

AP CAPITAL RESEARCH

# M&A Deal of The Week

## Aviva & Direct Line



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DATE

9th January 2025



# Executive Summary

## M&A DEAL OF THE WEEK

### Deal Summary

- On December 23, 2024, Aviva (LSE: AV) announced its acquisition of Direct Line Insurance Group in a £3.7 billion cash-and-share deal. This transaction is a strategic move for Aviva, reinforcing its leadership in the UK personal lines insurance market while leveraging Direct Line's established brands to deliver enhanced customer value.
- The acquisition will add significant scale to Aviva's personal lines portfolio, increasing its share of the UK motor and home insurance markets to over 20% and 15%, respectively, and creating a combined personal lines franchise generating approximately £26 billion in gross written premiums annually. The transaction is expected to deliver pre-tax cost synergies of £125 million and drive underlying EPS accretion from the first full year post-completion.
- The deal, structured through a combination of cash, new Aviva shares, and pre-completion dividends, represents a 73.3% premium to Direct Line's November 27, 2024 closing price. The transaction ensures leadership continuity and alignment with Aviva's long-term growth strategy.
- This move builds on Aviva's strategy to focus on capital-light businesses, combining its existing strengths with Direct Line's complementary capabilities. The acquisition will enable Aviva to provide a more comprehensive range of customer-centric insurance solutions supported by advanced digital capabilities.
- With this acquisition, Aviva strengthens its ability to deliver competitive pricing, faster claims processing, and a broader product portfolio to customers. The transaction positions Aviva to drive long-term growth and shareholder value while maintaining financial resilience.
- The deal enhances Aviva's scale and efficiency, uniting its personal lines, digital capabilities, and operational expertise with Direct Line's well-known brands. This integration will create a stronger platform to meet evolving customer needs and compete effectively in the UK insurance market.
- Leadership continuity is a key feature, with Adam Winslow joining Aviva's senior management team to oversee the integration. Dame Amanda Blanc, Aviva's CEO, emphasized the strategic alignment of the two organizations and their shared focus on innovation and operational excellence.
- Aviva expects the UK personal lines insurance market to continue growing steadily, supported by technological advancements and changing consumer preferences. This acquisition represents a pivotal step in Aviva's evolution as the leading UK insurer, positioning the firm to capitalize on future opportunities in a dynamic and competitive market.

### Key Figures

- |                                     |  |
|-------------------------------------|--|
| • <b>Deal Value:</b> £3.7 billion   | • <b>Deal premium:</b> 73.3%             |
| • <b>Aviva EV/EBITDA:</b> 1.1x      | • <b>Direct Line EV/EBITDA:</b> 9.9x     |
| • <b>Aviva EV:</b> £3.04B           | • <b>Direct Line EV:</b> £2.41 B         |
| • <b>Aviva P/E:</b> 10.7x           | • <b>Direct Line P/E:</b> 11.04x         |
| • <b>Aviva D/E:</b> 70%             | • <b>Direct Line D/E:</b> 20%            |
| • <b>Aviva EV/Sales:</b> 0.1.x      | • <b>Direct Line EV/Sales:</b> 0.7x      |
| • <b>Aviva Market Cap:</b> £13.31 B | • <b>Direct Line Market Cap:</b> £3.41 B |



# Company Information

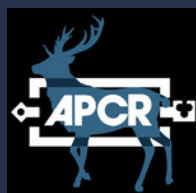
## M&A DEAL OF THE WEEK

### AVIVA

- First founded in 1696, Aviva is a leading insurance company with a strong focus on life, general, and health insurance products. Operating in several international markets, Aviva has a robust presence in the insurance industry. Aviva's business is segmented into life insurance, general insurance, and health insurance, with life insurance being the largest segment.
- Regarding financials, 2024 was a significant year for Aviva, with the company reporting revenue of £22,643 million, reflecting substantial growth compared to prior years. The cost of sales in 2024 was £28,566 million, indicating a substantial investment in operations. Gross profit for 2024 was £6,575 million, showcasing strong revenue generation despite high costs. The gross profit margin was approximately 29%, slightly lower than the 30% margin in 2023, indicating a slight increase in operational costs relative to revenue.
- Aviva achieved earnings of £1,415 million in 2024, underscoring its robust financial performance. The net profit margin was approximately 6.3%, an improvement from 5.8% in 2023, indicating better efficiency in managing costs and enhancing profitability.

### Direct Line Group

- First founded in 1985, Direct Line Group is a prominent insurance company primarily operating in the UK. They offer a wide range of insurance products, including car, home, and travel insurance, catering to the needs of various customers. The business is segmented into different revenue streams, with the main driver being its car insurance segment, followed by home and travel insurance.
- In terms of financial performance, 2024 saw Direct Line reporting revenue of £3,479 million, showing a steady performance compared to previous years. The cost of sales in 2024 was £2,050 million, maintaining efficiency in managing costs. Gross profit for 2024 stood at £1,429 million, reflecting solid profitability. The gross profit margin was approximately 41%, indicating a healthy spread between revenue and the cost of sales. YoY, the gross profit margin has shown improvement from 36% in 2023, demonstrating enhanced cost management and revenue optimization.
- Direct Line achieved earnings of £434 million in 2024, demonstrating strong financial health. The net profit margin was approximately 12.5%, an improvement from 8.4% in 2023, indicating better control over costs and improved profitability.



# Deal Rationale and Risk

## M&A DEAL OF THE WEEK

### **Rationale - Strengthening Market Position and Achieving Operational Efficiencies**

#### **Enhancing Market Position and Scale**

The combined entity is expected to control over 20% of the UK motor insurance market, with a market capitalisation of £16.6 billion, cementing its position as a market leader. Direct Line's strong brand portfolio- encompassing Direct Line, Churchill, and Green Flag- adds substantial market share to Aviva's existing operations. This consolidation is expected to strengthen Aviva's competitive edge, increase bargaining power with suppliers, and drive greater operational efficiencies. The expanded scale also positions Aviva for better resource allocation and customer reach, creating an attractive value proposition for both customers and investors.

#### **Synergies Realisation and Operational Efficiencies**

A key driver behind the acquisition is the potential for significant synergies, particularly in cost savings and operational streamlining. The companies aim to achieve at least £125 million in annual cost reductions by cutting overlapping roles, streamlining back-office functions, and eliminating duplicative IT systems and corporate roles. These synergies will arise from integrating operations, leveraging Direct Line's market presence, and cross-selling complementary offerings. The result will be improved profitability, benefiting both Aviva and Direct Line shareholders.

#### **Acceleration of UK Business Growth**

This acquisition supports Aviva's strategy to accelerate growth in its core UK business. By absorbing Direct Line's large customer base and well-established brands, Aviva is poised to expand its footprint in both direct-to-consumer and intermediary distribution channels. The deal further aligns with Aviva's focus on capital-light business models, with motor insurance offering high volume but relatively lower capital intensity. The acquisition will enable Aviva to capture additional market share in a segment that is critical to its overall growth strategy.

### **Risk**

#### **Regulatory and Market Considerations**

While the transaction is expected to unlock significant synergies, it also raises potential regulatory concerns, particularly with regard to competition law. The combined entity would control over 20% of the UK motor insurance market, which may attract scrutiny from competition authorities. This could result in required divestitures or adjustments to ensure compliance with competition laws, potentially delaying or altering the deal.

#### **Integration Challenges**

The integration of Direct Line's brands (Direct Line, Churchill, and Green Flag) with Aviva's operations carries risks of brand dilution and customer confusion if not managed carefully. Additionally, aligning operations, cultures, and systems is crucial to realising £125 million in cost savings. Any challenges in this process could hinder synergies and impact overall performance.

#### **Employee Reductions**

The planned job cuts, estimated at 1,600-2,300 roles, could impact employee morale and retention. While some redundancies are expected over three years, there may be unforeseen challenges in managing this process without disrupting operations or damaging the company's reputation.

#### **Credit Rating Impact**

A key risk in Aviva's £3.7bn acquisition of Direct Line is its potential impact on credit ratings. Special ratings agency AM Best has placed Aviva's A+ and AA- ratings under review due to uncertainties around the deal's financial effects. While expected to boost revenues, the acquisition could strain capital and increase leverage, potentially leading to a downgrade. The final rating will depend on successful integration and financial stability post-acquisition.



# Industry Analysis

## M&A DEAL OF THE WEEK

### The UK Insurance Industry

The UK insurance sector remains a cornerstone of the national economy, offering comprehensive risk protection and financial stability. Recent mergers, such as the Direct Line and Aviva deal, reflect ongoing consolidation in the industry aimed at driving operational efficiencies and enhancing market positioning.

#### Home Insurance

The UK home insurance market is expected to grow slowly from \$7.16 billion in 2025 to 8.03 billion dollars by 2030, with a Compound Annual Growth Rate (CAGR) of 2.31%. This growth highlights resilience despite economic uncertainties and rising claims costs driven by climate-related risks. Property insurance continues to dominate personal lines in gross written premiums, supported by a strong demand for tailored risk management solutions.

**UK Home Insurance Market**  
Market Size in USD Billion  
CAGR 2.31%



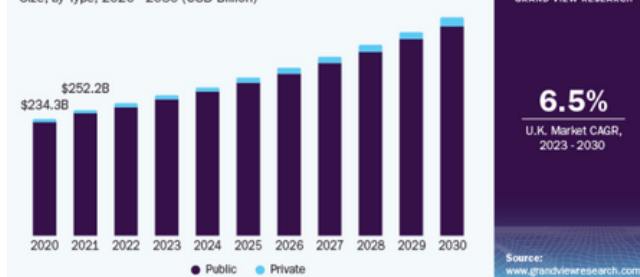
Source: Mordor Intelligence



#### Health Insurance

The UK health insurance market is forecasted to expand significantly, with a CAGR of 6.5% from 2023 to 2030. This growth is fueled by increased demand for private health insurance as pressures on public healthcare systems continue to rise. Consumers are prioritizing faster access to healthcare services and more personalized coverage options.

**U.K. Health Insurance Market**  
Size, by Type, 2020 - 2030 (USD Billion)



#### Market Structure

The UK insurance market is competitive, with leading players like Aviva, Direct Line, and Lloyds Banking Group holding substantial market shares. However, the market remains fragmented with mid-sized and smaller firms competing in niche segments such as equestrian insurance. Consolidation trends, as evidenced by the Direct Line and Aviva acquisition, reflect the drive for economies of scale, cost synergies, and enhanced distribution capabilities.

### Emerging Trends and Insights

**1 - Digital Transformation:** The insurance industry in the UK is undergoing a technological shift driven by the growth of InsurTech companies, which have increased nearly tenfold over the past two decades. These firms are deploying technologies such as artificial intelligence, the Internet of Things, and blockchain to enhance underwriting accuracy, improve customer interactions, and streamline claims processing. Established insurers are increasingly adopting these innovations to maintain their competitiveness in the market.

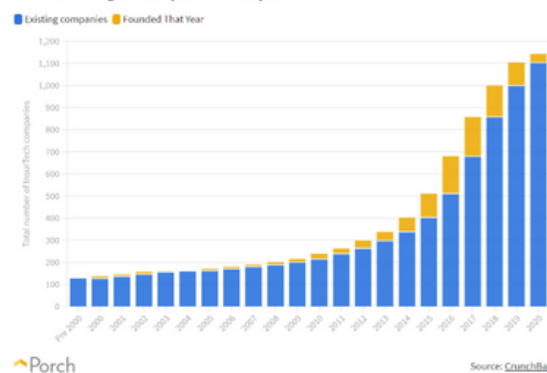
**2 - Evolving Consumer Behavior:** Consumer preferences are shifting towards policies that offer flexibility and personalization. Usage-based insurance, like telematics-driven motor coverage, tailors premiums to driving habits, offering fairness and cost efficiency. Digital platforms for home insurance are also gaining traction, simplifying processes and enabling on-demand management. Younger, tech-savvy consumers value these solutions for their convenience and transparency, positioning insurers who adapt as leaders in this evolving market.

**3 - Climate Risk Mitigation:** Climate-related risks, including more frequent extreme weather events, are driving higher property insurance claims. Insurers are improving risk assessments by using advanced data analytics and predictive modeling to enhance underwriting and pricing. Collaborations with environmental experts and incentives for resilience-focused property upgrades help insurers proactively address climate challenges while building customer trust.

**4 - Health Insurance Growth:** The demand for private health insurance is rising as consumers seek faster and more efficient healthcare services. Challenges within the NHS, such as long waiting times and resource shortages, have pushed many toward private options for quicker access and specialized care. Insurers are expanding offerings with wellness programs and telemedicine, establishing private health insurance as a critical alternative to public healthcare limitations.

**The Rise of InsurTech**

How InsurTech grew nearly tenfold in 20 years



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# Final Thoughts

## M&A DEAL OF THE WEEK

### **Samuel Thompson**

Aviva and Direct Line joining forces marks a major shake-up in the UK insurance landscape. By merging Aviva's vast international reach with Direct Line's innovative approach to general insurance, the combined entity is set to benefit from substantial synergies. These include cost savings, a more diverse product offering, and a stronger market presence. This merger is a positive move for both companies and the UK insurance market. The partnership is expected to create a dynamic and adaptable organization that can better meet the evolving needs of customers and enhance returns for Aviva's shareholders.

### **Maariya Rahman**

The merger of Aviva and Direct Line presents an exciting opportunity to change the UK insurance market by combining Aviva's global reach and expertise with Direct Line's innovative general insurance capabilities. This merger can unlock significant synergies, including cost efficiencies, a broader product portfolio, and increased market positioning for Aviva. Overall the merger between Aviva and Direct Line is great for both companies and the UK insurance industry as a whole. By combining their strengths, the partnership has the potential to create a more diversified organisation that is better equipped to meet the changing needs of customers and deliver greater shareholder value.

### **Piotr Ambrozewski**

Aviva's acquisition of Direct Line for £3.7 billion is a bold and strategic move that reinforces its position as the leading insurer in the UK market. The deal not only boosts Aviva's market share in the UK motor and home insurance sectors but also unlocks significant synergies and operational efficiencies, with potential cost savings of £125 million annually. While the acquisition strengthens Aviva's customer offering and digital capabilities, it does come with notable risks, including regulatory scrutiny, integration challenges, and potential credit rating pressure. Success in addressing these risks and effectively integrating Direct Line's brands will be key to maximising the value of the transaction. Overall, this acquisition positions Aviva well for long-term growth, with enhanced scale, improved market reach, and a stronger competitive edge in a rapidly changing insurance landscape.



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