

Editor's Note: In our July 2005 issue, we published an article Mr. Wevodau had written for us regarding the logistics of acquiring an insurance agency. Due to the response to that story from readers, we went back to Steve and asked him to offer up some advice from the other side—selling an agency. In this article he explains the required steps to follow when you want to get out of the business. For the record, we are not advocating exiting the business or selling your agency. But let's face it, we're all getting older and sooner or later retirement time will roll around or we'll simply have the bug to cash in our chips and try something new. This is good advice to consider. —JH

10 Basic Rules of Selling an Insurance Agency

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Is it time for you to get off the merry-go-round? If you're considering selling your agency, there are a few things you'll need to know. Yes, there are rewards but, naturally, areas of risk also exist. Before grabbing for that brass ring, much must be considered. We've developed 10 important rules that every agency owner should follow if they've decided to take this major step.

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1 Make sure a sale is the right step for you. A serious consideration of the risk-versus-reward equation must be undertaken before the decision to sell is made. This is one of your major turning points in life and, just like marriage, making such a change will mean significant ramifications throughout your existence. While it presents a great challenge, it also offers one of the greatest rewards most of us will ever face.

Consider all parties that stand to be affected by the agency sale: your spouse, any business partners, other investors and close associates. What about family members who are directly involved in the business? While you might not need agreement from all these parties that selling the business is right, you probably will need their support, and you certainly want to consider their welfare.

Whether the time is now right to put your business on the market presents a related consideration. Of course you want to sell when the business is peaking and revenue and earnings are at their most attractive. However, you're not in control of all the variables.

Trends in health insurance have made it more challenging for agency owners to predict their future as they react to market changes, incorporate the sale of new products, and battle the decreasing loyalty of price-squeezed customers. What you're going to do is try to stay ahead of the market curve and time the sale just right so you exit at the peak of the trend. This requires that you factor in the time to sale, as consummating an agency transaction usually takes four to 10 months. The risk is that your buyer is so attuned to market trends that he might see the value slipping and decide to pack his bags or, at the very least, lower the multiples. Because valuation is also tied to market conditions, changes in the marketplace that diminish your rate of return can cause the value of the business to decline by commensurate proportions.

If your agency is a small, family-run business, perhaps you are considering succession planning and want to liquidate your ownership interest but not disrupt operations. This requires a careful fit between the buyer and the existing business, which, in this case, is a much more important factor than market conditions and timing of the sale.

Perhaps your decision to sell is based on a desire to grow the business, diversify your product lines or build infrastructure so you can better service policies in-force. A sale to a larger organization can release your agency's liquidity and create capital that allows you to continue to grow the business as a manager. While there are benefits to this approach – the ability to operate on a larger scale and the opportunity to really challenge your entrepreneurial skills – being part of a larger organization also brings new challenges. Examine whether you could operate under a set of business objectives dictated by someone else, and whether operating within a larger firm would be satisfying to you.

The first order of business, then, is to seriously examine the financial and personal objectives that are driving you to consider to sell, and then factor in the question of whether the market is right for your offering.

2 Seek professional guidance. Retaining a business advisor or lawyer who specializes in mergers and acquisitions is a wise second step. It's often a mistake for agency owners to rely on the counsel of their local CPA or corporate attorney. These advisors may have served you well on many matters in the past, but the unique experience of selling a business is best handled by those who have seen the ins and outs of many transactions. Consider the many components to the acquisition process: business valuation, market assessment, preparation of offering memorandums, review of the tax implications, and legal and financial due-diligence, to name a few. Handling these correctly requires the understanding of sequential events that are common to the M&A process.

Also consider the drafting, review and negotiations required for the definitive, employment, non-compete and option agreements. An investment in seasoned professionals will most likely result in a more lucrative overall deal, a reasonable tradeoff for the additional cost incurred.

3 Establish a realistic value for your business. Calculating the value of an agency falls somewhere between an art and a science. Acquirers might use different methodology, and often will not disclose how they arrived at the appraisal price for your business. That's why it is important for you to have a clear, realistic set of parameters for your agency's value. A business advisor can guide you here. Establish realistic benchmarks and create a selling price that you can live with. The investment will be money well spent when you are faced with a buyer's offer.

4 Take the sales offensive. Entering the market under your own volition rather than being reactionary to an offer is much more likely to optimize your sale proceeds. Being reactive, where you allow the buyer to approach and make an offer, puts you at the mercy of the buyer's timelines and pricing methodologies. On the other hand, if you are proactive and take the offensive, you have much more control over the process. You set the terms and you take full advantage of the abundance of buyers in the marketplace, seeking them before they find you. Plan to be considering offers from multiple suitors. A business advisor will be very helpful in this process, because the advisor can simultaneously maintain control of the selling process while representing your best interests.

5 Properly present your company. Take a careful approach to presenting your company to a prospective buyer. A common mistake by agency owners is to open their books to a suitor, immediately generating a cash-basis financial statement. This is much less than a complete picture of the agency's value and, in fact, will result in a skewed valuation of the firm.

A business advisor will typically begin by creating an offering memorandum. This document includes historical financial performance, tax information, ownership interests, forward projections, business and market trends, a narrative overview and other historical information about the firm. With this comprehensive document in hand, your advisor can fully represent the value of your firm.

Consider just a couple of the financial elements often overlooked by an agency owner who puts together his own financials. Often, a primary goal of owners is to minimize tax liability while maximizing personal cash flow out of the business. The net result of this practice, however, is to skew the presentation of the business from the point of view of generally accepted accounting principles, and those GAAP guidelines should be the basis for a valuation.

Therefore, business owners should carefully evaluate and quantify personal expenses charged to the business and treat them as "add-backs," which will increase the book income of the agency. Many add-backs are overlooked, and if the buyer calculates value on a multiple of earnings, an unwitting seller can be leaving significant sale proceeds on the table.

Another problem with the use of cash-based financials is that they may misrepresent the performance of your agency. Remember the "matching principle" taught in your college accounting class? It states that in order to fairly present your financial picture, costs should be proportionally matched with revenue as it is earned. This is at odds with the revenue cycle generated by an agency.

Typically, most of an agency's expense will come from placing business or generating sales. However, most premiums are paid on a monthly basis, thus the agency commission must follow this cycle. If you use cash accounting, your revenues and expenses will not match because you will be offsetting your entire expense of that account with only one-twelfth of the income. In order for your accounting snapshot to be accurate, numerous adjustments must be made, such as incorporating deferred commission revenues or, alternatively, spreading out or deferring acquisition costs. Because a buyer will base an offer on earnings, it is imperative that you use all the tools possible to optimize your agency's earnings.

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Finally, your offering memorandum must seek to accentuate any elements of your business that may create exceptional value for the buyer. You want the buyer to clearly see revenue possibilities or the value of intangibles. Recurring revenue is something that always gets the attention of buyers. Economic value creation can be proven through your seasoned book of business with a high renewal rate. If the buyer seeks the prestige of your firm to enhance their operations, the presence of a well-respected management team or the industry stature you've built for your agency could be key intangibles that add significant value.

6 Study all the details of the offer. Thus far we've discussed all the legwork necessary to get your agency ready for sale. Once the offering memorandum is created, the next step is to send it to prospective buyers. Once the buyers receive the offering memorandum, they will often take the step of performing some preliminary due-diligence prior to making a formal offer.

The offer generally is presented in a letter of intent (LOI), usually with time-sensitive stipulations that require the agency owner's acknowledgement and written acceptance. This is like getting engaged. At this point, you've established intent to continue forward together, but either party can terminate the agreement prior to closing the deal.

The LOI is always contingent upon the buyer's satisfactory completion of legal and financial due-diligence. An LOI is always negotiable, and a good business advisor can provide valuable guidance at this juncture, drawing from their experiences to steer negotiations toward the best benefit to you.

The LOI often includes much more than just the price of the agency and each element needs careful evaluation. It may include employment agreements, non-compete covenants, the long-term value of stock options, deferred purchase consideration, hold-back provisions, base compensation and benefits, contingent bonuses or performance incentives, and the tax treatment of the transaction. Consider whether the buyer is placing adequate value on your key people, and how deep the incentives, stock options and employment agreements go into the staff. Be mindful of the fact that how your people are treated will have a key effect on the success of the business after the sale.

You'll want guidance from your advisor on the technical aspects of the offer, or the relative merits of competing offers. One buyer may be chosen over another, for instance, because of that firm's reputation, which should be given considerable weight in your decision in addition to the economic factors.

7 Negotiate! At this stage, consider all the possible negotiations before signing the LOI. Your advisor can help you bargain for higher consideration, such as splitting the synergy value, which is the revenue or expense benefit gained by the buyer through the combination of the two businesses. Your counter-proposals will allow you to deal with any issues that make you uncomfortable, whether they are compensation, consideration or the structure of the transaction.

The revised LOI must remove any obstacles from completion of the transaction before you go to the time and expense of legal and financial due-diligence. Do not be afraid that your negotiations will cause a buyer to walk away from the deal. Rarely does a deal fall apart if the parties are within a 10% tolerance on the offering price. The buyer's firm has opportunity cost tied up in the deal, and they don't want to lose it.

8 Get your house in order. Once you sign the LOI, you can expect the buyer to come knocking at your door, and you need to be ready. The next step in the transaction process will very likely require the most amount of effort on your part: preparing for the buyer's legal and financial due-diligence actions, which will involve visits to your operation and detailed review of your books and records.

The buyer will be looking to verify everything that has been represented

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about your company. That's why a multiple-day site visit is usually necessary. The buyer's team will review contracts, accounting records, systems, employment files, payroll, bank statements, articles of incorporation—virtually everything that shows your company's structure and operations. They will want to validate the financial statement representations, but also will do risk assessments, reviewing such things as product concentration, personal production levels, pending or threatening litigation, etc.

The buyer also will want to survey the skill sets of your personnel—particularly management—and make an overall assessment of the status of your employees. This is a critical step. The buyer needs to know that your staff's level of knowledge, experience and commitment will serve the company well after it's sold.

Due-diligence review lists are generally quite extensive, and can range from 40 to 150 categories of requested information that you will need to provide. Your best approach is to proactively ask for that checklist at least a couple of weeks before the buyer's team is scheduled to make its site visit; then you can prepare as much information as possible in advance. This request should be made, through the buyer's legal counsel or finance representative, as soon as possible after the LOI is signed.

When preparing for the site visit, it is imperative to keep your staff informed, allowing them the time to compile the requested materials and fit the visit into their schedules. Most buyers will treat this sensitively: If you are concerned about announcing the visit to your general employee population, they will probably agree to hold the visit at a neutral location. Also apprise your lawyer, financial advisor and accountant of the visit; to be sure of their availability, should you need them. The bottom line is, for a successful site visit from a prospective buyer, you need to be prepared and have all permanent file information readily available.

9 Make sure you are comfortable with the buyer. You may want to perform your own due-diligence on the buyer, especially if you're planning to be involved with the company after the transaction. It's most important that you believe that the buyer's operating model is conducive to you and your business culture. Your due-diligence might also include a site visit—going to the buyer's headquarters, meeting with management and key employees, and discussing their plan of integration. Try to discover if there will be any employee casualties due to the integration and how the buyer handles that type of situation, because you want to make sure your staff will be treated with respect and dignity. Ask about their tenure policy to be sure there is a grand fathering of tenure for severance purposes.

You might also review the buyer's benefit plans, evaluate their communications methods and review their complete operating cycle. If they've acquired other agencies, ask to talk to key people at those organizations. It is advisable to go through channels to speak to those people rather than tracking them down on your own. But a one-on-one conversation with a former business owner who

was in your position will tell you more about the buyer's culture than any other steps you might take.

10 Take it slow. Creating a deliberate process for the sale is the best way to conduct this serious, life-changing transaction. Haste has never benefited either side. Be sure you scrutinize every aspect of the deal as it proceeds.

Although many offers come with a time-frame demanding a response within days or weeks, do not succumb to pressures to do it quickly. It is important to put this into perspective: Is it right for anyone to ask you to make one of the biggest commitments of your life in a number of days? Buyers want to keep the momentum going so there won't be any second thoughts or seller's remorse. But forcing you to adhere to their timeline provides a bit of an unfair advantage: You can be dragged along without a clear understanding of the process or sequence of events.

The buyer might also want to minimize the possibility of other offers coming across your desk while theirs is being considered. Such an event could clearly raise the stakes. While you must make a good-faith effort to consider the offer in front of you, you should not need to worry about the effect of competition on the sale. Take it slow, work with your advisors and make sure they bring relevant experience to the table so you can comprehensively evaluate the transaction at your own pace.

You are about to take a very big step when selling your agency, one that will have profound effects on you and the people around you. The most important considerations should be to make these decisions very cautiously, stand firm on your convictions, and maintain a thorough understanding of the eventual outcome. To safeguard this most important process, realize that you are not an expert at this, and engage the services of professional advisors. Follow their recommendations, trust your instincts, and prepare yourself for a most rewarding experience. ■



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