Manual for Buying An Insurance Agency

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Introduction

Our firm has been helping match-up buyers and sellers of independent insurance agencies for nearly 9 years. Over this time, we have garnered a wealth of information that can help those interested in buying another independent insurance agency.

Most of this whitepaper will discuss pitfalls to avoid in the acquisition process, however, we will also share more lighthearted comments.

Some buyers we work with have bought many agencies over the years while others are “newbies” to the process. No matter which category you may be in, please take time to consider the details in this paper.

“Finding Sellers”

Many agency buyers are eager to acquire another business but have an extremely hard time finding sellers that they might have interest. Usually the buyer starts out by using Google to type in keywords such as: “Buy an insurance agency”, “Buying insurance agency”, “Buying independent insurance agency” and so forth. Many of the Google results will lead you to web-boards where either 1.) agency owners or 2.) Mergers and Acquisitions firms list various agencies for sale. This is a good place to start.

Having said this, the market for independent insurance agencies (especially P&C agencies) is a true “Seller’s Market”. For every seller out there, you can expect that you are competing against 15-20 other buyers or more. To the seller or the M&A firm, you are just another “Joe Schmo” who inquired about the agency for sale. You might be the 11^{th} email of the day regarding the seller and you may or may not get a response as most ads are “blind ads”. In other words, since you don’t have all of the details about the actual agency seller or to a lesser degree the M&A firm, you can only hope that your inquiry will be returned.

Sometimes you do get a response and sometimes you don’t. Our point here is that you should not rely solely on responding to advertisements on the internet as the percentages are against you. A majority of the acquisitions that do close each year are never advertised or known to the general market. So the preeminent question is: “How do people find sellers that are not advertised?”

Some of the ways that buyers find sellers (other than via an advertisement include):

- The buyer has groomed relationships with other agency owners in his area. These relationships blossom and then suddenly one day the agency seller is remembering his old friend who has expressed interest in buying his agency. Think of the old phrase: “Old Boy Network”. One of the biggest mistakes an agency buyer can make is to gain a bad reputation in his area. No matter what you say or do, many agency owners will not sell to you no matter the price. Don’t cheat, lie, steal or do anything that may be considered unethical as your actions <u>will</u> be noticed.
- Outgoing postcards and emails. These usually give poor results.
- Inside news from carrier representatives. Many times a carrier representative will casually talk with an agency owner and the owner mentions that he’s looking to sell. Thus, it’s important that you keep in contact with your carrier representatives on a regular basis so that they remember you when they find someone for sale.
- Direct cold calls from one agency owner (the buyer) to other agency owners in the area (possible sellers). Cold calls are an excellent tool, however, many owners that are seeking to sell may not tell you that. Please keep in mind that you <u>are</u> the competition and they fear you may try to manipulate their interest in selling against them.
- Relationships with M&A firms. If you find an M&A firm that deals exclusively with independent insurance agencies, nurture a relationship with them. The firm may not have a seller teed-up in your area immediately, however, they may come back to you months or even years later with a prospective seller.

Going beyond the avenues above, we suggest having an M&A firm make confidential cold calls to agency owners in your area. You may ask why you should hire an M&A firm to do the calling vs. your own efforts? This is an honest question, however, please consider the benefits of working with an M&A firm in this fashion:

- By being an third-party (and not the direct competition as an insurance agency), oftentimes agency owners will be more open about their career, family and business plans for the future.
- If you (the buyer) are working as a captive agency owner or are working for another independent insurance agency, you may not want the corporate headquarters or your boss to find out that you are seeking to jump ship. Thus, by having an M&A firm make the calls, your name doesn't get spread around that you are in the market to buy. The community of independent insurance agency owners is very close knit especially in more rural areas and rumors spread fast.
- The M&A firm can ask "qualifying" questions of the prospective seller in order to rule-out sellers that may not be right for you the buyer. Why waste your time with a seller that you are not going to be interested in?

M&A firms will charge a flat rate, hourly rate or even a "success fee" for their calling services. Maybe they even have a mixture of pricing options. Just be sure that you understand what you're paying for and how much you'll be spending. Furthermore, it's good not to lock yourself into any one M&A firm as that could curtail the number of sellers that may be out there.

All in all, finding sellers can be quite easy if you do it the right way but also it can be very difficult and frustrating if you choose the wrong option.

“Buy Right!”

Whether you are going through your first acquisition or your 20th, it can be quite exciting when you close on a transaction. Your acquisition, if done right, adds to your existing commissions and may allow for reduction of expenses of the combined agency. Who doesn’t like that?

Many insurance agency buyers, will acquire an agency that will hurt them in the long-term out of desperation to close an acquisition. Don’t buy something that may not fit in with your current business model or long-term strategy. It’s better to hold out for a seller that is going to benefit you as opposed to one that may or may not work. It’s kind of like dating. You’ll date someone who “may” be a good match but then you run across that right person who you want to marry. Don’t continue a relationship with the “maybes”.

Some of the characteristics of transactions where the buyer may go astray with “Buying Right!” include:

- The buyer has never sold insurance or owned an agency and wants to acquire any agency that pops up. Maybe it’s better to get 6-24 months experience in the insurance agency business for another owner before going out on your own.
- The buyer is much smaller vs. the seller. Oftentimes, you’ll see a buyer that is 50% or 25% of the size of the seller. Is it really wise to buy an agency with $2 million per year in commissions when your agency is at only $500,000 per year? Some problems here may relate to:
    - You just bought a very large agency and the business of the larger agency tanks soon after you acquire it. Thereafter, you are stuck with a sinking log so-to-speak. Are you going to be able to keep up with the payments you are making to a lender for the acquisition? Don’t put yourself in a possible financial catastrophe.
    - The larger agency operates in a totally different way than your current agency. Think of it in terms of baseball. Except for a few superstars, most baseball players work their way up through the various levels of the minor leagues before they head off to the “Big Leagues”. It’s not common for a guy to graduate high school and go straight to the Cleveland Indians. If you don’t have the management skills to operate a larger-sized agency, you could be in for trouble.
    - Many lenders for acquisitions will not lend to a “small fry” buying the “bigger fry” for many reasons. Thus, it doesn’t make sense to spin your wheels with a prospective seller if you can’t get the money for the acquisition. This is true unless you have the proverbial “Rich Uncle” that will spot you the money.
- The buyer has very little in terms of cash for an acquisition. If you just declared bankruptcy and have $500 to your name are you going to be able to close on a transaction of $200,000 or more? Probably not. Build up your financial position first before heading off to bigger things.
- The buyer primarily does “personal lines” but the seller focuses solely on selling insurance to large Fortune 500 firms. You won’t have the experience, knowledge or competence to continue the success of the seller.
- You are located in Upstate New York and you seek to acquire a small agency in rural Mississippi. Not only will you have a “cultural” mismatch with the clients of the acquired agency, but, will you be able to effectively run an agency 5 states away?

- After interviewing with the seller, sometimes you will feel a mismatch in personalities or management practices. This comes into play when the seller is paid to stay with the agency after a sale. If your personalities clash or your management strategies are at odds, you won't have much fun after the acquisition.
- You overpay for an agency. Let's say that the agency is worth $250,000, however, you pay $400,000, then you have made a mistake. Don't overpay just because you want to buy. The seller will be happy with his big fat check, but, you'll have "buyer's remorse" for years to come.

Use some basic common sense when you are seeking to buy another agency. If your gut tells you there's something wrong in regards to going forward with any particular seller, back away and look for another seller. As a final thought, think of all of the speculators that bought real estate in '07/'08 and now they are upside down on their loans (or are in bankruptcy). Did they buy right? The old saying: "Sell when others are buying and buy when others are selling holds true over the years".

“Don’t Be A Jerk!”

One of the biggest mistakes a buyer can make is to burn a bridge with a prospective seller or an M&A firm. As for the sellers, oftentimes the negotiations between the buyer and seller may become tense and everyone’s blood pressure rises. The smart buyer will remain cool no matter what the seller says or does. Don’t let your human emotions cause you to lose working with a seller.

What happens is a buyer will get upset and say something totally unprofessional to the seller and then the seller decides he won’t work with the buyer no matter what. Recently, we’ve had a buyer that told us that: “He wouldn’t work with the buyer if that buyer were the last buyer on earth!” More often than not, if you let the situation settle for a day or two both the buyer and seller will come to their senses. It’s amazing how a cooling off period can refocus both the buyer and seller on what is most important in the negotiations and not get caught up in their personal emotions.

If you have been introduced to an exciting seller via an M&A firm, there are both written and unwritten rules to follow that will benefit you as the buyer. If you don’t follow the rules, the M&A firm will cut you off on future sellers that may come their way. Below are a few rules of the relationship:

> **Fees** – If you try to circumvent the M&A firm as a buyer on their fee, you are in for trouble. First and foremost, if the M&A firm thinks you are trying to navigate around their fee, they’ll tell the seller. Most sellers want to deal with honest, ethical and likeable buyers. Thus, don’t get a bad reputation that could deep six your negotiations with the seller. As a final point on fees, if you agree to pay a success fee to the M&A firm, don’t try to negotiate a lower fee after you have signed their agreements.
>
> The M&A firm will not be happy and you won’t get further leads for sellers on-down-the-road. You either agree to their fee and pay it, or you don’t sign the fee agreement.
>
> **Payment** – Don’t risk a lawsuit and/or getting a bad reputation in the business community as a cheat by not paying the M&A firm’s fee on time. If you don’t have the money to pay the M&A fee, then you should not be buying the seller in question as you will be stretching your finances too thin. Maybe it is better to wait for some time to build up your cash reserves or consider acquiring a seller that won’t take as much of your available cash.
>
> **Calls/Emails** – Just because you and the seller have developed a chummy relationship, doesn’t mean you can ignore calls and emails from the M&A firm. By sticking with basic business etiquette, you will groom your relationship with the M&A for years to come. You will be at the top of the list when new sellers come up at the M&A firm.
>
> **Instructions** – If the M&A firm asks you to wait to call the seller, follow their instructions. Most oftentimes a seller will want to be introduced to the buyer via the M&A firm directly. If you call the seller without the blessing of the M&A firm, the buyer may not know who you are and why you are calling. In fact, the buyer may become upset, end the call with the buyer and call her contact at the M&A firm to complain.

> **Suggestions** – Be smart and draw upon the experience of the M&A firm. Unless the M&A firm has been in business only a few years, they'll have a lot of niche knowledge regarding the buying and selling of insurance agencies. Thus, when the M&A firm makes a suggestion, strongly consider their recommended course of action. Do you think that the M&A may have run across a particular question or concern from the multitude of previous buyers they have worked with?

All in all, if are professional, courteous, ethical and polite in your dealings both with the prospective seller and the M&A intermediary, you can't go wrong.

“Agency Pricing”

The following section is borrowed from our whitepaper named “Manual For Selling Your Insurance Agency”, however, it is also relevant to agency buyers.

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.

Independent "Benefits" Agencies

- 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:

"Increasing & Decreasing Factors"

- 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!

“Financials”

The collection, review and analysis of the seller’s financials is one of the key parts of the due diligence process. You may have a personality fit with the seller and he seems like a good guy to work with. However, how does his revenues, expenses and profitability look like over the last 3-5 years? Are his revenues rising or declining? Is his business bloated with too many employees? Are there any large one-time expenses? These are some of the questions that may come up during a thorough review of the financials.

In terms of financials, there are two main items that are needed: 1.) Profit & Loss statements (P&L’s) as well as 2.) corporate tax returns. The P&L’s are the most important of the two items as they will give the buyer the most details about the seller’s financial health. On the other hand, the tax returns are a confirmation of the revenues and expenses contained in the P&L’s, however, a tax return may not give the “line item” detail expressed in the P&L’s.

Many buyers want to review the financials of the seller before they have a phone call or meeting with the seller. Most sellers are highly reticent to give out their detailed financials before they have a degree of comfort with the buyer. Even a 15-20 minute phone call between the buyer and seller will put the seller at ease. In short, don’t expect to receive the financials at the very beginning of the process. Be patient otherwise you could sour the talks with the seller!

In terms of the P&L’s there are several items to consider as follows:

- You should be requesting at least 3 years of year-end P&L’s, but, it also is important to look at a YTD P&L for the current year and/or individual P&L’s for the last 12 consecutive months.
- Having a YTD P&L will give you an idea on the performance of the seller through the present day. If you are looking at a YTD P&L through 6-30-16, it’s interesting to get a “feel” how the first part of the year is going. Questions that may come up while reviewing the YTD P&L may include:
    - How are the revenues doing for the first half of the year? What is the straight line extrapolation for the revenues for a full year? In our example, let’s assume revenues are $265,000 for the first 6 months of the year. If we divide the revenues by 6 and multiply by 12, we may get a rough idea of where the present year may end.
- Receiving the last 12 consecutive months (also known as 12 month rolling average) of P&L’s will give the buyer an idea on if there is any seasonality with revenues or expenses. You might incorrectly assume that the seller is having a bad year (6/12 calculation) due to your review of the YTD P&L, but, after reviewing the last 12 consecutive months you may realize several things:
    - The buyer has a few large accounts that renew later in the year.
    - Certain annual expenses are paid in the first part of the year.

  Special Note

  The most ideal comparison is having two sets of consecutive P&L statements. For example, if you receive individual statements for 11-1-15 through 10-31-16, it’s also good to get the individual statements from 11-1-14 through 10-31-15. In this way, you can compare two sets of P&L’s that outline the financial performance of the seller during an equal time period.

As a final thought, it’s also good to 1.) receive carrier statements and 2.) “1099’s” from the carriers to the seller. These two items only further reinforce the accuracy of the commission income for the seller. Multiple sources provide a higher degree of certainity.

“Legal Eagles”

Many buyers as well as sellers have regretted that they didn’t involve a qualified business lawyer during the acquisition process. Even against the advice of many M&A firms, the buyer and/or seller will try to save a dollar by doing the legal agreements themselves. It’s true you might save $1,000 to $2,000 by doing itself, but, are you going to risk $100,000 or more if the transaction goes awry after the closing? Of course not.

There are several primary sets of documents used during the M&A process as follows:

Letter of Intent (LOI) – An LOI is usually a non-binding document that simply outlines the general pricing, terms and parameters of the proposed sale. The LOI is most often generated by the buyer and it doesn’t have to be overly intricate as it’s non-binding. The only part of the LOI that might be binding is the time that the buyer has an “exclusive” period to court the seller. In other words, the buyer will ask that you give them 30-90 days to close on the transaction without the seller talking with other parties.

Many sellers will scoff at a 90 day period, thus, 45-60 days might be more palatable. Many M&A firms will have templates to use for an LOI, so that you don’t have to start from scratch. Having said that, it will be important that your lawyer take a cursory look at the LOI before it is forwarded to the seller.

Purchase Agreement (PA) – The PA will be the overall comprehensive document that spells out the entirety of the sale between the buyer and seller. It will be much more intricate and in-depth than an LOI. As opposed to a 1-2 page LOI, a PA might be up to 20+ pages with addendums and sub-schedules. You do want a business lawyer to generate the document and make changes as the final negotiations proceed. Do not do this one on your own! Otherwise, you can be at serious risk.

Non-Competes (NC) & Employment Agreements (EA) – As a buyer it’s plain to see that you don’t want to hand over a wad of cash to the seller only to have the seller open up shop down the street. Don’t let that happen! Most sellers are honorable, however, it is always recommended to have the seller approve a NC as part of the closing process. Some buyers will state that NC are not valid in “right to work states”. Please keep in mind that you are not preventing the seller from working, however, the buyer will be barred from selling in your area and to your current clients at the time of the purchase. Most buyers will specify a certain mile radius that the seller is excluded for conducting business. In short, insist on a NC and if the seller balks, you may want to walk away from the transaction.

As for EA’s, if the previous owner wants to continue work in the business for a few months to several years, you’ll need to generate an EA. EA’s will typically include provisions such as:

- Duties and required obligations of the previous owner
- Number of hours to work per week
- Salary paid to the previous owner for their continued work in the agency
- Specified time period that that the EA will be in-place
- An end date for the final exit of the previous owner

If you don’t use a good business lawyer, you may overlook a provision that could really cost you. As people are different so are business laws from state-to-state. The money spent on a lawyer will be one of your best investments!

As a recent example, we came across a buyer and seller who didn’t involve a lawyer on either side. From the buyer’s side, they are upset that they don’t have a NC with the seller. The seller’s old clientele is coming to seller to handle their insurance. This is lost money for the buyer and the client commissions are rightly due to the buyer.

On the seller’s side, the exact timing of payments from the buyer were not completely spelled out, thus, the seller is not receiving the agreed upon payments. Both sides are looking to bring a lawsuit against the other. All of this could have been avoided by using lawyers on both sides of the transaction. Don’t end up in this situation.

“Lenders”

Unless you are a large national firm or have a very high net worth, you may need to borrow money for the transaction. Borrowing can be an excellent idea as you can leverage a 10%-20% down payment to bring an excellent return. It’s the principle of Other People’s Money (OPM). Although, at the time of writing this whitepaper interest rates are rising, rates are still reasonable. There are several types of loan rates:

- **Secured Loans (Usually via a SBA Lender)** – 6%-8% per year…up to a 10 year term
- **Unsecured Loans** – These usually come via lenders who are reinvesting money from private equity funds. Rates here are in the 15% range.
- **Private Lending** – You may have the proverbial “rich uncle” or a family member who has excess money burning a hole in their pocket. The interest rates and payment terms between the parties will vary in every example.

In any event, a good amount of agency buyers will be borrowing some type of money. Selecting the right lender for you is of most importance. Over the years, we’ve seen transactions go sideways due to the actions (or lack thereof) of a lender. Some of the pitfalls with lenders include:

- <u>**Timing**</u> **-** Working with a lender that is too busy to pay attention to your loan or they feel your loan is not that important due to the size of the proposed loan. It’s imperative that you talk with the lender about these subjects. What typical loan size do you work with? How long will it be from beginning to end with the lending process?
- <u>**Criteria**</u> **-** You’ll need to understand what minimum criteria the lender will look at when evaluating if they’ll work with you. What is your credit score? Have you had a bankruptcy in the last 10 years? Do you have any outstanding tax liens? Will you have 10%-20% of the selling price as a down payment.
- <u>**Processes**</u> – Is the lender handling the entire lending process in-house or are parts of it being sourced via third parties? The more the lender does in-house the better as the 1.) lender can control the process and 2.) the process will go much faster. Many lenders will sub-contract activities like:
    - SBA legal compliance
    - Compilation and packaging of the final lending paperwork
    - Business valuations
- <u>**Responsiveness**</u> **-** Time is of high importance when doing an acquisition. If there are major delays due to the lender (or other parties), many times the seller will walk. At the beginning of the process when you are seeking to find the right lender, take note of how responsive they are with you. Do they return your emails/calls right away? Do they seem in a hurry when you have them on the phone?
- <u>**Knowledge**</u> – Most industry lenders who specialize in loans for independent insurance agency acquisitions, will have a high degree of knowledge of the lending process. Some items to ask include: How long have they been in the insurance agency marketplace?, How much experience does your loan representative have with regards to commercial lending? Does the representative have significant experience with loans for insurance agencies?
- <u>**Costs**</u> – Take time to know what costs will be involved with working with a particular lender. Also, ask at what stage will the lending costs are to be paid. Obviously, you want to have a fairly high degree of certainty 1.) that the lender will approve your loan and 2.)

that the seller is ready to go forward. Costs of all types can run between $4,000 - $10,000 per transaction.

- **<u>Competition</u>** – It's highly advisable that you talk with more than one lender. By doing this you can check out each lender's rates, payment practices, fees and processes. Likewise by having a backup lender, you'll have a second lender in waiting if the first one bows out. There's nothing more negative than getting a last minute "no" from a lender a week or two before a closing. Both you and the seller will be highly disappointed and frustrated. In fact, many sellers will back out of the transaction due to the bad news.

Pitfalls of working with lenders are one aspect of the lending process. There are things on the borrower's side that can help or hurt the situation. Some examples are below:

- **<u>Honesty</u>** – As with all things in life, if you are honest with people you don't have to worry about the lies you've told. All borrowers may have flaws in regards to past loans or their current financial position. It's best that you be upfront about the good items and bad ones regarding your finances. If a lender catches you in a lie, they will not believe anything you say after that. They may even excuse themselves in working with you altogether. Most lenders are very conservative and will rely heavily on the information you provide them to make a decision. Thus, don't lose their trust at all costs!
- **<u>Responsiveness</u>** – We mentioned this subject above and your responsiveness back to the lender will be of importance as well.
- **<u>Relationship</u>** – As you work with a lender (or multiple lenders), you'll want to groom a friendly but businesslike relationship with the contacts at any particular lender. If the lender likes you, they will be more pliable in how they work with you. On the other hand, if you come across as pushy, abrasive, arrogant or rude, the lender will not go the extra mile. As you mom said, treat others as you'd want to be treated.
- **<u>Timing</u>** – Timing is going to be important to both you and the seller. It's advisable to set conservative expectations of the time to close with the seller upfront. Most lenders will take at least 4 weeks to 12 weeks to close a transaction barring any major holidays (especially Thanksgiving, Christmas and New Year's). It's better to set the timing at the longer end of the range and then come back with a closing that occurs sooner. Lenders (especially SBA lenders) are slow, methodical and can drive you nuts.

We won't go through each and every step of the lending process in this whitepaper as each lender works differently. It's best to start talking with multiple lenders even before you find an agency seller. In this way, 1.) you can tell the prospect you are pre-approved for up to a specified amount and 2.) you can close in a fairly reasonable time. Too often we see buyers who work-out all of the financial details of the transaction with the seller only to start the lending process too late. As with all business transactions the old phrase "Time Kills Deals!" is true today as it was decades ago.

Finally, if you work with experienced lenders, they will walk you through each and every step their lending process. If they don't, you need to dump them right away.

<u>“Negotiations/Closing”</u>

So you’ve been lucky enough to find an insurance agency to acquire and have talked with or met the seller a few times. At this point you will start the conversation regarding pricing, payment terms, employment agreements, “non-competes” and the like. This is where the real work begins and you’ll need to navigate the waters very carefully.

The first step in the negotiation stage is to send a “Letter Of Intent” or LOI. An LOI should be “non-binding (in other words it’s not legally enforceable) and be concise, to the point and no more than two pages. Templates for LOI’s can be found online, from M&A firms as well as other insurance agency owners.

Since an LOI is non-binding, your lawyer doesn’t necessarily be involved unless you really want them to be. Save the money for the Purchase Agreement which needs heavy involvement from a lawyer. In a LOI, the basics that should be included are:

- Names, addresses etc. of the buyer and seller
- Selling price
- Payment terms
- Seller loan details (i.e. interest, term period etc.) if applicable
- Proposed closing date
- An “exclusivity” period of 30-45 days. In other words, once the LOI is mutually approved, the seller is prohibited from talking with other buyers for the TBD time period. In this way, your work doesn’t go to waste via another buyer coming in at the last minute.
- Due diligence requests

Don’t worry if the LOI is not absolutely perfect or comprehensive as its purpose is twofold:

- Show the seller you are serious about going forward and outlining the general details of the transaction.
- Locking the seller in to your firm for a period of time as mentioned above.

At this point, you’ll be sending the LOI to the seller and then wait for their response. If the seller approves the LOI on the first go around, that’s awesome. In reality, the seller will want to make some changes to the LOI before moving forward. The biggest two points to be negotiated are pricing and payment terms.

If you are reasonably close to the pricing and payment terms the buyer has in mind, the changes might be minor. If the pricing and payment terms are far apart from the seller’s desire, your LOI might be dead in the water. During the initial calls/meetings with the seller, general pricing, payment terms and a proposed timeline will usually come up.

Most sellers do not deviate significantly from the multiple aspects of the proposed sale. As an example, if the buyer proposes a selling price of $500,000 with 50% at closing while the seller is seeking $750,000 with 80% at closing, you might be in trouble. There are rare cases when the buyer is far apart from the seller and the seller may end negotiations altogether.

After the LOI is mutually approved, many of the actions/requests below will occur:

- Collection of financial and carrier due diligence
- Collection of employment and “non-compete” agreements
- Leases of office space if applicable
- Contracts the seller has with their carriers
- The buyer will need to have time to work through the many steps that a lender may have. Lenders can be very frustrating to work with, thus, be patient and reinforce to the seller patience is the best course.
- Creation of the final purchase agreements and any addendums
- Selection of an escrow agent (if applicable)
- Determine exact time and place of the closing
- Review of the final purchase agreements by the buyer’s and seller’s lawyers. Make sure your lawyer is not heading off to Tahiti for a 3 week vacation right before you want to close!
- Interviews of the seller’s employees if the buyer will allow it. They may not want to tip off their employees about a pending sale. From the buyer’s perspective, interviewing the employees will give you a more subjective “vibe” about the performance of the agency.
- The actual closing

If either the buyer or seller creates a large delay in moving forward between the acceptance of the LOI and closing, someone may become snooty and call off the transaction. Thus, act with speed and urgency with requests from the other party. Don’t let a delay muddy your transaction.

“Final Thoughts”

After the closing, you will be focused on a million details with the transition of the newly acquired agency. Various “to dos” will include:

- Transfer of accounting and agency management systems
- Changes of “Agent of Record” by the carriers
- Possible reductions in the office staff
- Transfer of leases to the new owner
- Access to the seller’s website
- Change of bank accounts (usually the seller will keep their old accounts). You want the commissions to come to your account. Right?
- Visits to larger clients of the newly acquired agency

The acquisition process usually lasts about 6 months from beginning to end. Over the years, we have seen the process go as little as one week and in a few instances 2.5 years. The point here is the buyer and seller 1.) need to be realistic in the timetable and 2.) be patient.

Hopefully the transition with the seller goes well and brings more profits to your firm. Most of the time, the transition goes well, however, a rare negative case may pop up.

In the end, we wish you a successful trip through the M&A process and its desired results!