share of InsurTech investment dollars from 2012 to 2019. Price comparison websites and aggregators (PCW-AGG), with their very low capital requirements, account for almost the same percentage of companies but only 3% of InsurTech investment. Distribution plays – either retail digital agencies (DIAs) or MGAs – account for about a third of companies and about 20% of investment. These include familiar newcomers such as Hippo, Slice, CoverWallet, Embroker, Sure, and Pie in P&C, and bright Health, Ethos, Health IQ, Stride Health, and Ladder in Life-Health. The tech “enablers” provide technology solutions (e.g. AI, Big Data and advanced analytics, RPA, IoT, digital platforms, etc.) for carriers, brokers, and agents across their value chains. They are by far the largest group (almost 45% of all InsurTech companies) and represent about a third of all capital raised from 2012 to 2019.

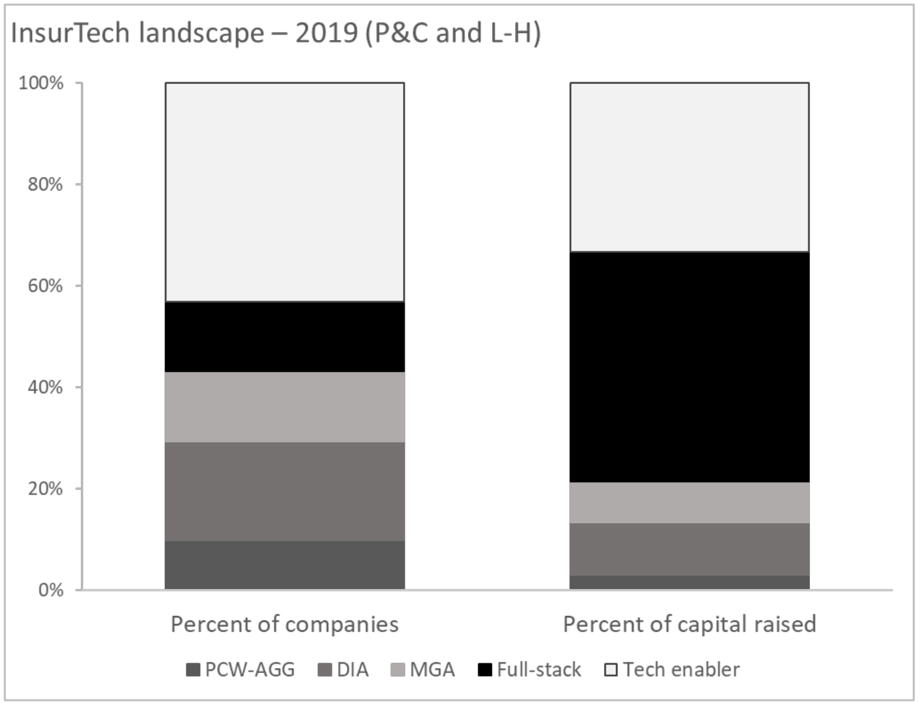


Figure 8 InsurTech companies and investment by primary business model

How will the various models fare post the COVID-19 recession?

Full-stack insurers: InsurTechs who chose the challenging path to become fully integrated, licensed, capitalized *and regulated* carriers had already learned the harsh insurance reality that consistent losses to fuel revenue growth, while perhaps acceptable with investors looking for the next great unicorn, do not fly with rating agencies and insurance commissioners who can shut unprofitable carriers down. By 2018, Root, Lemonade, and Metromile had already begun raising prices and tightening underwriting standards to improve their lackluster operating results.

As EBITDA results also improve, the full-stack segment could thrive as the virus subsides, and, as digital-native companies, they can capitalize as the world accelerates transformation to online, digital, and mobile engagement. In the short term, one positive for full-stacks may be fewer auto insurance claims as roadways are empty; however, if fewer people are buying new cars, moving into new apartments, or buying/building homes in the short run, there could be a negative offset.

DIAs and MGAs: as consumers continue to gravitate toward online versus in-person transactions and interactions due to lingering health concerns and consciousness, and as more gain comfort and experience with moving their personal lives online, digital agents, MGAs, and others enabling digital, online distribution stand to succeed. The same short-term negatives affecting the full stack carriers of fewer "changes" requiring insurance will also affect DIAs and MGAs, but the long-term impact could be very positive for digital distribution plays.

PCWs-AGGs: the aggregators and price comparison sites always do well in recessions as consumers reevaluate their coverages and premiums and shop around to try to cut expenses. Therefore, this segment is very well positioned in a downturn; however, the segment may be saturated. Current firms or new entrants will need innovative approaches, expanded carrier/broker partners/networks, and even newer technology innovations to attract additional customers, niches, and investors.

Tech enablers: InsurTechs offering new technology solutions for underwriting, claims, marketing, distribution, policy administration, or other internal operations may face a murkier future. Much of their success depends on the digital initiatives of established carriers, brokers, and agents looking for innovative, third-party solutions to supplant, augment or ameliorate legacy systems, processes, and approaches. While this digital transformation in insurance was widespread, if ponderous, before coronavirus, it may well grind to a halt in the short-term.

The long-term impact for enablers may be very positive as the industry fully realizes the urgency and critical importance of digital transformation. This could prioritize and accelerate digital initiatives once the near-term recessionary pressures abate. InsurTech enablers who facilitate self-service, DIY, mobile, and virtual capabilities will do best, and those with sufficient cash on hand, verified proofs of concept, and existing long-term contracts and relationships will be well-positioned going forward.

Other Pockets of Opportunity

Some trends will continue, emerge, expand or evolve during and after this crisis:

- **Cybersecurity evolution:** the current and likely ongoing shift to work-from-home, digital-video meetings, and online interactions/transactions will only heighten the already intense focus on cybersecurity and risk. Technologies that go beyond already tested (but perhaps not at the frenetic scale and volume of a COVID-19 world) cybersecurity solutions will greatly succeed. For new and incumbent insurers, new cyber product lines, coverages, and limits will present underwriting challenges but possibly new or expanded revenue opportunities.

- **Uptick in M&A:** while the market may be frozen for the next several weeks, and deal volume and investing down for multiple quarters, deal activity will continue. With some promising but cash-strapped companies struggling, secondary but complementary firms rethinking their go-forward strategies, entrepreneurs rethinking life objectives, and investors seeing deal sizes drop while sitting on a stockpile of dry powder, the time may never be better for well-positioned investors and acquirers to pursue M&A opportunities. The key in post COVID-19 M&A will be to take a strategic approach – not just doing deals because prices seem "low." Looking for targets that provide positive cost, revenue, market share, product extension, brand, and customer synergies will provide long-term competitive and strategic advantage.

- **Continued gains for female entrepreneurs:** while investment in female-owned or co-owned startup, seed, and early-stage companies remains disproportionately low, the numbers are rising, if slowly (Figure 9).

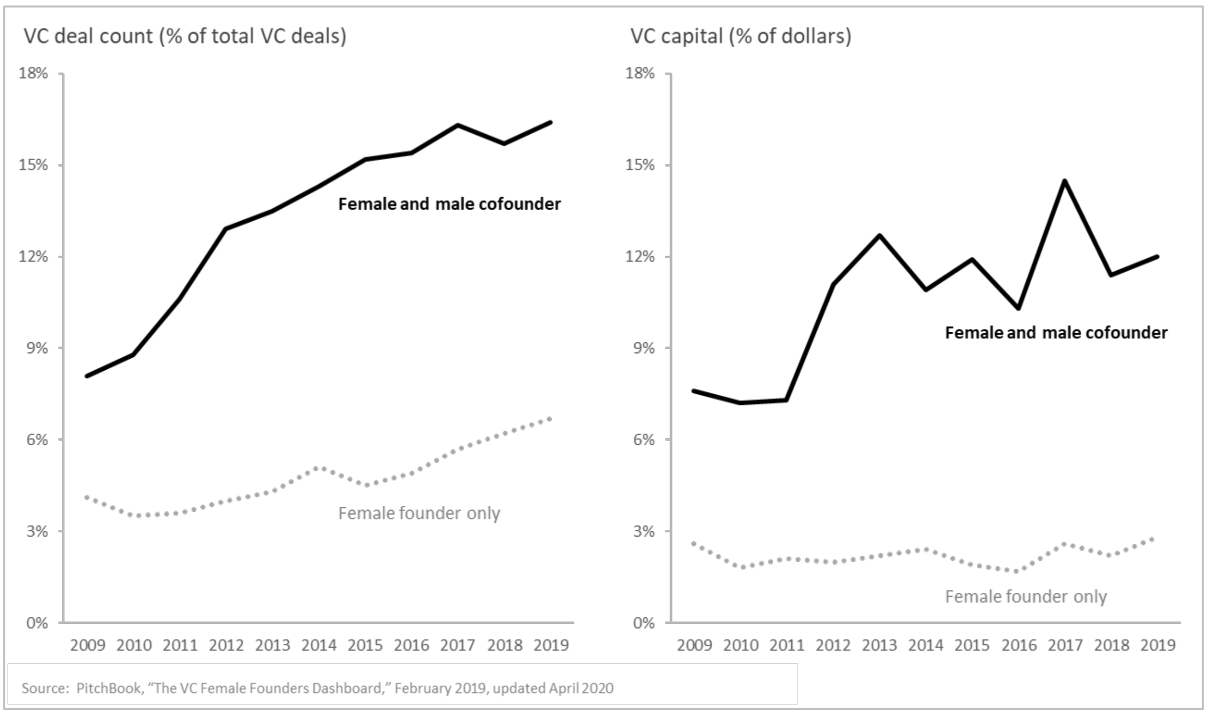


Figure 9 Female ownership of VC invested firms is rising

While similar gender data specific to early-stage InsurTechs isn't readily available, there is no reason to believe the numbers are materially different, if not worse, in InsurTech. With a keener focus on underlying business fundamentals, bona fide EBITDA prospects, and an appetite for even more unique and innovative approaches to capture untapped market potential in a post-pandemic world, VC investors will continue to eschew gender bias, and prospects for female investors – even in InsurTech – will remain bright.