FLUENT
RISK PARTNERS

Dear Partners,

It is my pleasure to share the inaugural partner letter of Fluent Risk Partners. I formed Fluent to acquire and build exceptional insurance businesses for the long term. Our focus will be on the MGA / MGU sector, although we'll opportunistically look at any insurance asset that we believe has a competitive advantage in some form.

The key to our success is and will always be partnership. Fluent seeks to partner with excellent managers to build value over long time horizons. We know, everyone says this. So how are we different? We'll answer this important question shortly.

Our Focus is P&C Insurance MGA and MGUs

Though we'll be flexible regarding what insurance assets we ultimately invest in, our focus is on property and casualty managing general agencies (MGAs), sometimes also called managing general underwriters (MGUs). These are insurance brokerages that operate in a niche area of the market that is not well covered by standard carriers. Perhaps these businesses write coverage for apartment buildings built before 1950 in the southeast United States, windfarms on the west coast, or product liability for pet toys.

What differentiates them is (1) a niche in which they have deep expertise and a relatively large market share and (2) they *both* underwrite and acquire business (directly or through brokers). A good MGA is comprised of a team of specialists with deep sector knowledge, has distribution in place, low customer churn, strong carrier relationships, and stable or growing revenue and free cash flow.

An important distinction between MGAs and insurance carriers is the presence of capital. Carriers have underwriting, distribution, administration, and claims systems (even when some of these elements are outsourced), and importantly, they write policies against their own pool of proprietary capital (referred to variously as statutory capital and/or capital and surplus). In essence, an insurance carrier is a stack of money against which insurance policies are written.

MGAs have underwriting capacity and distribution, but no capital. Rather, they write policies that are then passed on to carrier partners which take the insured risk onto their books. For this reason, the MGA/MGU market is sometimes referred to as the delegated authority market, in the sense of delegated underwriting authority.

MGAs make money on a commission basis, usually some share of premium written (it varies, but say 8-12% net of wholesaler and retail broker commissions). Some will earn a profit share as well, based on how well their underwriting performs. We admire this profit-sharing approach very much.

The result is that MGAs are niche businesses with high recurring revenue, good margins and high returns on capital. We are more concerned with the quality of their operations, strong relationships with brokers, carriers, and insureds, and underwriting excellence than whether or not they can grow quickly, or even at all, assuming defensibility of their underwriting niche. To us, stable revenue and margins are as indicative of quality as growth can be.

We aren't the first ones to realize that a well-run MGA/MGU is an exceptional business. Private equity and large consolidators have entered the space and bought up brokerages at astronomical multiples over the last few years. We can't (and won't) be paying top dollar for the assets we acquire, so we'll have to compete on a different basis.

As we've seen illustrated in 2022 and many times throughout history, it is eminently possible to overpay for excellent assets. We are value investors at heart; I was at a diehard public equity value shop prior to launching Fluent. We are happy to pay a fair multiple for a wonderful business, but we can't make an acquisition work by overpaying. Often, these strategies require layoffs to justify the high multiple that was paid or are part of a rollup where the acquired business is one of literally dozens as part of a high-volume sector consolidation strategy.

In contrast, we won't succeed through an acquire and fire strategy. We expect to grow teams over time, not shrink them. Every company we purchase is special, and we'll be good stewards of its assets and people forever. We know that we are often buying the life work of the seller, and we'll treat the company with the respect and attention it deserves.

An Investment Hypothesis

One hypothesis driving our investment activity is that technology and capital are disaggregating. Let me explain what we mean.

As we said earlier, you can think of an insurance carrier as broadly comprised of two elements: a capital stack and what I will call the "insurance organization". The insurance organization is comprised of everything the insurance company does: policy acquisition, underwriting, claims, administration. The insurance organization does all this with a view to write policies against the capital stack, which acts as the pool of money that indemnifies risk and pays claims in the event of a loss.

The dynamics that govern the capital stack and the insurance organization are very different. Virtually every element of the insurance organization is impacted by technology in some way, and we've seen a deluge of technology innovation in this space in the last decade plus.

Technology innovation is marked by discontinuous, disruptive change. New applications are better by an order of magnitude on some highly relevant dimension: more effective, faster, cheaper, or all of the above. Examples of this in the insurance organization could be data leading to AI/ML underwriting tools that help surface important patterns and lead to improved pricing granularity, near instant or parametric first notice of loss and claims automation, or new business models enabling seamless distribution, such as embedded insurance. On a standalone basis, technology-driven businesses tend to enjoy increasing returns to scale and generate high returns on capital once free cash flow is greater than reinvestment activity.

Contrast this with capital, which is governed by a wholly different and essentially timeless set of dynamics. The rate of change in capital management businesses is essentially zero. Capital is cyclical, and capital is deployed most wisely when done so countercyclically. Good managers of capital will tend to be skeptical of change, including from that imparted by new technology. Technology innovations, while they produce wealth for a few, are hard if not impossible to invest in ex-ante. Economic benefits from tech innovation tend to be passed on to customers and change rapidly, so the longest-running capital managers often avoid them. Think of a seasoned underwriting manager that expertly sidesteps unprofitable business during a soft market, or a wise value investor investing in fundamentally good but overly discounted assets. By managing the cycle well, capital managers endure over many decades, and the best compound at 12-15% rates for long periods of time.

These two dynamics are both present (in spades) in the insurance industry, which is part of what drives the tension between "traditional" insurance carriers and insurtech businesses. Many insurtech innovators and founders will complain about a lack of innovation at carriers. Executives at incumbents worry that new innovations are overhyped and overpriced, and don't actually move the needle. Carriers are furthermore constrained by their regulatory and shareholder mandate to run lean, keep costs down, and book near term profits, which disincentivizes implementing new technologies with an uncertain payoff when existing systems are basically working fine.

These very different dynamics could result in technology and capital drifting further apart over time, which for Fluent Risk Partners is an investable trend. The management styles, return profiles and natural shareholder bases of the two are drastically different. While we'll always focus on both prudence *and* innovation, we believe there is a good chance that innovative activities drift towards the MGA market, while carriers rely more and more on trustworthy MGAs and other service providers to match risk with capital in low-cost, customer-centric ways.

Overall, we believe that MGAs that couple smart technology investments with world class talent while relentlessly focusing on creating value for carrier partners will prosper in the coming decades. Our objective is to buy them at fair prices, be real partners (adding value if we can but never micromanaging), and facilitate an environment where they can create large amounts of value for their ecosystem.

Our Operating Method

Fluent seeks to partner, through acquisition, with exceptional insurance talent. Pragmatically speaking, this will mean that we buy less than 100% (say 80% on average, but always a majority stake) of the assets we acquire, provide an appropriate level of support, and leave management alone to run their company. The goal of the 80% number is that we want management to be real beneficiaries from the partnership, and to continue to have skin in the game with the 20% stake they retain. In many cases, we will help sellers take some chips off the table, while preserving their upside. We get to partner with great managers running wonderful businesses. A win-win!

We are still early in building Fluent Risk Partners, and as such we're cautious on making broad proclamatory statements about how we'll do things. We know that our operating model will to a large extent emerge, rather than being planned.

But our core operating philosophy of partnering with good managers and leaving them alone to steer their companies to success will never change.

We are fans of Daniel Pink's theory of intrinsic motivation, and as such we draw on it here. Fluent will run in a decentralized manner, letting our partner companies pursue their destinies. Specifically, managers and teams at Fluent will have autonomy, mastery, purpose, and excellence.

Autonomy. Leaders are free to lead their organization as they see fit. We'll work together if they have a view to do so, but they've got an open vista to grow their business and attack whatever market verticals they desire. Or perhaps they simply run the best business possible in a unique niche. Both are welcome at Fluent Risk Partners.

Mastery. We know that every person that works with us is the hero of their own story. *Fluent will be a platform for world class insurance talent to realize its potential.* To us, this means gaining and exercising more and more competence in one's chosen area. Everyone needs to both have and realize career advancement opportunities over time.

Purpose. Everyone makes meaning and interprets life in different ways. In the context of Fluent, purpose could be building the best business possible, becoming a world-leading expert in a specific area of business, or providing for one's family. More broadly, Fluent will create value for all our stakeholders. We'll enable insureds to protect against risk, employees to prosper, carriers to earn a diversified return stream, distribution partners to expertly place risk and enjoy the reward, and shareholders to compound capital.

Fluent will build intrinsic value by creating extrinsic value: our employees, insureds, brokers, carriers, and reinsurers will all benefit from doing business with us.

Excellence. None of this works if the result isn't excellent. We know we can't be good at everything, but in our core competencies we will excel. We hold ourselves to a higher standard than anyone else might demand of us. We do so because excellence is its own reward and is often the unplanned result of autonomous people and organizations pursuing mastery for the right reasons. Excellence compounds, and small acts of positive differentiation can add up to a powerhouse of superior business performance. Though not our primary motivator, we will also enjoy the financial rewards that we earn.

In terms of organizational structure, we are more of a hub-and-spoke model than a holding company. The partners (subsidiaries, though we don't love that word) will provide value to their ecosystems, which we will share in as owners. In turn, that value will be used to create a set of shared services at the hub. These could be marketing, a set of AI functionalities, talent sourcing, or financial planning. Cross-sell opportunities will be exploited where they exist and make sense. My personal focus will be on structuring and incentives, capital allocation, and most importantly by far, talent.

Even though I've studied insurance extensively and invested in the sector through public and private markets, we'll nevertheless be relying on the acquired company management to bring true insurance fluency to the table: we can't provide it. We'll rely on our networks of insurance investors and operators to help us make good acquisitions, but at the end of the day, it is our manager partners that know their businesses best.

More good news: we aren't running a Berkshire Hathaway "invest the float" strategy. Rather, we seek to build something like the "Constellation Software of insurance", to the extent possible.

The Process

This letter is meant as an introduction to Fluent, to who I am and our high-level thinking on how we'll approach the acquisition search process. While our primary concentration is MGAs, we're also open to other choice insurance assets acquired at reasonable prices: carriers, wholesalers, retail brokers, even distressed assets if we think we have a clear path to adding value. Despite this opportunism, our overwhelming focus is managing general agencies with strong underwriting cultures, a track record of success, and talented management. Once we find a deal, we'll write a detailed investment thesis on why we believe it makes sense, funding sources, and deal structure.

The Overall Vision

The result of all this will be that over time, Fluent Risk Partners will be a network that connects capital to risk and executes with exceptional pricing and claims discipline. This network will create large amounts of extrinsic value for every person and organization that it touches. Fluent will be a great home for great businesses. We'll attack big markets and occupy profitable niches. Most importantly, we'll be a platform for people to achieve their potential. I know that this is about them, not me.

I'm sure this all sounds starry eyed and idealistic. It is. We know that there will be setbacks along the way. Nevertheless, we are firmly resolved to build a great business with talented, good people. We hope you'll join us in this journey.

Brendan C. Snow

CEO

January 24, 2023