



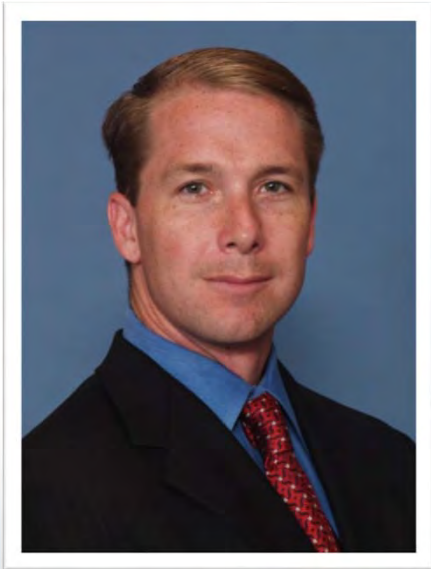
# VALUATION

## Insurance Distribution Company M&A Valuations presented by Chris Hughes | Merger & Acquisition Services

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# Chris Hughes | Merger & Acquisition Services



- Managing Director of Insurance Distribution for Merger & Acquisition Services, specializing on insurance agencies, MGAs, MGUs, E&S
- Over 10 years of insurance and legal experience
- Served as an advisor for a boutique firm in CT where his exclusive focus was on insurance distribution companies
- Spent 7 years as a senior product manager for Hartford Financial Services Group (“HIG”) with full P&L accountability for specialty products, and as director of HIG’s internal retained asset and structured settlement departments
- Practiced commercial litigation in Boca Raton, Florida
- Mr. Hughes was honorably discharged from active duty in the United States Marine Corps (USMC) in 1992
- Earned a J.D. degree from Northern Illinois University, a M.B.A. from the University of Connecticut, and a B.A. from the University of West Florida.



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## Insurance Distribution Firm Valuation

### Course Objectives

- Valuation Methodology
- Overview of the Pro-Forma Income Statement
- Current Market Environment
- Deal Structures- Components and Examples
- Asset Vs. Stock Sale

## The Pro-Forma Income Statement

### What is a Pro-Forma Income Statement?

- The Income Statement reflects the earnings of the firm.
- Pro-Forma adjustments show the normalized earnings.
- Valuing the firm is primarily based upon Pro-Forma EBITDA.

### Key Terms

- Pro-Forma – Normalized financial statements.
- EBITDA – Earnings Before Interest, Taxes, Depreciation, Amortization.



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## **The Pro-Forma Income Statement**

### **Begin with most recent Income Statement and adjust:**

- Owner Salary and corresponding expenses
- Excess/Redundant Staffing
- Extraordinary and/or Non-recurring Income
- Extraordinary and/or Non-recurring Expenses
- Personal Expenses
- Depreciation & Interest
- Taxes

**Goal : To derive an income statement that illustrates the Pro-Forma EBITDA of the entity.**

Income Statement (000s)	2015	Adjustments	Pro-Foma	Notes
<b>REVENUES</b>				
Commission & Fees	\$5,350	\$0	\$5,350	
Contingent & Bonus	\$425	\$0	\$425	
Interest Income	<u>\$75</u>	<u>(\$75)</u>	<u>\$0</u>	<b>A</b>
<b>TOTAL REVENUES</b>	<b>\$5,850</b>	<b>(\$75)</b>	<b>\$5,775</b>	
<b>EXPENSES</b>				
<b>Compensation</b>				
Owner's Compensation	\$400	(\$200)	\$200	<b>B</b>
Compensation	\$1,290	(\$125)	\$1,165	<b>C</b>
Employee Benefits	\$104	(\$20)	\$84	<b>D</b>
Payroll Taxes	<u>\$70</u>	<u>(\$13)</u>	<u>\$57</u>	<b>E</b>
<b>Total Compensation</b>	<b>\$1,864</b>	<b>(\$358)</b>	<b>\$1,506</b>	
<b>Selling</b>				
Commission Expense	\$175	\$0	\$175	
Travel & Entertainment	\$195	(\$95)	\$100	<b>F</b>
Automobile	\$105	(\$75)	\$30	<b>G</b>
Advertising/Marketing	<u>\$150</u>	<u>\$0</u>	<u>\$150</u>	
<b>Total Selling</b>	<b>\$625</b>	<b>(\$170)</b>	<b>\$455</b>	
<b>Operating</b>	<b>\$1,675</b>	<b>(\$45)</b>	<b>\$1,630</b>	<b>H</b>
<b>Non-Operating</b>				
Amortization	\$200	(\$200)	\$0	<b>I</b>
Depreciation	\$55	(\$55)	\$0	<b>I</b>
Interest	<u>\$32</u>	<u>(\$32)</u>	<u>\$0</u>	<b>I</b>
<b>Total Non-Operating</b>	<b>\$287</b>	<b>(\$287)</b>	<b>\$0</b>	
<b>TOTAL EXPENSES</b>	<b>\$4,164</b>	<b>(\$573)</b>	<b>\$3,591</b>	
<b>EBITDA</b>	<b>\$1,686</b>	<b>\$498</b>	<b>\$2,184</b>	<b>37.3%</b>

## Income Statement Recast Notes

- A. Adjust out non-operating interest income
- B. Normalize Owner's Compensation to Market Salary
- C. Adjust out excess spouse compensation
- D. Normalize Employee Benefits reflecting B & C above
- E. Normalize Payroll taxes from Owner/Excess Comp
- F. Adjust Country Club and Personal Travel
- G. Adjust Family Car and Boat Expenses
- H. Adjust Excess Rent paid to Owner
- I. Adjust out all Non-Operating Expenses (Acquisition Amort)



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## Current Independent Agency Valuation Multiples

<b>Agency Revenue</b>	<b>Multiple of EBITDA</b>
Less than \$2MM	7 - 8X
\$2MM - \$10MM	8 - 10X
Greater than \$10MM	10-13X





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## Valuation Range Example

Multiple of EBITDA	EBITDA	Valuation	Revenue	Multiple of Revenue
8.00	\$2,184	\$17,472	\$5,775	3.03
8.25	\$2,184	\$18,018	\$5,775	3.12
8.50	\$2,184	\$18,564	\$5,775	3.21



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## Valuation Drivers

1. Growth (Organic & M&A)
2. Profitability
3. Client Concentration & Nature of Relationships
4. Size and Scale of Operations
5. Mix of business
6. Retention Ratios & Loss Ratios
7. Management – Key Personnel/Producers
8. Services or Products (niches being more desirable)
9. Systemization (internal systems)
10. Contracts (Non-competes, Carriers)



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## Private Equity's Market Influence

- The valuations for insurance distribution firms are, and have been, at an unprecedented peak over the past two years, and the outlook remains strong.
- Currently the market is priced at a **50% premium to normal market conditions.**
- The driver of this valuation premium is private equity new buyers using low interest rate debt to fuel acquisitions.
- Private equity groups and publicly traded brokers have created an expensive and competitive landscape for insurance distribution assets over the past 2 to 3 years.
- While valuations have leveled off – there is no indication of lower valuations in the short term.



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## 2015 Broker Deals

Buyer	# of Deals	% of Total	Type	Private Equity Sponsor
Acrisure, LLC	41	9%	Private Equity	Genstar Capital LLC
Hub International Limited	34	8%	Private Equity	Hellman & Friedman LLC
Assured Partners, Inc.	29	6%	Private Equity	Apax Partners LLP
Broad Street Partners, Inc.	22	5%	Private Equity	Ontario Teachers' Pension Plan
Arthur J. Gallagher & Co.	19	4%	Public	N/A
Confie Seguros California, Inc.	13	3%	Private Equity	ABRY Partners
NFP Corp.	12	3%	Private Equity	Madison Dearborn Partners
Brown & Brown, Inc.	9	2%	Public	N/A
Hilb Group, LLC	8	2%	Private Equity	ABRY Partners
Alliant Insurance Services, Inc.	7	2%	Private Equity	Kohlberg Kravis Roberts & Co. LP.
Marsh & McLennan Companies, Inc.	7	2%	Public	N/A
Patriot National, Inc.	7	2%	Public	N/A
Integro Ltd.	6	1%	Private Equity	Odyssey Investment Partners, LLC
USI, Inc.	6	1%	Private Equity	Onex Corp.
RSC Insurance Brokerage, Inc.	5	1%	Private Equity	Kohlberg & Co. LLC
All Other Transactions	223	50%	-	-
<b>Total</b>	<b>448</b>	<b>100%</b>	-	-



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## Significant Trading Valuations

### Public Insurance Brokers Enterprise Valuations (\$MM)

Company	Enterprise Value	TTM Revenue	TTM EBITDA	EV/Revenue	EV/EBITDA	EBITDA Margin	
Brown & Brown, Inc.	\$ 5,566	\$ 1,660	\$ 549	3.29	9.94	33%	
Willis Towers Watson Public Limited	\$ 10,290	\$ 3,810	\$ 858	2.88	12.76	23%	
Aon Corp	\$ 32,500	\$ 11,660	\$ 2,550	2.75	12.59	22%	
Arthur J. Gallagher	\$ 9,580	\$ 5,300	\$ 812	1.81	11.8	15%	
Marsh & McLennan	\$ 33,750	\$ 12,890	\$ 2,840	2.62	11.88	22%	
Source: Yahoo! Finance (as of 3/17/2016)				<b>Average</b>	<b>2.67</b>	<b>11.79</b>	<b>23%</b>

## Industry Acquisitions 2012-2015 (\$MM)

Announcement Date	Acquirer	Target	Price	Price/Revenue
5/1/12	Brown & Brown, Inc.	InsurCorp	\$ 33	6.68X
2/24/14	Brown & Brown, Inc.	Pacific Resource Benefits Advisors	125	5.51X
3/1/15	Brown & Brown, Inc.	Spain Agency, Inc.	30	4.59X
5/21/13	Brown & Brown, Inc.	Beecher Carlson Holdings	360	4.26X
9/1/12	Brown & Brown, Inc.	Texas Security General Insurance Agency	24	4.12X
5/19/14	Arthur J. Gallagher & Co.	Noraxis Capital Corporation	436	4.00X
2/1/15	Brown & Brown, Inc.	Liberty Insurance Brokers	16	3.94X
5/1/12	Brown & Brown, Inc.	Richard W. Endlar Insurance Agency	16	3.55X
6/1/13	Brown & Brown, Inc.	Rollins Agency	18	3.30X
12/1/12	Brown & Brown, Inc.	Rowlands & Barranca Agency	13	3.19X
12/6/12	Brown & Brown, Inc.	Benhke & Associates	13	3.13X
4/9/14	BancorpSouth, Inc.	Knox Insurance Group	9	3.13X
12/18/13	BancorpSouth, Inc.	Gem Insurance Agencies	27	2.99X
5/1/13	CBIZ, Inc.	Associated Insurance Agents	9	2.45X
2/1/12	Evercore Partners Inc.	Creative Agency Group	24	2.37X
12/31/12	Fidelity National Financial, Inc.	Digital Insurance	101	2.03X
7/17/13	Health Insurance Innovations, Inc.	Sunrise Health Plans	19	1.94X
2/3/12	BB&T Corporation	Crump Insurance Services	570	1.90X
9/20/13	Jardine Lloyd Thompson Group	Reinsurance brokerage business	250	1.51X
1/1/12	Associated Insurance Centers Inc.	First United Insurance Group	4	1.50X
3/31/15	Pathfinder Bancorp, Inc.	Huntington Agency	0	1.50X
4/15/13	Madison Dear Borrn Partners, LLC	National Financial Partners	1284	1.2X
4/1/12	Goldman Sachs Group, Inc.	BBVA Compass Insurance Agency	29	1.10X
1/2/13	Peoples Bancorp Inc.	Commercial Insurance accounts	2	0.94X
8/12/14	Tiptree Financial Inc.	Fortegra Financial Corporation	209	0.58X
7/31/14	Landenburg Thalmann Inc.	HCGC Holdings	12	0.26X

Mean 1: 2.76X

Mean 2: 2.90X



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## Components of Deal Structures

Deal structure can take many forms, but below are the most common structures and components:

- Upfront Payment (Cash & Equivalents)
- Upfront Component with an Earn-Out
- Upfront Component with a Promissory Note
- Employment/Producer Agreements
- Non-compete Agreements



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## Firm Offers Example

<b>Insurance Distribution Firm</b> <b>\$5,775,000 in Revenue</b> <b>\$2,184,000 in Pro-Forma EBITDA</b>			
<b>(\$ in 000s)</b>	<b>Offer 1</b>	<b>Offer 2</b>	<b>Offer 3</b>
Cash at Closing	\$ 15,000	\$ 15,000	\$ 14,000
Earn Out			
Year 1	\$ -	\$ 500	\$ -
Year 2	\$ -	\$ 500	\$ 4,800
Year 3	\$ 5,000	\$ 500	\$ -
Year 4	\$ -	\$ 500	\$ -
Year 5	\$ -	\$ 500	\$ -
<b>Total Consideration</b>	<b>\$ 20,000</b>	<b>\$ 17,500</b>	<b>\$ 18,800</b>
Multiple of Revenue	3.46	3.03	3.26
Multiple of EBITDA	9.16	8.01	8.61



## Earn-Out Factors

### Offer 1

- Earn Out is Paid at end of 3<sup>rd</sup> year.
- Earn-Out is paid if Revenue meets 10% CAGR (Compounded Annual Growth Rate).

### Offer 2

- All Earn-Out payments guaranteed in Promissory Note.

### Offer 3

- Earn-Out Payment is average of future 2 years of EBITDA multiple less Cash at Closing amount.
- Assumes 5% EBITDA Growth each year.



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## **Asset Sale vs. Stock Sale**

### **Most insurance agencies are sold as Asset Sales**

- Buyer has a stepped up basis in assets to depreciate over 15 years;
- Liabilities do not transfer to the Buyer, unless specifically provided for;
- Seller maintains corporate existence;
- Specific assets and/or liabilities may be retained.

### **Stock Sales**

- Generally, all obligations are transferred (unknown contingent liabilities);
- No step up in basis (lower value to the buyer, and lower price to the seller);

### **IRC Sec. 338(h)**

- Allows for a stock sale to be treated as a sale of assets for tax purposes.



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## Tax Implications – C Corp vs. S Corp/LLC Asset Sale

C Corps shareholders are “double taxed” resulting in a significant tax. Shareholders may elect S Corp status – but look back period is 10 years.

Insurance Firm Asset Sale (000s)	C Corp	S Corp / LLC
Cash at Closing	\$ 15,000	\$ 15,000
Basis	\$ 500	\$ 500
Corpotate Tax @ 39%	\$ 5,655	\$ -
Distributions to Shareholders	\$ 9,345	\$ 15,000
Capital Gains Tax @ 22%	\$ 2,056	\$ 3,300
After Tax Cash Available	\$ 7,289	\$ 11,700
	<b>Difference</b>	<b>\$ 4,411</b>



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# Thank You for Your Attention!

## Questions?

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