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SPECIAL FOCUS ON AGENCY MANAGEMENT PAGE 10

The "Regenerative" Nature of Independent Agencies Attractive to M&A Buyers

Agency M&A Requires Preparing in Advance, Says SIAA's Masiello

CONCORD, N.H. — After years of being told that independent insurance agents were on the verge of extinction, the channel is looking stronger than ever. It continues to garner interest from private equity firms and other organizations — including other agencies — in the merger and acquisitions (M&A) space, and some large national carriers have added independent agents to take a multichannel approach. Matt Masiello, CEO of SIAA, talked to the New Hampshire Insurance Marketing Association (NHIMA) about the M&A market and what agencies can be doing today to prepare for a potential sale in the future.

"There's a supply and demand battle going on in the M&A industry right now relative to insurance because it is such a great industry," said Masiello. "The independent agency channel is going through an amazing transition. What we're seeing is these regenerative characteristics in the independent agency channel in the number of new agencies that are coming on board and the melding of the direct, exclusive and independent agency channels."

SIAA CEO Matt Masiello (center) with New Hampshire Insurance Marketing Association board members Lori Sherman of New England Indemnity Company, Marielle Grenier of the Cincinatti Insurance Companies, Jason Becht of the Hanover Insurance Group, and Robyn Palardis of Patriot Insurance Company.

SIAA has helped open 2,000 independent agencies in the last five years, according to Masiello. "That's just within our own ecosystem where we know the people, the entities and the agencies that join, but it shows the regenerative properties and the opportunities that we all have."

In talking to NHIMA's carrier marketing representatives, Masiello urged them not to discount startup agencies. In SIAA's tracking of startup agencies in cohort groups that joined SIAA in 2017, which was a standout group, the agencies increased the new business they wrote from $26 million in 2017 to over $200 million five years later. "That class of 2017 are the next acquisitions five, 10 or 15 years down the road. So we're not only creating this regenerative opportunity within the independent agency

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channel of these new agencies coming onboard, we're feeding the future M&A pipeline across the industry."

The Types of Buyers

There are various types of buyers looking to acquire independent agencies, including strategic acquirers, financial investors and peer-to-peer.

Strategic acquirers are organizations that already have assets in the insurance industry. By purchasing an agency, they are looking to pick up synergies, according to Masiello. He explained that strategic acquirers want to grow their margin and EBITDA (earnings before interest, taxes, depreciation and amortization).

"Their goal is to buy an insurance agency, efficiently integrate it into their agency — their books of business, their operations — move the accounts into their service teams, maybe assign large accounts to specific producers, combine the management system and maybe combine facilities," said Masiello. Strategic acquirers may be independent or backed by private equity firms.

The second type of buyer, financial investors, tend to be private equity focused. They are seeking to put capital into a business to help it grow — not necessarily buying it to integrate it into what they already have. For example, if an agency is growing at 10%, they want to see it grow at 15% or 20%. Financial investors typically keep the agency leadership in place, but their goal is to "supercharge" the business. One way that they do that is by "professionalizing" the leadership team.

"It's not that somebody ran an agency badly — they're just looking to do it differently." Masiello said his family-owned business went through this process when they sold to a private equity company. "They professionalized the business by bringing in people from around the country with different skills, traits and capabilities. In our scenario, even people from outside the industry came in."

Financial investors often focus on younger sellers, according to Masiello. It could be a principal looking for more capital who is willing to sell 70%, 80% or even 90% of the agency while keeping some ownership. Financial investors want to grow both organically and inorganically (through acquisitions) and then sell again in the future.

Lastly, there are peer-to-peer acquisitions, where one agency buys another. "We love that because it keeps the agencies local and keeps the leadership in the state," said Masiello.

Heading to Market

Before heading to market, agency principals need to decide what they want to do in the future. Leave the agency? Retire? Remain with the agency? Masiello noted that when one agency sells to another, the principal is often asked to continue working there for a year or two to focus on key client retention.

If selling to a private equity firm or a financial investor, principals are often asked to remain at the agency for a minimum of five years to grow the value of the agency.

"There are two types of independent agency owners: the ones who say, 'If I sell,' and those that say, 'When I sell.' When you're a private equity owned business, it's when you sell because that is their business model — build a business, sell it, capitalize it and then do it all over again," said Masiello.

It should be noted that deciding to sell an agency should not be a quick decision. In Masiello's opinion, principals should start working to sell an agency no less than two years in advance of going to market. He said the best advice he has ever been given is, "Run your business like it is for sale, even if it's not."

Preparing to Sell an Agency

When preparing to sell an agency, principals need to concentrate on three key areas — people, technology and retention.

The People: From a personnel standpoint, buyers are looking for stable agencies with employees who are going to be helpful during a transition whether they are staying with the agency or leaving. Buyers are not attracted to agencies with high turnover rates.

"When doing an acquisition, we want to see an employee handbook that covers the basics and protects confidential information and personally identifiable information (PII)," said Masiello.

Although there has been volatility regarding noncompete efforts at the federal and state levels, agencies should be protecting their trade secrets in a reasonable and enforceable way. "We're not looking to prevent people from working at other places. We're simply trying to protect intellectual property, trade secrets, PII, etc.," said Masiello.

The Technology: Agencies need to utilize as much of their agency management systems (AMS) as possible. Masiello said he is frequently asked which AMS system is the best; his answer is, "The one you use." He encouraged everyone to join AMS user groups to understand their full capabilities.

Agencies should have modern tech stacks — a collection of technology solutions — in addition to an AMS. They should include a VoIP (Voice over Internet Protocol) and a customer relationship management system at the very least.

In addition to getting the most out of AMS, agencies should be using policy downloads. "Download is paramount in an agency because when someone comes in to do due diligence, they want to know that the information is right there," said Masiello.

Retention: A perennial problem area for agencies is finding and retaining talent. "Talent acquisition is the hardest thing to do in this industry, so acquirers are looking for that talent. If I'm a seller, having good talent is a big deal."

Client retention is equally as important to buyers as sellers. "If somebody has poor retention, it's going to lower the value and the multiple for the agency," said Masiello.

Craig Sargent, president of the North

American Insurance Alliance, who was unable to attend the NHIMA meeting, suggested that agencies going to market should analyze their carrier retention levels and the number of policies in force with each one.

The Sales Process

Principals looking to sell their agencies should not wait too long to build the team of professionals they will need around them, such as attorneys, accountants and appraisers to value the agency. Masiello cautioned against getting a letter of interest before hiring an attorney or accountant. In the years leading up to a potential sale, consultants who specialize in M&A can help principals determine the business structure, tax liabilities and whether the agency should be in a trust.

As can be the case for many small, family-run businesses, if principals are paying nonworking family members, they should put an end to that practice. Leasing a car in the name of an agency if planning to sell the agency before the lease is up should be avoided as well. "Remember, run your business like you're going to sell it. Get things like this cleaned up."

Masiello is of the mindset that if principals plan to go to market with their agency, they should inform their employees as early in the process as feasible to get them onboard in understanding the potential benefits.

Space for Small Hometown Agencies?

When asked by a NHIMA member if there will still be room for a small hometown independent insurance agency in the next five or 10 years, given all of the players now involved in the industry, Masiello's answer was 1,000% yes.

"When agencies are sold, some producers leave to start their own agencies. And we continue to see the shift of the captive and exclusive channel [to include or be fully transitioned to] the independent agency channel, so that regenerative process is still there," said Masiello.

Additionally, some acquisition aggregators will handle agency operations differently after they purchase an agency. If an agency writes a lot of personal lines and small commercial, the aggregator may shift the small commercial to a service or call center. "Not every customer or small-business owner wants to be handled like that. So that's a great place for a small agency to get business as a startup," said Masiello.

Generally, it takes approximately three years for an agency to get up and running. When they first start, principals will most likely need another source of income, such as spousal income, or significant savings because it can take between 30 and 90 days to get a commission.

"I think you'll see more startups in the next couple of years, but [principals] need to get to their third renewal cycle [to become viable]. The point at which service eclipses sales is when they will start to struggle. That's the point where they need to be hiring staff or using service centers and virtual assistants, so they can continue to sell as well," said Masiello. ■