How Much Is Your Agency Worth?

BY **MIKE BRADY**

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Many insurance agency owners have long relied on an old formula for determining the value of their business.

"I don't need a valuation," one owner told me, "I know how it works. Everyone gets a multiple between one and two times revenue." Interestingly, the following year that owner was surprised when a prospective buyer started looking at his company and things got more complicated.

The first problem with the "one to two formula" is that it's both true and false. Many transactions do end up valuing out at 1 to 2 times revenue. Depending on the size of your firm, that can be a very big range. Consider the difference between one and two times revenue for a $1 million agency. The difference is a million dollars!

So you need to ask yourself: Is getting more of the second million that you *might* have gotten worth a little time and money? Is your goal simply to get out--or to get out with as much money in your pocket as possible?

The second problem with the "one to two formula" is that using such a formula doesn't mean that your business was fairly valued. Buyers are generally pretty sophisticated today and will want to consider a variety of factors besides revenue. As a result, using a more sophisticated method can protect you, if you're smart.

Here's an example. An owner, 62, has an agency with a $2 million book of business. The owner wanted to sell and thought a multiple of revenue of 1.5 or higher would produce a sale price of $3 million to $3.5 million for the agency. He hadn't done any prior homework or planning for this exit strategy. The transaction ended up closing for $2 million.

What accounted for the lower value? Several very important factors played a role:

- Two accounts made up 40 percent of the book, and one of those large accounts was a long-time friend of the owner with no loyalty to the acquiring agency;
- The owner was not willing to stay involved going forward;
- The agency's other top producer did not have an employment contract;
- Fifty percent of the book was with one carrier.

While it would be natural for the owner to feel disappointed or that he had been outflanked by a savvy buyer, perhaps the reality is different. Had the owner done more due diligence and gotten a thorough valuation, each of those costly--and very fixable--vulnerabilities would likely have come to light and been remedied before the selling process even began. In effect, his attempt to take an easier path cost him as much as a million and a half dollars.

This kind of mistake is much more common than most agency owners realize. We've seen it again and again. Unfortunately, there is no way to fix it later--or even during the selling process. What's done is done.

What's the alternative?

The smartest path is for owners to really know the value of their agency. Valuations are not just for transaction purposes. They identify risks and vulnerabilities while you still have plenty of time to address them. And they can educate owners so they are as savvy and prepared as the buyers who will be combing their books. The old saying is still true: It's never too early to plan ahead. And it's never too early to begin to build toward an exit strategy that maximizes your take-away.

Even though your agency is likely the largest asset you own, most owners spend little if any time understanding what their agency is worth and how to increase the value. Identifying areas that need to be addressed is good business *and* good for your sale price. After all, you probably spend most of your day identifying areas of risk that your clients should consider addressing, why not do the same for your business?

What are the payoffs of a valuation?

Agency owners with a well-prepared and current valuation understand two things very clearly: 1) the real value of their agency; and 2) exactly where they can maximize that value when the change of ownership takes place.

In addition, valuations can play a role in planning and growth. Having a current valuation is not only a good tool for strategic planning (such as succession and continuity), but can also be used to help secure financing quickly for unexpected opportunities, such as to acquire talent or assets. It's quite common for a valuation to speed up financing by allowing your bank's underwriters to quickly understand and verify the value of the agency. This speed can provide a first-mover advantage over competitors who are not prepared.

A skilled and thorough agency valuation can also assist you in both planning and growing your agency. This planning can be leveraged in increasing both the present and future value of your agency.

Valuing Your Agency

Key factors to include when valuing your insurance agency

- Age and employment status of key employees, especially producers
- Dependency on large accounts
- Dependency on a certain industry
- Age, business life cycle of clients
- Receivable issues
- Quality of insurance markets
- Overreliance on certain insurance markets
- Historical profitability of clients for insurance markets
- Agency location, number of offices
- Employee quality and productivity
- Technology platform, age of technology
- Sales management
- Brand and reputation
- Cash/asset management
- Office facility
- Historical growth rate

How can you leverage your value?

A thorough agency valuation, updated every few years, provides the proper foundation for planning, growth and the eventual sale of the agency--all good reasons for getting around to it now.

Because there are far better methods of valuing an agency today than using the old multiple of revenue rule, we are convinced that considering multiple factors beyond just the book of business dollar value (see above) will provide a far more accurate value and a larger reward for the agency owner who has built their business over many years.

Keep in mind that a solid valuation can not only increase your options and a potential payout when you sell, it can also save you money, especially in taxes.

Once the valuation is completed, that value should play a central role in the owner's corporate perpetuation and personal estate planning, and your advisers can put it to good use to minimize taxes. To ignore what is likely your largest asset makes little sense, yet many owners do just that. The tangible impact of not incorporating this planning into your agency will be largely felt when you exit the business, usually at the time when you can least afford it.

Owners who take the time to not only accurately determine the value of their agency today, and who do all they can to increase that value, are the smart owners who maximize that value.

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