RON CHRISTOPHER COMPANY
Mergers & Acquisitions Specialists

Manual for Selling Your Insurance Agency

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Introduction

For 8 years our firm has been helping match-up buyers and sellers of independent insurance agencies across America. During this time, we have garnered a wealth of knowledge about how to help agency owners go about selling their agencies. In this manual, we'll explore real-life stories of actual sellers (their names won't be revealed) who were successful in selling their agencies as well as those who ignored our advice. Many agency owners that have ignored our suggestions, have later regretted their decisions.

Most independent insurance agency owners are excellent at selling insurance but may not have the knowledge or experience in selling a business. Furthermore, these same owners may have "let things go" in terms of keeping their businesses healthy from a strategic and financial perspective.

As in all things in life, the past is the past and what really matters is your future choices. Likewise, outside forces in your personal life and in the business world overall are typically outside of your control. Don't worry about what you can't control but rather focus on how best to plan the transition of your agency to a new owner for the benefit of yourself and your family. Think about how the sale of your agency will allow for a beautiful retirement with your family.

We see too many agency owners who have made missteps and now look back at how much better off they could be financially if they had done things differently. Your agency has been your life's work, thus it's imperative things are done correctly in selling your agency. Otherwise, serious unforeseen heartache may be in your future.

Of course, we wish a successful transition for all agency owners and are here to assist, advise and negotiate the best ending for all involved.

“Don’t Wait Too Long!”

The biggest of the biggest mistakes sellers make, is waiting too long to sell. When the owner started the business he thought about how much money he was going to make and the freedom and pride of working for himself. He didn’t think about what would happen on-down-the-road in 25-40 years when he was ready to retire. Most sales of agencies occur due to the desire to retire, failing health or even the sudden death of the owner.

A good amount of owners don’t have any plan for the transition or sale of their business. They “hope and pray” that a solution will present itself at some point but don’t take any direct action to plan ahead over their working carreers. The planning for retirement should start 5-10 years before the desired retirement date as opposed to a few months or even a year or two ahead of time.

The worst stories we’ve heard involve selling at significantly reduced values due to a sudden death, serious illness, loss of a key employee or decline in the overall business of the agency.

In one instance, a seller sold at 25% of what they would have gained from the sale just 4 years before. The total reduction of value was somewhere near $1 million and it was due to an unexpected combination of conditions. In this instance, the owner’s husband (the husband owned and started the agency) died unexpectedly. Then the agency lost a few key employees who took business with them. Furthermore, the area of town where the agency was located went downhill and drastically influenced their financial results. Lastly, the agency didn’t keep up with the last automation systems and the office became completely unorganized.

Don’t be this seller! Be the one that sells at the height of sales and profits. Sell when the economy is thriving. Sell when others are not selling. Sell when you still have your health and vigor. Sell when you still have zeal for the business. In general, sell when all things are at their peak as the peak won’t last forever.

As the years pass by, many owners go on “mental cruise control” and sit back and rest on their past work. The business is humming along and profits come in year-after-year without much variation. Also, the owner has stashed away money and is very comfortable with his finances. In his mind, he’s on a luxury cruise liner enjoying the success of his work. However, to his detriment, he doesn’t see the iceberg through the fog that will sink his proverbial ship.

He doesn’t see the new competitors who are more hungry and aggressive than he is. He doesn’t adapt to new technologies that can help improve his business. He has no idea that a sudden deep recession is coming like the one in 2008. He has no idea that one or two of his key producers are planning a coup and are leaving with hard-won major key accounts. He has no inkling that one of his key carriers is getting ready to drop his agency for whatever frivolous reason the carrier's executives have. He feels all is well and there's no reason for action. Not true!

Take action today for a perpetuation or continuation plan for your agency. There are several options for your business once you decide to exit including:

- Sell the business to a son, daughter or close relative.
- Sell the business to a trusted employee.
- Merge with another agency and become an owner in the overall business with an "exit agreement" in-place.
- Sell to an outside agency owner or corporation.

The first two options are usually the most desirable as the owner has an emotional tie (son or daughter) or has a work history (an employee) with the buying party. The problem with these two options may include:

- The family member may not have the moxy and management abilities to continue the success of the agency.
- The son or daughter may not have the money or financial profile to obtain the money to buyout mom or dad.
- The trusted employee may not have the money to buy out the agency owner as mentioned directly above.

Merging with another agency is a good option, however, consider "the devil is in the details". Some questions that come up may include:

- What will my role be in the new larger organization?
- Will I be restricted in how and when I work?
- What will be my compensation while part of the new organization?
- Will I be a majority or minority owner?
- How will I be compensated for my stake in the new business once I decide to sell my shares?
- Do my new partners have a track record of increasing profits and sales?
- Can my partners be trusted?
- Do I like my new partners?

Thus, a merger is an avenue to consider, however, there may be some pitfalls.

Most agency owners eventually decide to sell to an outside, established agency owner. Although there are some cons to this avenue, the upside is usually better than the other options.

In closing, the longer you wait to sell, your available options will be reduced and each individual option may not be as attractive as in years past.

“Retire When You Begin”

Since waiting too long is the not the best option, you can plan for your retirement when you first start your business. From day 1 until day 3,650 and beyond, you should take stock of your situation each year. Certainly, on day 1 you should put in place a few strategies.

The biggest item is making sure you form a LLC or Corporation to protect yourself from lawsuits. Many business owners of all types still operate as a sole proprietors and leave their personal assets open for the taking from frivolous lawsuits. For less than $500, a business lawyer can help file the paperwork and don’t try to do this on your own. Lawyers exist for a reason.

How you structure your business today may play a significant role in your financial future decades on-down-the-road. Spend the money and do it right!

We will revisit the details later, however, unless you plan to trade the stock of your business on the NYSE or NASDAQ, there’s not much benefit to incorporating as a “C Corp.” election. LLC’s and S Corp.’s are “pass through” entities, thus, you won’t face potential double taxation at the time of the sale. Again, we’ll discuss tax implications later in the manual.

As mentioned before, the best option for the perpetuation of your business is to groom a capable family member or trusted employee. From the very beginning of your business, you should be evaluating if you have a family member or an employee that can take over some day.

Having that capable family member may not always be a viable option. Your son may be eager to take over the business but does not have the seasoned skills you have which made the agency successful. Your daughter may have interest, however, she may later decide that she wants to go back to veterinary school. Obviously having a son or daughter that can come into your agency is the best option but it may or may not work in the long term.

The next logical successor for your agency is to turn the keys over to a trusted long term employee. Some questions to ask yourself about such a situation include:

- Do they have the money to buy the agency?
- Can they qualify for outside financing?
- Does the employee have excellent management skills?
- Do the other employees get along with the potential new employee-owner?
- Does the employee have a plan to continue or accelerate the growth of the agency?
- Does the employee have any collateral to secure money owned to you as a “Seller Note”?

Of the above questions, the biggest concern is money and will you get paid. Coming up with $75,000 for a smaller agency is way different than receiving a check for $2.4 million for a larger sale. Isn’t that right?

Furthermore, a good amount of transactions occur by selling to third-parties who are already well-established agency owners or larger conglomerates. Some of the pros and cons of these situations are:

Pros:

- Many will have the cash on-hand or an established banking relationship to close the transaction quickly.
- They have the experience in buying agencies before, thus, the process may go much smoother and quicker than a first-time buyer.
- The outside party may have access to carriers, marketing skills, back office processes and web advertising that could take your business to the next level.
- They may have a highly sophisticated agency management systems that could help your business be more efficient.

Cons:

- The third-party has a reputation of slashing employees after a sale closes.
- They have a history of only servicing your larger clients while quietly pushing away your smaller customers.
- You may not have the ability to work in the business after a sale as they may bring in their own management.
- The culture of how the office is run may change.
- Your office may be closed and combined with another office some distance away.

The overall idea here is that there is no perfect buyer as the world is not perfect. You’ll need to think long and hard about what you want from a sale and consider who might best give you what you want. Some sellers are only concerned about receiving the highest price. However, most agency sellers are thinking in more subjective terms about how their business is run after a sale and their possible future involvement with the agency.

This is especially true if you plan to continue to live in the town where the agency is based.

“Tax Class”

The ever present IRS is going to want a cut of the proceeds of your business. How much you pay to old Uncle Sam depends on 1.) how you have structured the corporate status of your agency and 2.) how the contract to sell is structured. In most cases, you’ll be taxed at the long-term capital gain rate of 15% but a portion of your money may get taxed at regular income rates which approach 40% for high income owners. Don’t be the 40% guy!

The number one determinant of the outcome of your tax bill is via working with a highly qualified CPA that has experience is selling businesses. Likewise, you shouldn’t wait until you are ready to sell to find such a CPA, however, you should be working with such a person 5-10 years out before retirement. Planning ahead is always better vs. waiting until the last minute.

Every day CPAs, bookkeepers and accountants give out inaccurate advice about how to handle the tax implications of the sale of your agency. It is suggested to ask other business owners in the area who they’ve used to plan their corporate tax bills. Also, you may want to get references of business owners that the CPA/bookkeeper/accountant has helped plan their taxes during a sale. Get some proof of their success!

The biggest mistake many agency owners have is being lazy or reluctant to see if their current CPA is the right CPA for tax planning. They may be hesitant to challenge their old trusted “numbers guy” to see if he has the experience needed. The books and taxes may be done by a family member, thus, they may have an emotional reason to avoid embarrassing that family member if the family member hasn’t planned correctly. Don’t be afraid or lax in seeking-out the best tax advice professional! It’s your money and don’t let the government get an unfair share.

Separately, many agencies were founded and set up as a “C Corporation” which is subject to potential double taxation. If your business is currently a “C” selection, you do have the option to change the business to a “pass through” tax entity like an “S Corporation”, “LLC” etc. However, the guys at the IRS will make you wait 5 years to be fully exempt from double taxation. Anyone that is a C Corporation should contact their lawyer and/or CPA to make the change to a pass through entity. Don’t wait!

This one single change can save you a lot of money.

As one last note about taxes in selling your business relates to how the purchase price is allocated in an “Asset Sale”. In a “Stock Sale”, the capital gain is straight forward as you simply take the 1.) selling price of the stock and 2.) deduct the cost basis. As an example, if you have a selling price of $500,000 and your cost basis is $100,000 you will have a capital gain of $400,000 and be taxed at your assigned capital gains’ rate.

<u>This next section has excerpts from "The Complete Guide to Selling a Business by Fred S. Steingold". We recommend that everyone buy and read his book at least once! Maybe twice.</u>

Having said this, if you are doing an Asset Sale, the outcome can be quite different. Since most insurance agencies are either Corporations (mostly an "S" selection but sometimes a "C" selection) or a pass-through LLC, we'll limit our comments to these categories.

The IRS looks at two categories of Assets as follows:

<u>Capital Assets</u>

- Office equipment
- Furniture
- Company cars
- Real estate and land
- Copyrights

<u>Intangible Assets</u>

- Goodwill
- Employee agreements
- Carrier agreements
- Copyrighted materials
- Non-compete agreements

The best situation in terms of computing capital gains' taxes, is with working with an S Corporation or an LLC since they are treated as a pass-through entity. Furthermore, there's a special provision by the IRS to treat "recaptured depreciation" as ordinary income and taxed in the year of the sale even though the overall sale may be done on an installment basis over a period of years. Don't get caught off-guard here.

Thus, it's best to keep the amount of Capital Assets assigned to the sale to a minimum. However, the buyer will want to have the Capital Assets valued at a higher amount to help his taxes over the coming years.

Other key items to consider when talking with your CPA about Capital Gains Taxes of your insurance agency include:

- Are there monies being paid to you directly for a non-compete? This is very relevant when you are a C Corporation.
- The same idea above applies but with "personal goodwill".
- Can you pay yourself a large bonus at closing under a C Corporation? The idea here is that you'll reduce the double taxation effect by reducing the taxable income of the C Corporation.

Disclosure Notice

RCC encourages all agency sellers to get thorough advice from a qualified CPA or tax attorney regarding the complexities of reducing their tax bill. Don’t rely fully on our general discussion outlined above.

“Screening For Gold!”

Just as prospectors used screens to pine for gold in streams in the California Gold Rush, agency sellers should use a screen to ferret-out good buyers from bad buyers. Many agency owners will put an ad out on the internet and then wait for buyers to come their way. This is a huge mistake! We use “huge” in the way Donald Trump would say it.

Below are some of the reasons not to openly advertise your business:

- You’ll receive a copious amount of inquiries from serious buyers as well as “tire kickers”.
- Your competition may use the public information to misinform your clients about the future of your business. “John is for sale as he’s in a tenuous financial position” could be a statement made-up by your competitors.
- Many buyers will not have the experience to run your business.
- Quite a few interested parties will not have either 1.) the money on-hand or 2.) the creditworthiness to acquire your firm.
- Dealing with all of the interested parties will take a toll on your time from running your business.
- Your carries may misinterpret your potential sale and take action that harms your current operations.

Why waste your time with a strategy that usually fails?

Working with a Mergers & Acquisitions firm is the best option, however, there are some positives and negatives:

Positives

- You’ll be talking with buyers who have been screened by the M&A firm. This will save you a lot of time and headache as mentioned before.
- The M&A firm can advise you on such subjects as:
    - Suggested pricing and payment terms for your agency.
    - Negotiation strategies.
    - Timing of the M&A process.
    - Templates for Letter of Intents and Purchase Agreements.
    - Recommendations on business lawyers to review your agreements.
    - Help with accurately reflecting your financial and corporate tax statements.
- They can help buyers find specialized lenders for insurance agency acquisitions.
- Niche industry knowledge with the selling of independent insurance agencies.
- For a predetermined “upfront” flat fee, the M&A firm may be able to provide specialized reports or dossiers regarding your agency. In this way, you’ll be marketed in a more positive light. The only caution here is make sure the dossier

isn’t too long and you are not getting charged $5,000 to $10,000 for such a document.

Negatives

- It’s a “Seller’s Market” in the independent insurance agency market, thus, most buyers are willing to pay the fee of the M&A firm. Stay away from firms that want the seller to pay their fee which can be up to 10% of the transaction value. There is no reason for the seller to pay 10% when there are so many buyers for each seller.
- The M&A firm may want to lock you in to only talking with buyers they bring to your attention. This is a reasonable request but the seller should limit the time period to something 3 months or less. In this way, you aren’t bogged down by an M&A firm that is not performing.
- The M&A firm doesn’t return your calls or update you regularly on their progress.
- You have a personality conflict with the representative at the M&A firm. Work with those you like and trust.
- You get street chatter that the M&A firm you are working with is shady or unethical. Dump them immediately.

At the end of the day, working with a credible and well-established M&A firm will be your best option. As a final note, our firm worked with a seller who openly advertised his business for sale in the beginning. He now regrets it as he wasted 12 months working with a seller that never closed on his agency.

“Agency Pricing”

When it comes to pricing your agency for sale, the question: “What is my agency worth?” is open to interpretation. As in any market, the actual buyers and sellers set market pricing as opposed to M&A firms. More specifically, as it relates to the independent insurance agency market, there are 1.) ratios to consider as well as 2.) subjective mitigating factors that affect the final selling price.

Of course, any seller wants to have the highest pricing possible while a buyer is seeking to make an acquisition for as little as possible. This is a natural response. Where things go wrong is when either a seller or buyer is expecting pricing way outside of the market norms. On the selling side, a seller may be emotionally tied to the history of his agency and feel his agency is extra special for this reason or that. The seller may be very proud of the business he built and believes it is so special that he deserves a very high amount for the business.

On the other side of the aisle, buyers may feel that they are not getting a “good deal” unless they pick something up under market value. While there are instances of very high prices and very low ones, we all remember classroom discussions of “bell curves”. The basic idea is that 80% of the transaction values will be within the middle part of the bell curve. Likewise, there will be two segments at each end of the spectrum which will be outliers (very high and very low prices). These outliers may only represent 20% of the total transactions in the marketplace.

Looking at 8 years of experience in M&A work with independent insurance agencies, the following observations can be made:

<u>Independent P&C Agencies</u>

- Selling prices are typically between 1.5X to 2.0X annual commissions.
- 2.5X to 3.0X commissions is realistic if the seller has highly desirable carriers or is in a special niche market that’s in demand (i.e. trucking, marine, aviation etc.)
- More sophisticated buyers may also look at Adjusted EBITDA which closely relates to Adjusted Cash flow. Typically 4.5X to 6.0X adjusted EBITDA may be appropriate as a selling amount. If you have questions about coming up with EBITDA or Cash Flow numbers, feel free to give us a call.

<u>Independent “Benefits” Agencies</u>

- Those sellers with mostly individual health insurance clients, will receive a much lower amount than those who are doing group health insurance. This is due to the extreme uncertainty in the market created by Obamacare. Each situation is unique unto itself, however, 1.0X annual commissions may be a starting point.

- As for group health insurance, the values will be significantly higher as buyers view selling to groups much more profitable and stable. Figures up to as high as 2.25X annual commissions are possible all else being equal.
- For those selling life insurance that generate only an upfront commission a multiple of 1.0X commissions is a general rule-of-thumb. If your life insurance products generate repeat or trailing commissions over a number of years, the multiple will go up.

Additionally, there will be both objective and subjective factors that can further affect the final selling price. Below are examples both factors that can increase or decrease the agreed upon selling amount:

<u>"Increasing & Decreasing Factors"</u>

- Seller is located in a major metropolitan area. There will be more competition amongst buyers as your agency will attract both 1.) local buyers as well as 2.) those from distant locales who are trying to establish themselves in your area. If you are in a rural town of 2,500 people, not many buyers will have interest.
- Agencies who have increasing commissions over multiple years. Buyers become very skittish with sellers who have commissions in significant decline (10%+ decline in any given recent year).
- High profit margins. It's important that you keep all of your expenses in-line with the revenue brought in each year. An agency with a 60% profit margin is going to garner a higher value than one with a 15% profit margin. The biggest expense in most service businesses is 1.) labor and 2.) employee benefits. In general, an agency should be bringing in at least $100,000 in commissions for every full-time employee equivalent. If you are below this mark, start looking at who might be your "marginal" employees. Those agencies with $150,000 to $200,000 in annual commissions per employee, are very desireable.
- Those sellers with flexible payment terms will attract a higher selling price. If you are asking for 100% cash at closing, many buyers may think you are hiding something negative about the business. In other words, they may feel you are selling them the proverbial swamp land and you'll never be seen again as you will "take the money and run". Even coming down to payment terms of 80% to 90% at closing will help your case. Likewise, if you are open to having part of the selling price attributable to future renewals of commissions, this will further increase the value of the transaction.
- Agencies with highly desirable carriers will command higher pricing.
- If you are doing primarily commercial insurance or selling benefits to groups, buyers will want statistics such as:
  - How many clients?
  - Average length of time the clients have been with the agency? Longer is better here in terms of value to the buyer.
  - Are there any clients with commissions comprising 10%+ or more of the agency's revenues? Having a few large "whale" accounts may temper the

enthusiasm of buyers as losing one account could significantly hurt profits.

- Factors affecting pricing for agencies with mostly personal lines or individual policies include:
    - How many clients?
    - Average age of your clients? If the average age of your clientele is 65, you'll need to find some younger clients. Otherwise, the business may begin to falter due to the demographics and attrition due to age.
- If your agency has many carriers in common with the prospective buyer, this will help you. By combining both businesses, profit sharing and contingency bonuses will be higher than the two entities operating separately.
- Even though loss ratios are basically out of the control of agency owners, many incentives given by the carriers are affected by this ratio. Thus, a buyer may be hesitant to go forward (or offer a lesser price), if your loss ratios are outside the norms for your area. Erie Insurance is one carrier that is of particular note in this line of thought. You can be a significant agency owner that has been with Erie for decades, however, if you acquire another Erie agency with bad loss ratios, Erie may cut your incentives heavily. Sometimes Erie will nix the entire sale between the seller and buyer.
- Any agency that has very little "walk-in" traffic or is basically doing all of its business via the internet, email and phone, will command a higher price.
- Agencies that can be combined with another agency in their local area are more desirable.
- If you lack the following financial and client systems, buyers will peg a lower value on your business:
    - Agency management system.
    - Excellent financial records. Financial statements that are 1.) done by the buyer and 2.) are in handwritten ledgers are a major turnoff as it may allow for misrepresentation of the agency's performance to the seller. It's best a bookkeeper or accountant create, keep and maintain your financial statements as well as tax returns.
    - Large amounts of paper files.
- Tying the sale or lease of your office building to the sale of the agency, will lower a potential selling price. Most buyers of agencies want just the agency and not the real estate. It's best to get a commercial real estate agent to help you lease or sell the building to a third party.
- If you don't have "Non Competes" or "Non Piracy" agreements in-place with your employees, this can also be a negative. Buyers will wonder if your best employees will fly away from the nest and become competitors after a sale occurs.
- Those agency owners who are part of "consolidators", "aggregators" and other middlemen who provide access to carriers not otherwise available to the agency owner, will have a smaller pool of buyers. Most of these intermediary groups require their agents to sell to another agency owner in the group and/or pay a very significant buyout fee to exit the contract.

In summary, pricing of an agency can be both simple (ratios) and complex (subjective items listed above). Thus, many years before you decide to sell, you should be considering the details discussed in this chapter. Otherwise, you may lose out on a lot of retirement money for you and your family. Don't let you life's hard work go to waste!

“Due Diligence”

Any time that you buy a new house, it’s standard practice to thoroughly view every nook and cranny of the house. Nobody wants to make the mistake of buying a house and then feel regret because they overlook a minor or even major defect in the house. We have all heard of horror stories of where a friend bought a house and the seller didn’t disclose a significant problem with the house. Now your friend is financially responsible to fix the problem as opposed to the previous owner.

In most cases, home buyers will not only go over the house themselves but they’ll hire a professional home inspector in order to be thorough.

Buyers of independent insurance agencies will be very meticulous in “checking out” your business before they commit to buy. To this end, buyers will be asking the seller to provide answers to various questions as well as sharing written documentation/reports relating to the health of your agency. Typical items that come up during the due diligence phase include:

- Providing the buyer with at least 3 years of your corporate tax returns.
- Providing the buyer with at least 3 years of your year-end P&L statements. The buyer may also ask for a year-to-date P&L especially if you are half-way through the year (July or later).
- Providing the buyer with 3 years of year-end carrier statements.
- A listing of your employees, their duties and respective salaries.
- Basic questions that may come up include:
    - Have you (the seller) been involved or are involved in any pending lawsuits?
    - Do you have “Non Compete” and “Non Piracy” agreements your current employees?
    - Are there any significant clients who have indicated they are switching to another insurance agency?
    - If they are buying your building, many questions will come up about the history of the property, any significant repairs that are needed as well as simple things like property taxes.
    - Do you have direct appointments with your current crop of carriers?
    - Are you part of any consolidators?
    - Is any of your business brokered?
    - Do you have written agreements with carriers, consolidators and brokers?
    - If you are part of a consolidation group, are there any restrictions in selling your agency?
    - Does your agency do any “agency bill” transactions?
    - Do you have an agency management system?
    - Are you doing all of the bookkeeping/tax reporting or do you have a CPA which performs the duties? If you are keeping paper logs of your revenues and expenses, this can be a big turnoff for buyers!

- Have you had any E&O claims over the last 10 years?

Many other questions and requests will come up during the due diligence phase beyond what is listed above. The important thing for the buyer is to be prepared. If you don't keep accurate financial records that's going to a problem. If you haven't filed your corporate tax returns the last few years, that will be a problem. If your corporate tax returns differ significantly from your P&L statements, that will be a problem.

The general idea is you should be preparing your due diligence at least a year before deciding to sell. There are so many sellers that are very unorganized and buyers shy away as the buyer feels the seller is hiding something (even if they are not). Neat, accurate and orderly documentation regarding the vibrancy of your agency, will go a long way in selling your agency.

As a final thought, if there are material negatives about your business (i.e. commissions falling, a carrier is getting ready to cancel a contract, you have a key employee that has left who is taking part of your business etc.), you'll need to be upfront and forthright with the buyer. You can try to hide these facts, however, most experienced buyers develop a special sense for sellers who are being deceitful.

It's better to get out in front of the situation and tell the buyer in the initial talks all of the negatives (as well as positives) about your business. As an example, let's say your commissions are falling, however, you can tell the buyer that with the help of the buyer's carriers, the agency can write new business and grow again! If you are getting ready to lose a carrier, you may share with the buyer your plans to switch your clientele over to another existing carrier. The general methodology here is to 1.) state the negative and 2.) offer a solution that will eliminate or mitigate the negative.

If you do hide something significant and the business suffers after a sale, you have a high chance of facing a lawsuit from the new owner. That won't be fun at all and could hurt your reputation with your clientele!

“Loans For Buyers”

The best buyers are the ones have enough cash that they don’t need to go to a third-party to borrow money (i.e. local bank, specialized lenders, private equity, family members etc.) “Cash Is King”, however, buyers flush with money are in the minority of buyers for small to mid-size agencies. Large regional or national insurance agencies for sale typically get bought by other large agencies with excess cash on-hand.

Having said this, the process of a buyer getting a loan from any source can be time consuming and frustrating for all parties involved. Be prepared to tack-on 8 weeks to the selling process if a lender is involved. Lenders with any bit of intelligence will thoroughly check out both 1.) the borrower (your buyer) and 2.) the overall cash flow of the agency being acquired.

Key items that will immediately rule out borrowers/buyers from day one include:

- Bankruptcies in the last 10 years.
- Legal financial judgements that are unresolved against the buyer as a person or as a business.
- A credit score of less than 650.
- Buyers with less than 10% of the transaction value in cash for a downpayment. If the buyer has to borrow the 10% for a downpayment, that doesn’t help. The cash needs to be cash sitting leisurely in bank account or financial product. In short, if you are buying an agency for $500,000, you need at least $50,000 in unencumbered cash.

Furthermore, items that can delay or “deep six” a transaction that relate to the seller includes:

- Revenues that are significantly declining year-over-year. Usually 10% or more per year.
- Sellers that are about to lose a contract with one of their major carriers.
- Sellers that are in legal trouble on a civil level or with state entities (Insurance Department).
- Sellers that are bleeding cash in relation to their revenues.

Most buyers and sellers don’t have the negative factors listed above, however, it’s important to ask questions of the other party involved to rule-out potential roadblocks. Oftentimes, a good M&A firm will screen both the buyer and seller before an introduction is made.

As a final note, if your situation does present a big negative, it’s best to be upfront with the other party. Maybe there’s a way that the other party can help and allow for the transaction to go forward. If you don’t disclose a negative and the other party uncovers it, you’ll lose all credibility in the negotiations.

“Closing Preparations”

Oftentimes buyers and sellers will go through a honeymoon period during the initial meetings and negotiations. Both sides are congenial and feel that they can strike a deal. However, once a “meeting of the minds” occurs, the real work starts.

There are several items that can slow down the process and cause consternation for all involved. Some of the common “slowdowns” include:

- Preparation of the final agreements and closing documents. Lawyers work at their own pace and sporadically you’ll run across a lawyer that completely puts your work aside as she is working on a “whale of an account”. In other words, the “other work” is more money for her vs. your work. This situation is quite frequent with one-person law offices.
- We’ve all heard of “Dueling Banjos” from the movie *Deliverance*, however, you can run into “Dueling Lawyers” as well. Some lawyers can be overly picky about non-relevant language and will fight it out with the opposing lawyer purely because of ego. Don’t let your lawyer go into this mode, otherwise, you may delay a closing or the other party may throw up their hands and simply walk away.
- Any legal documents relating to the sale, should be accurate in terms of names and the spelling of the parties involved. You don’t want to delay a closing because a word is misspelled or your lawyer puts down the wrong legal name. For example, you may use “Don Brown Insurance Agency” for your daily work, however, the legal name of your business may be “Don Brown Insurance, LLC”.
- If the buyer is using a third-party bank or lender for funds to buy your agency, many “last minute” requests may come up from the bank or lender. There’s not much you can do here except to address their request as soon as it hits your desk. Don’t delay.
- During the final phase of the M&A process, the buyer will typically want to be assured that all of the seller’s insurance carriers will stay in-place once the transfer of ownership occurs. Thus, the buyer and seller should be in contact with the carriers at least a month in advance of closing.
- One obvious but ignored problem is when a buyer or seller takes a family vacation right before a closing. Your lawyer, the buyer’s lender or another party may ask you to sign a document or address an issue while you are sunning yourself on the beach. Be smart and rearrange your vacation to be at a different time.
- As mentioned in a previous chapter, the collection and distribution of financial and carrier due diligence should occur quickly.

These are a few of the hurdles that can cost time but it isn’t an all-inclusive list. Planning for a closing will take time away from running your agency, however, you don’t want to lose out on a closing due to your daily work. Yes, you may have to put some things off with clients or employees, however, are you going to risk the long-term benefit of selling your agency for a few extra hours per week? Are those extra hours really going to matter 5 years on-down-the-road when you are enjoying long family vacations?

“Final Thoughts”

Over the years or even decades, most independent insurance owners have enjoyed helping their customers as well as working with their fellow employees. For all of us, there comes a time and place that we want to either cut back our working hours or retire in order to spend more time with close family and friends.

In the first chapter, we mentioned the perils of waiting too long to sell or set up an “heir apparent” for your agency. If you are thinking of retiring anytime within the next 5-10 years, you need to start today (this afternoon) in assembling your team of advisors that will help you with your future transition. Don’t put it off as you’ll regret it on-down-the-line for sure.

Preparing to sell and the actual selling process can seem like a serious migraine. If you do things right, you’ll forget about the headache soon after the sale closes. You have worked a lifetime in building your business, now it’s time to enjoy it!

If you have any questions about the selling of your agency, we welcome your call or email. No question is too small to ask.

Best wishes in your endeavors both today and in the future.

Joel Farley