

PRESERVE YOUR LEGACY
WEBINAR SERIES PART 1

Valuation & Benchmarking

PRESENTED BY...



Mike Mensch



Angela Adams



Mike Strakhov



1

Valuation & Benchmarking

Attendee Stats:

- **Geography:** 38 states
- **AMS:** Vertafore (40%), Applied (28%), Other (34%)
- **# Owners:** 1 (58%), 2 (27%), 3 or more (16%)
- **Valuation:** Never (60%), < 2 years (20%), > 2 years (20%)
- **Exit timeline:** < 2 years (16%), 2-5 years (21%), 5-10 years (25%), > 10 years (39%)

Poll Results...

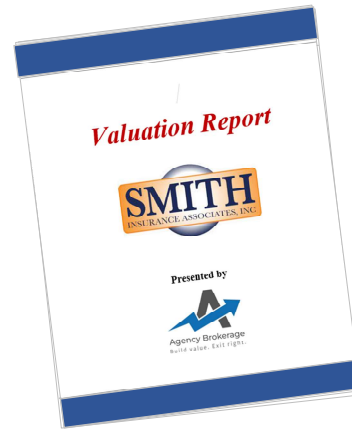


2

Intro to Agency Valuations

Some uses for agency valuations

- Business planning
- Shareholder buyout
- M&A transaction support
- Litigation support
- Tax compliance
- ESOP compliance
- Life insurance underwriting



Intro to Agency Valuations

The purpose of the valuation drives

- Standard of value
- Asset adjustments
- Cash flow adjustments
- Valuation methods
- Premiums/discounts

➤ The “value” that is calculated

Purpose



Standard

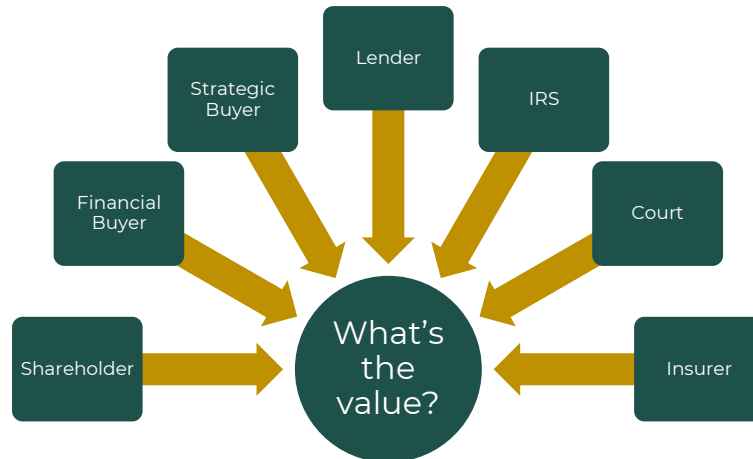


Process/Methods



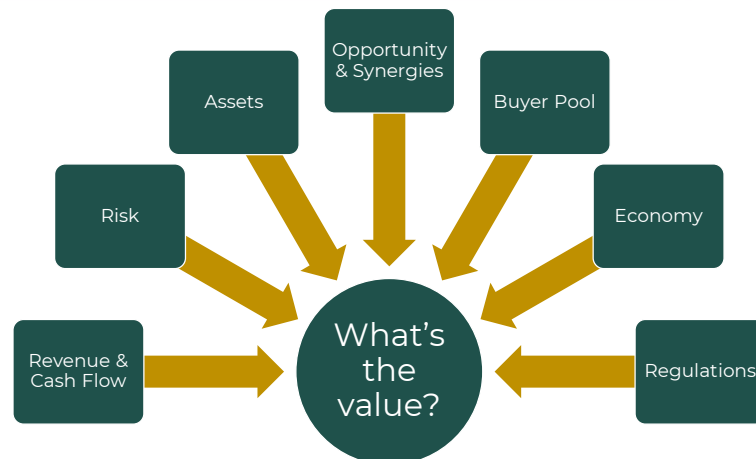
Value

Intro to Agency Valuations



Businesses have more than one value.

Intro to Agency Valuations



The "value" is affected by numerous variables.

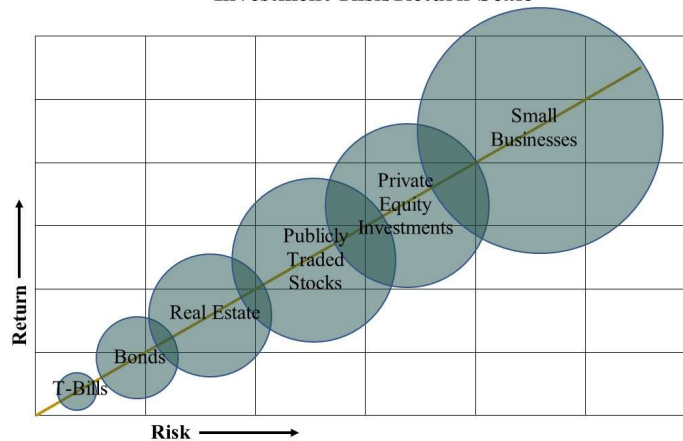
Intro to Agency Valuations

Valuation principles

- Present value – cash flow
- Future value – growth
- **Expectation – risk/reward**
- **Substitution – alternative options**

Intro to Agency Valuations

Investment Risk/Return Scale



Higher risk =
Higher expected return =
Lower relative value

Example

AJG (publicly traded)

- Revenue = **\$8.5B**
 - EV/EBITDA = **19.5**
- Small agency
- Revenue = **\$1M**
 - EV/EBITDA = **6 to 9**

Intro to Agency Valuations

Analysis process

- Financial:
 - 3-5 years of financial statements
- Book of Business:
 - 3-5 years of revenue reports
- Operational:
 - Organizational structure
 - Accounting & data policies
 - Agreements related to restrictions over the book of business
 - Customer acquisition & retention
 - Employee roster
 - Agency acquisition history

Intro to Agency Valuations

Focus of the pro forma

- Revenue persistency & growth
 - Type of income
 - Carrier/broker income trends

Income Statement Comparison									
Source:	2018 IS	%	2019 IS	%	2020 IS	%	TTM IS*	%	CAGR
Revenues									
P&C Commissions	\$ 1,680,666	93.7%	\$ 1,732,285	92.4%	\$ 1,674,630	90.4%	\$ 1,674,542	84.0%	-0.1%
L&H Commissions	\$ 76,429	4.3%	\$ 93,112	5.0%	\$ 107,597	5.8%	\$ 101,396	5.1%	9.9%
Contingent Income	\$ 32,039	1.8%	\$ 16,584	0.9%	\$ 42,200	2.3%	\$ 101,478	5.1%	46.9%
Fee Income	\$ 775	0.0%	\$ 31,436	1.7%	\$ 23,383	1.3%	\$ 20,046	1.0%	195.7%
Miscellaneous Income	\$ 4,633	0.3%	\$ 2,350	0.1%	\$ 3,658	0.2%	\$ 97,100	4.9%	175.7%
Total Revenues	\$ 1,794,541	100.0%	\$ 1,875,767	100.0%	\$ 1,851,468	100.0%	\$ 1,994,562	100.0%	3.6%

Intro to Agency Valuations

Focus of the pro forma

- Revenue persistency & growth
- Income & expense adjustments
- Owners' market comp

Common issues

- Business dependence on owner(s)
- Employee compensation
- Producer splits & BOB ownership
- Affiliations

CY 2021 Pro Forma						
Source:	P&L	%	Adjustment	Recasted	%	Notes
Revenues						
P&C Commissions	\$ 1,674,542	84.0%		\$ 1,674,542	88.3%	
L&H Commissions	\$ 101,396	5.1%		\$ 101,396	5.3%	
Contingent Income	\$ 101,478	5.1%		\$ 101,478	5.3%	
Fee Income	\$ 20,046	1.0%		\$ 20,046	1.1%	
Miscellaneous Income	\$ 97,100	4.9%	\$ (97,100)	\$ -	0.0%	1
Total Revenues	\$ 1,994,562	100%	\$ (97,100)	\$ 1,897,462	100%	
Expenses						
Officer Wages	\$ 275,000	13.8%	\$ (125,000)	\$ 150,000	7.9%	2
Producer Expense	\$ 158,986	8.0%		\$ 158,986	8.4%	
Office Salaries	\$ 574,701	28.8%		\$ 574,701	30.3%	
Retirement Contributions	\$ 49,792	2.5%	\$ (16,540)	\$ 33,252	1.8%	2
Payroll Taxes	\$ 62,372	3.1%	\$ (7,500)	\$ 54,872	2.9%	2
Advertising	\$ 25,551	1.3%		\$ 25,551	1.3%	
Automobile	\$ 13,540	0.7%	\$ (13,540)	\$ -	0.0%	3
Dues & Subscriptions	\$ 47,336	2.4%	\$ (4,800)	\$ 42,536	2.2%	4
Insurance	\$ 73,720	3.7%	\$ (21,500)	\$ 52,220	2.8%	5
Legal & Professional	\$ 11,663	0.6%	\$ (5,400)	\$ 6,263	0.3%	5
Rent	\$ 60,000	3.0%	\$ 6,000	\$ 66,000	3.5%	6
Repairs & Maintenance	\$ 33,749	1.7%	\$ (17,500)	\$ 16,249	0.9%	6
Property Taxes	\$ 7,344	0.4%	\$ (7,344)	\$ -	0.0%	6
Supplies & Postage	\$ 36,348	1.8%		\$ 36,348	1.9%	
Utilities	\$ 15,462	0.8%	\$ (4,200)	\$ 11,262	0.6%	5
Miscellaneous	\$ 13,311	0.7%	\$ (7,500)	\$ 5,811	0.3%	5
Total Expenses	\$ 1,458,874	73.1%	\$ (224,823)	\$ 1,234,051	65.0%	
Net Operating Income	\$ 535,688	26.9%		\$ 663,411	35.0%	Adj. EBITDA

Intro to Agency Valuations

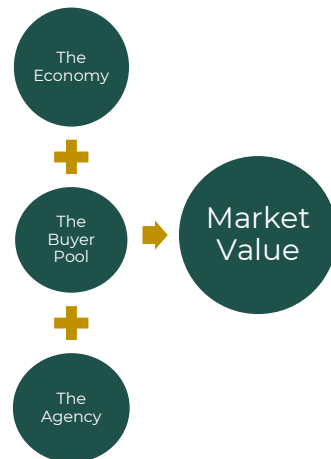
• Conclusion of value

Valuation Analysis Summary			
Valuation Method	Amount	Weight	Value
Income Approach			
Capitalization of Earnings Method	\$ 4,257,458	0%	\$ -
Discounted Future Cash Flow Method	\$ 4,835,684	40%	\$ 1,934,274
Market Approach			
Guideline Public Company Method	\$ 5,607,221	30%	\$ 1,682,166
Direct Data Method (Revenue)	\$ 5,336,801	15%	\$ 800,520
Direct Data Method (EBITDA)	\$ 5,153,656	15%	\$ 773,048
Weighted Average Value (Rounded)			
Less: 20% Discount for Lack of Control			
Less: 20% Discount for Marketability			
Plus: Excess assets			
Times: Ownership interest being valued			
Estimated Value of Ownership Interest			

Valuation process:

1. Review historic financials.
2. Review operational data.
3. Create pro forma.
4. Estimate value using multiple approaches.
5. Apply weighting to valuation approaches.
6. Adjust weighted value based on conditions.

The Market Value of an Agency



1. The Economy

- Growth, tax rates, interest rates, availability of capital, etc.
- Influenced by *market timing*.

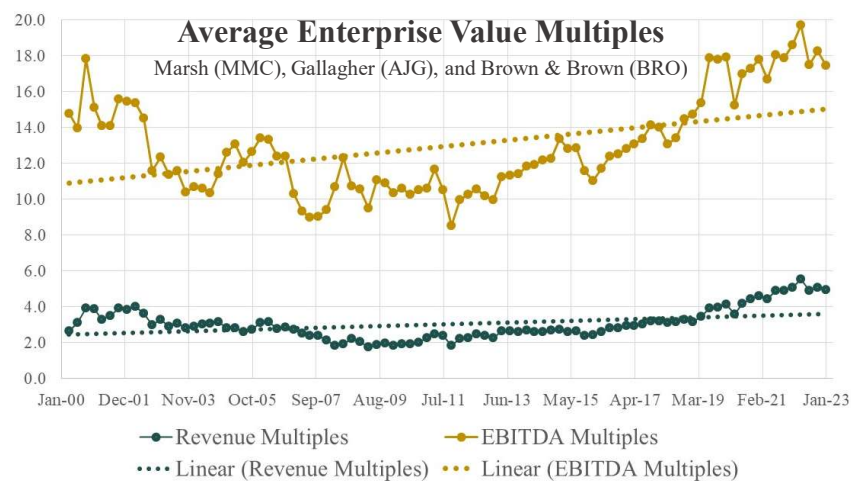
2. The Buyer Pool

- Number & type of buyers
- Influenced by *sale process*.

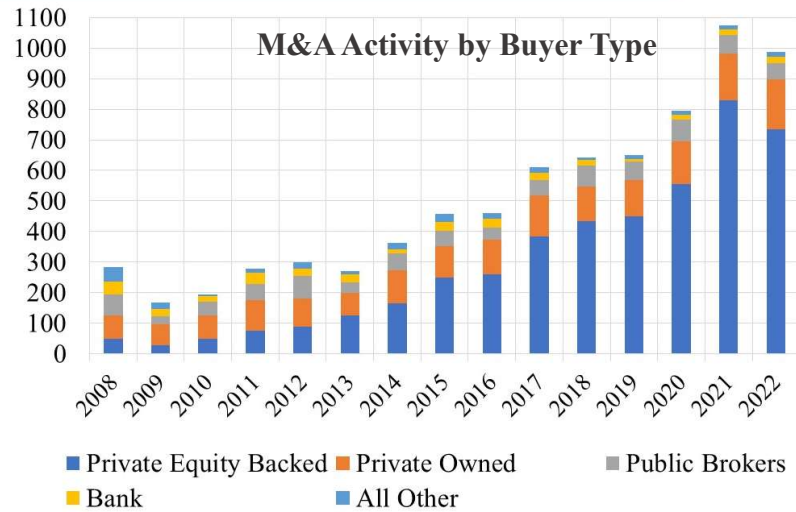
3. The Agency

- Size, growth, book of business, profitability, staffing, systems, etc.
- Influenced by *business planning*.

Market Value – Market Cycles

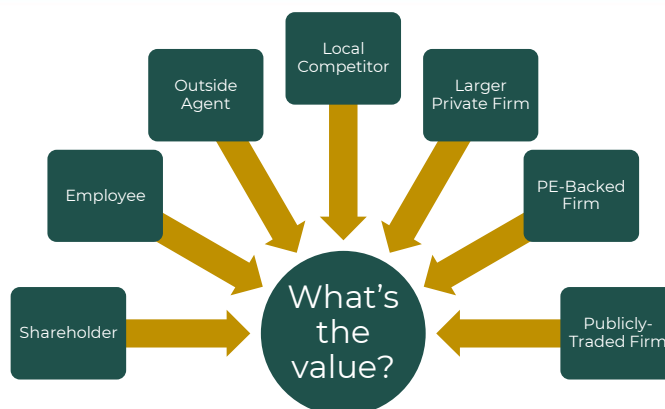


Market Value – Market Cycles



15

Market Value – Buyer Pool



Every buyer has a different view on value based on their financial position, risk tolerance, synergies, and growth plans.

16

Market Value – Your Agency

Inherent factors:

- ✓ Revenue and (pro forma) earnings
- ✓ Size and location
- ✓ Quality of business (carriers, clients, LOB, retention)
- ✓ Growth rate and scalability
- ✓ Niche practices
- ✓ Technology and data records
- ✓ Quality of staff and producers
- ✓ Nature of contracts with third parties
- ✓ Owner exit timeline



17

Market Value – Your Agency

Things you can do TODAY:

- Conduct a SWOT analysis
- Study your numbers
- Pro-actively focus on growth
- Understand effect of profitability
- Create a team to supplement your weak areas



18

Market Value – Your Agency

SWOT Analysis:

- Strengths, Weaknesses, Opportunities and Threats
- Honest assessment of your agency
- Will help you grow
- Will help you articulate your value to suitors



19

Market Value – Your Agency

Know your book of business:

- 80/20 Rule (client and carrier relationships):
- Be intentional about what (LOB) and where (carriers)
- Identify your ideal client
- Are you maximizing contingency bonus opportunities?
- Review network and cluster agreements



20

Market Value – Your Agency

Know your numbers:

- Organic growth
- Retention
- Productivity (revenue/employee)
- Target profit margin
- Be pro-active - Make a plan and measure results.



21

Market Value – Your Agency

Best Practice tips:

- Financial records
 - Get your data organized
 - Put procedures in place
 - Clean up expenses
- Employee Agreements
 - Employee non-solicitation agreements
 - Standardize agreements with employees and producers



22

Market Value - Recap

Factors affecting agency market value:

1. The Economy
 - Influenced by *market timing*.
 2. The Buyer Pool
 - Influenced by *sale process*.
 3. The Agency
 - Influenced by *business planning*.
- ❖ Preparation and process execution are key to maximizing the value of the agency *and* ensuring a smooth transition of ownership.



23

Benchmarking

What is benchmarking?

- Comparing your agency's financial metrics to peers.

Why benchmark your agency?

- ✓ Maximize profitability and value.
- ✓ Maximize productivity.
- ✓ Budgeting for the future.
- ✓ Better manage your business
- ✓ Identify areas for improvement

Limitations of benchmarks

- Often looking at *average* metrics across a variety of "peers."
- Often dealing with *unadjusted* financials.



24

Benchmarking

Peer Comparison									
	Agency #1		Agency #2		Agency #3		Agency #4		Average
Revenue	\$1,632,698		\$1,730,250		\$1,952,230		\$2,105,352		
Expenses (adjusted)	%		%		%		%		%
Wages & Bonuses	\$ 605,731	37.1	\$ 377,195	21.8	\$ 550,529	28.2	\$ 732,662	34.8	30.5
Producer Commissions	\$ -	0.0	\$ 442,944	25.6	\$ -	0.0	\$ 347,383	16.5	10.5
Rent & Utilities	\$ 70,206	4.3	\$ 74,401	4.3	\$ 37,092	1.9	\$ 124,867	5.9	4.1
Taxes & Benefits	\$ 65,308	4.0	\$ 84,782	4.9	\$ 68,328	3.5	\$ 96,846	4.6	4.3
Telephone & Software	\$ 42,450	2.6	\$ 48,447	2.8	\$ 1,562	0.1	\$ 109,478	5.2	2.7
Advertising	\$ 57,144	3.5	\$ 22,493	1.3	\$ 50,758	2.6	\$ 15,478	0.7	2.0
Dues & Subscriptions	\$ 13,062	0.8	\$ 21,282	1.2	\$ 6,037	0.3	\$ 29,475	1.4	0.9
Printing, Postage & Supplies	\$ 27,756	1.7	\$ 43,256	2.5	\$ 42,949	2.2	\$ 31,790	1.5	2.0
Miscellaneous	\$ 51,880	3.2	\$ 55,368	3.2	\$ 23,426	1.2	\$ 82,406	3.9	2.9
Total Expenses	\$ 933,537	57.2	\$ 1,170,168	67.6	\$ 780,681	40.0	\$ 1,570,386	74.6	59.8
Adjusted EBITDA	\$ 699,161	42.8	\$ 560,082	32.4	\$ 1,171,549	60.0	\$ 534,966	25.4	40.2

- Adjusted EBITDA based on adjusting owner's compensation to a market rate.
- Note the disparity between EBITDA margins of "peers" (range of 25% to 60%).

Benchmarking

Agency Financial Models			
	Marketing Driven	Producer Driven	Hybrid
SALES EXPENSES			
Commissions*	0%	25-35%	10-20%
Meals, Travel & Entertainment	0%	1-2%	1%
Marketing, Advertising & Promotion	3-6%	1-2%	2-3%
OPERATING EXPENSES			
Wages & Bonuses*	30-40%	20-25%	25-35%
Payroll Taxes & Benefits	6-8%	5-7%	5-8%
Rent & Utilities	5-8%	5-8%	5-8%
Phones & Technology	2-3%	2-3%	2-3%
Printing, Postage & Supplies	2-3%	1-2%	2%
Business Insurance	1-2%	1-2%	1-2%
Other	3-5%	3-5%	3-5%
TOTAL EXPENSES (Full Range)	52-75%	65-90%	60-87%
Adjusted EBITDA (Full Range) **	25-48%	10-36%	13-40%
Adjusted EBITDA (Average) **	35-45%	25-35%	30-40%

*Includes allocating a market compensation for owners.

**Excludes depreciation, amortization, interest expense & income taxes.

Marketing Driven

- Agency drives business
- Examples:
 - Personal lines
 - Niche
- Principal's focus:
 - Processes
- Model's strength
 - Turn-key
- Model's weakness
 - Size limitation

Benchmarking

Agency Financial Models			
	Marketing Driven	Producer Driven	Hybrid
SALES EXPENSES			
Commissions*	0%	25-35%	10-20%
Meals, Travel & Entertainment	0%	1-2%	1%
Marketing, Advertising & Promotion	3-6%	1-2%	2-3%
OPERATING EXPENSES			
Wages & Bonuses*	30-40%	20-25%	25-35%
Payroll Taxes & Benefits	6-8%	5-7%	5-8%
Rent & Utilities	5-8%	5-8%	5-8%
Phones & Technology	2-3%	2-3%	2-3%
Printing, Postage & Supplies	2-3%	1-2%	2%
Business Insurance	1-2%	1-2%	1-2%
Other	3-5%	3-5%	3-5%
TOTAL EXPENSES (Full Range)	52-75%	65-90%	60-87%
Adjusted EBITDA (Full Range) **	25-48%	10-36%	13-40%
Adjusted EBITDA (Average) **	35-45%	25-35%	30-40%

*Includes allocating a market compensation for owners.

**Excludes depreciation, amortization, interest expense & income taxes.



Producer Driven

- Producers drive business
- Examples:
 - Commercial lines
 - Employee benefits
- Principal's focus:
 - Training & coaching
- Model's strength
 - Scalability
- Model's weakness
 - Level of management

27

Benchmarking

Agency Financial Models			
	Marketing Driven	Producer Driven	Hybrid
SALES EXPENSES			
Commissions*	0%	25-35%	10-20%
Meals, Travel & Entertainment	0%	1-2%	1%
Marketing, Advertising & Promotion	3-6%	1-2%	2-3%
OPERATING EXPENSES			
Wages & Bonuses*	30-40%	20-25%	25-35%
Payroll Taxes & Benefits	6-8%	5-7%	5-8%
Rent & Utilities	5-8%	5-8%	5-8%
Phones & Technology	2-3%	2-3%	2-3%
Printing, Postage & Supplies	2-3%	1-2%	2%
Business Insurance	1-2%	1-2%	1-2%
Other	3-5%	3-5%	3-5%
TOTAL EXPENSES (Full Range)	52-75%	65-90%	60-87%
Adjusted EBITDA (Full Range) **	25-48%	10-36%	13-40%
Adjusted EBITDA (Average) **	35-45%	25-35%	30-40%

*Includes allocating a market compensation for owners.

**Excludes depreciation, amortization, interest expense & income taxes.



Hybrid

- Both drive business
- Example:
 - Average PL/CL agency
- Principal's focus:
 - Scattered
- Model's strength
 - Diversification
- Model's weakness
 - Producer performance

28

Benchmarking

Peer Comparison									
	Agency #1		Agency #2		Agency #3		Agency #4		Average
Revenue	\$1,632,698		\$1,730,250		\$1,952,230		\$2,105,352		
Expenses (adjusted)	%		%		%		%		%
Wages & Bonuses	\$ 605,731	37.1	\$ 377,195	21.8	\$ 550,529	28.2	\$ 732,662	34.8	30.5
Producer Commissions	\$ -	0.0	\$ 442,944	25.6	\$ -	0.0	\$ 347,383	16.5	10.5
Rent & Utilities	\$ 70,206	4.3	\$ 74,401	4.3	\$ 37,092	1.9	\$ 124,867	5.9	4.1
Taxes & Benefits	\$ 65,308	4.0	\$ 84,782	4.9	\$ 68,328	3.5	\$ 96,846	4.6	4.3
Telephone & Software	\$ 42,450	2.6	\$ 48,447	2.8	\$ 1,562	0.1	\$ 109,478	5.2	2.7
Advertising	\$ 57,144	3.5	\$ 22,493	1.3	\$ 50,758	2.6	\$ 15,478	0.7	2.0
Dues & Subscriptions	\$ 13,062	0.8	\$ 21,282	1.2	\$ 6,037	0.3	\$ 29,475	1.4	0.9
Printing, Postage & Supplies	\$ 27,756	1.7	\$ 43,256	2.5	\$ 42,949	2.2	\$ 31,790	1.5	2.0
Miscellaneous	\$ 51,880	3.2	\$ 55,368	3.2	\$ 23,426	1.2	\$ 82,406	3.9	2.9
Total Expenses	\$ 933,537	57.2	\$ 1,170,168	67.6	\$ 780,681	40.0	\$ 1,570,386	74.6	59.8
Adjusted EBITDA	\$ 699,161	42.8	\$ 560,082	32.4	\$ 1,171,549	60.0	\$ 534,966	25.4	40.2

- Agency #1 (PL agency) & Agency #3 (niche agency) = Marketing Model
- Agency #2 (CL agency) = Producer Model
- Agency #4 (PL/CL agency) = Hybrid



29

Benchmarking

Growth & Profitability -> Hard to manage both

Optimum profitability found when revenue is stable:

- Growing agencies reinvest capital – new employees, marketing, tech, etc.
- Shrinking agencies struggle to manage costs while revenues are declining.

Agencies with EBITDA margins outside the normal range:

- Low = Sign of poor management – producer splits too high, too many staff, overpaying staff, or chasing unprofitable lines of business.
- High = Not investing in growth – “maintenance mode” or producer-owner with no backup.



30

Benchmarking

Tracking Growth & Profitability

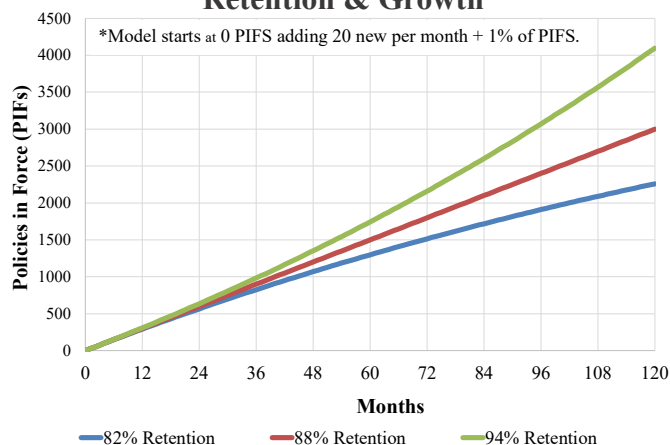
- Growth
 - ✓ YOY revenue, policy count and # clients
 - ✓ Sales velocity = (Current year new business income) / (Last year's com. income)
 - ✓ Customer retention
- Profitability (using applicable financial model)
 - ✓ Adjusted EBITDA margin
 - ✓ Expense ratios
- Growth & Profitability
 - ✓ Reagan's Rule of 20 = $\frac{1}{2}$ EBITDA Margin + Organic Growth = 20% (+/- 5%)
 - ✓ Ex: 5% growth and 30% EBITDA: Rule of 20 = $30\%/2 + 5\% = 20$
 - ✓ 20% or higher = shareholder return of 15-17%



31

Benchmarking

Retention & Growth



82% Retention	PIFs	% Written
5 Years	1299	68%
10 Years	2260	50%

88% Retention	PIFs	% Written
5 Years	1500	77%
10 Years	3000	63%

94% Retention	PIFs	% Written
5 Years	1744	88%
10 Years	4097	79%

82% retention -> 86% retention

- 5 years = 16% more PIFs
- 10 years = 33% more PIFs

82% retention -> 94% retention

- 5 years = 34% more PIFs
- 10 years = 81% more PIFs



32

Benchmarking

CSRs

- Compensation
 - Salary or hourly base wages + Incentive bonuses.
 - PTO and insurance.
 - Keep total CSR compensation < 30% of revenue.
- Potential issues
 - Too many staff based on the agency's revenue.
 - Compensation per person above market rate (including benefits).

CSR Benchmarks		
	PL CSR	CL CSR
Commissions per	\$120k - \$160k	\$200k - \$350k
Accounts per	600 - 800	200 - 400
Salary per	\$35k - \$45k	\$60k - \$80k

Benchmarking

Producers

- Compensation
 - Incentive comp. can vary by market and responsibilities.
 - Generally, commission-only for tenured producers.
 - Need 10-20% gap between new and renewal commission rate.
 - National average is a 40/30 split for CL producers.
 - Avoid paying renewal commission to PL producers.
- Potential Issues
 - Paying as 1099 when qualify as W2.
 - Commission split above market.
 - Ownership interest or ROFR.

Conclusion

Valuations

- Every agency has more than one value depending on who, what & why.
- The value is based on the principles of:
 - Current value – cash flow
 - Future value – growth
 - Expectation – risk/return
 - Substitution – alternatives
- Market value is dependent on:
 - The Economy – Influenced by market timing
 - The Buyer Pool – Influenced by sale process
 - The Agency – Influenced by business planning

“If you fail to plan, you are planning to fail.” – Ben Franklin

35

Conclusion

Benchmarking

- Provides management tools and helps increase the agency's value.
- Financial models
 - Marketing-driven
 - Producer-driven
 - Hybrid
- Peer = Agencies using same revenue model
- Study benchmarks -> organize systems -> track metrics -> improve the business

“What gets tracked, gets measured. What gets measured, gets managed. What gets managed, gets improved.” - Various

36

Action Items

Your next steps:

1. Download a copy of the presentation slides and perpetuation checklist.
2. Review the tips and benchmarking in this presentation.
3. Get organized so that you can effectively track agency metrics.
4. Review your metrics regularly and make changes as you go.
5. Seek help from professionals when you need it.

✓ Sign up for the next part of the webinar series!



37

Sign up for our next event!



April, 18th

Acquisition Strategy



Angela Adams



Mike Mensch



Mike Strakhov



38

Questions?



39

Thank you for attending!



40