

CounterPoint

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The Value. Equation

If growth is your plan,
it's time to get to the
foundation of what
actually drives value.

- The Value of **TRADING DOWN** Small Accounts
- Platform Agencies Generating **BETTER RETURNS**
- Average **ACCOUNT SIZE**

AUGUST | 2016



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*Merger & Acquisition Announced Transactions in Insurance Brokerage (1999-2015); Ranked by Total Number of Deals

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August Spotlight

Happy Little Trees

Complex concepts to simple steps.

Growing organically can be an extreme challenge in the coming cycle.

The premium rate environment, regulatory uncertainty, sweeping changes in employee benefits and the limping economy present many cascading obstacles for insurance agencies. Peak performers, however, refuse to accept the external environment as an excuse for success or failure.

Those leading organic growth have accepted one critical truth: success is defined by “achieving results regardless of the cycle.” And the mantra of this esteemed group of high performing brethren is “predictable, profitable, organic growth.” These organic growth leaders have executed a plan to drive results in good times and in bad. And they are doing so by implementing a process to become a value creation advisor.

Learn more about implementing a culture of change by downloading our **CounterPoint** supplement, *Happy Little Trees, Complex concepts to simple steps*, online at www.MarshBerry.com/trees.



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CONTRIBUTING AUTHORS

MEGAN BOSMA,
Senior Vice President

DUSTIN GIOVANELLI,
Consultant

ERIC HALLINAN,
Vice President

ZACK PITTMAN,
Sales Performance Consultant

BRAD UNGER,
Vice President



The Value. Equation

by *Eric Hallinan*,
Vice President

949.234.9652

Eric.Hallinan@MarshBerry.com

If growth is
your plan, it's
time to get to
the foundation
of what *actually*
drives value.



Is growth on your agenda? In the next five years, do you envision running an agency that's double the size of what you're operating today? Do you want a business that will fund your retirement—that you can sell at a premium come time for transition? Do you hope to build a legacy that will perpetuate?

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If you answered yes to any of these questions, then now is the time to **focus on what matters** to increase the value of your agency.

**Value—what does it mean to your firm?
How can you achieve your growth goals and maximize what your agency is worth?**

One definition of value—a very basic equation—is the sum of the benefit stream divided by the required rate of return. To us, the benefit stream is simply expected cash flow, often using EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) as a proxy. The required rate of return is the calculation of risk associated with the benefit stream. In practice, this equation is often referred to as a multiple of EBITDA.

Ultimately, value is **what an able buyer is willing to pay**, and that depends on what they see in the organization.

In our experience, certain factors may have more influence than others on the perception of value including: significant growth; a strong employee base with diversity in age; consistent profitability; and a history of reinvestment to fund growth.

There is no secret sauce to stirring up more value in your agency. But, those key ingredients are important for building up the benefit stream and reducing the perception of risk. A detailed action plan that focuses on sales and profitability can help you realize the value you want.

Now, let's address how you build these areas of your business that really matter so you may potentially realize greater value today and in the future, whether your ultimate goal is to sell or perpetuate.

Producing Value

New business is critical for growth. When agencies merely ride on renewals, they get stagnant.

Without new business, an agency will actually shrink due to leakage (softening rates, reduced exposure base, and lost business). We know that agencies can survive on renewals, but they don't grow—they maintain a lifestyle business that's merely status quo.

If you want to grow, you should continue to feed the sales pipeline with new business.

To do this, you must hire and develop producers, then give them the support they need to succeed. If salespeople are saddled with too much "service work," they'll be too burdened by paper to hunt for new business. They'll also get frustrated, given that service work does not come with a commission attached to it. As capacity grows, agencies should acquire solid service people to complement their producer teams.



"Here we have the calculations for this quarter's EBITDA."

Source: CartoonStock.com

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Hiring and developing new salespeople requires ongoing recruiting efforts since we know that there will likely be a failure rate among new producers. This failure rate will decrease with improved recruiting efforts (getting the right people on the bus) and improved training and mentoring. We believe that an agency that wants to grow should have a system for grooming producers and helping them succeed.

Ultimately, agencies are sales organizations. If you want to double in size within five years, you must have 15% revenue growth per year. One thing that will help get you there are strong producers who generate new business.

Securing Profitability

You can continue renewing clients and signing new business, but if you're not tuned into the expense side of the business, you could be pedaling fast and getting nowhere.

New business is fine. Profitable new business fuels growth because dollars can be reinvested into the firm. You need a

healthy profit so you can focus on producer development, improving systems (and technology), building a solid support staff and recruiting talent.

Our experience suggests that a growing agency should **aim for 20%-25% EBITDA.**

Expenses chip away at profit, so it's important to take a hard look at the finances and approach expenditures with discipline. Review producer compensation. How much are you paying for your facility and utilities? What do your insurance and benefit costs look like, and could you shop those? What about travel and entertainment? Be intentional in the way you spend.

Planning for Growth

It's one thing to shoot for a goal—say, "We'll grow 15% each year." Great. How?

We believe that every agency with a mind to grow should develop a five-year plan that can act as a detailed map to get the organization from its position today to where you want the firm to be in the future.

Begin by assessing where you stand today, financially. Review the book of business and employees. Sit down and create an organizational chart—put pen to paper. Outline expenses for each line of business and figure out exactly how many people you'll need to hire to achieve your growth goals.

Create an "ideal" organizational chart and compare that with today's. Do you need one new producer to double in size?

(Then, plan to hire two or more.) Will you need service people to support producers? What will that cost?

Outline budgets for years one, two, three and so on. Write down goals and attach each with an action plan. Break down large goals into steps that can be realistically achieved. As you go through this planning process, constantly ask the question, "How?"

Take time to reflect on where the business is today and what resources are required to fuel growth. Again, approach the process with intention. So many agencies live in the moment. They make snap decisions. While they might produce new business, they'll likely end up spending more time and resources than necessary putting out fires. That sacrifices profit. It's a vicious cycle that we believe can be stopped with intentional planning.

When we look at building value, perhaps the toughest thing about it, is that there are no shortcuts.

Also, there are no surprises, because at the end of the day, the two same factors impact an agency's value: the sum of your benefit stream divided by the required rate of return (or risk rate).

What are you doing today to increase your benefit stream? What risks are holding you back? Hone in on what matters, what drives value. Because value can be a choice. Your agency does not need to be the victim of market cycles and economic riptides.

When you focus on creating value and growing a premium agency, based on our experience then, your firm will be strong enough to not just weather the storms, but to thrive in any environment. ■

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METRIC OF THE MONTH

Average Account Size

Average account size quantifies the average dollars an agency receives per customer: total commissions and fees divided by number of clients. Improving this ratio can be a game-changer when it comes to enhancing agency value.

Producers often find themselves bogged down by a large number of small accounts demanding a bulk of their time and attention.

Agencies that monitor account size, and regularly practice transitioning the bottom portion of their producers' books to a small business unit, free up valuable producer time to hunt for bigger fish. The chart to the right displays the positive correlation between trading down small accounts and book growth.

Ultimately, an agency that grows its average account size should see returns in the form of increased capacity to write new business and a growing, more profitable client base. ■

VALUE CHECKLISTS

Improve Your Benefit Stream

- ✓ Drive more new business
- ✓ Round out existing accounts
- ✓ Increase average account size
- ✓ Hire and develop new producers
- ✓ Create efficiency with technology
- ✓ Optimized workflows
- ✓ Scrutinize expenses
- ✓ Pay off debts

Reduce Risk in your Business

- ✓ Create a history of profitability
- ✓ Continue to hire and develop young people
- ✓ Broaden ownership
- ✓ Evaluate restrictive covenants in producer contracts
- ✓ Work to eliminate concentration risks among accounts, carriers, employees, and producers
- ✓ Broaden client relationships with account managers and other team members

Source: MarshBerry opinion and experience. The above lists are not exhaustive and are for discussion purposes only. Individual results may vary.



Register Today!

MarshBerry's 2017 Peak Performance event is set for January 29-31, 2017, at the Hyatt Centric Park City.

MarshBerry's Peak Performance event is the preeminent event for specialty distributors and specialty carriers in the insurance space. This intimate networking opportunity allows executives to learn and improve their business while enjoying the slopes of Park City, Utah.

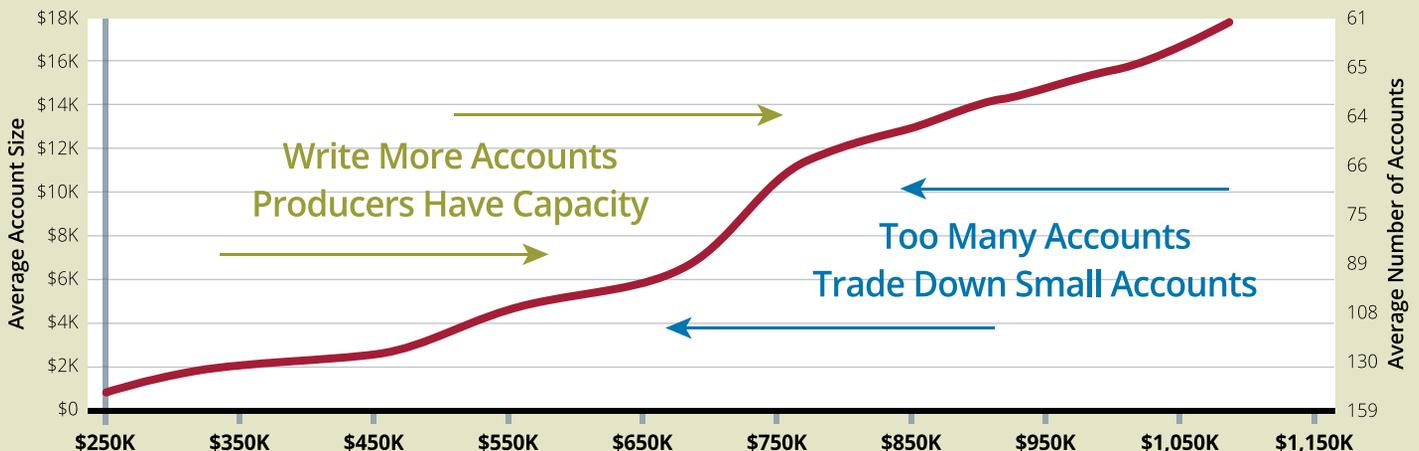
Registration Now Open!

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Contact Jessica Stogran at Jessica.Stogran@MarshBerry.com or 440.392.6558 for details.

AVERAGE BOOK OF BUSINESS RELATIVE TO NUMBER OF ACCOUNTS AND ACCOUNT SIZE



Source: MarshBerry Sales Performance Best Practices and Benchmarking Report 2014.



Specialist Platform Agencies Generating Better Returns

by **Brad Unger**, Vice President
440.220.5435 | Brad.Unger@MarshBerry.com

Among Platforms, specialist agencies generally trade at higher multiples of Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) than do their generalist counterparts.

In the March issue of CounterPoint, we presented a review of the 2015 transaction multiples and specifically called out Platform agencies as having higher-than-average transaction multiples for good reason — it's a good article that you might want to re-read for some context.

In the chart below, you will note that among Platform agencies, the average Base Purchase Price for a specialist was 9.39x EBITDA compared with 8.19x for generalists. This variance is largely carried through the realistic and maximum earn outs as well.

Defining Specialists

We think of specialist agencies as those retailers who focus 50% or more of their business on one niche or specialty line, or who have up to three-niches that comprise 75% of their business. For example, a specialist might focus on health care (i.e. whole accounts including professional liability) or complex Workers Compensation in various industries with high self-insured retentions. This analysis does not focus on wholesalers, Managing General Agents (MGAs), and other non-retail specialty brokers.

Value Creators

We believe that the value of specialist agents — and the chorus of demand from buyers — is driven by their ability to generate outsized returns. These firms are not simply so-called hot commodities, because they are not commodities at all — they are differentiated.

Looking at these firms, here's what the buyers see:

- **Specialist agents sell expertise and service, rather than insurance products.**

These firms know a select few businesses very well and they know how to efficiently and effectively put together a risk management program that is tailored to their clients' needs.

2015 TRANSACTION MULTIPLES
PURCHASE PRICE AS A MULTIPLE OF EBITDA

	Total Platform	Generalist Platform	Specialist Platform
Base Purchase Price	8.49	8.19	9.39
Realistic Earn Out	9.56	9.40	10.31
Maximum Earn Out	11.26	11.11	12.07

Source: MarshBerry proprietary database of transactions in which we were directly involved, those from which we have detailed information, transactions in the public record, our knowledge of the marketplace, and discussions with active buyers and sellers. Value illustrated is net of a working capital requirement, if any. Past performance is not indicative of future results. Multiples are averages and do not imply that all deals fall within these parameters.

Specialist agencies are coveted in the buyer marketplace and their market values reflect this in a very clear way.

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Peer Exchange Network News

2016 FALL APPEX SUMMIT October 18-12, Hilton Nashville

What to watch for:

- ***The Practical and Sustainable Way to Build a High-Performance Culture***, presented by *David Friedman, Founder & CEO, High Performing Culture, LLC*
- ***Win on a BOR, or Walk!***, presented by *Nick Kormos, Vice President, MarshBerry*
- ***Top Ten Attributes of a Successful Producer***, presented by *Curt Vondrasek, Vice President of Recruiting, MarshBerry*
- ***The State of the Industry***, Presented by *John Wepler, Chairman & CEO, MarshBerry*

When was the last time you took the pulse of your organization's culture?

MarshBerry's Employee Engagement Survey

is an online survey allowing employees to provide a holistic portrait of how well an organization is functioning internally. Conducting the study is a strategic way to gauge the impact of the decisions you make within your agency. It provides employees a forum to voice their opinions honestly and confidentially in order to spark change. It also enables you to track your results year-over-year to pinpoint trends and determine areas most in need for improvement.

Interested in learning more about our Peer Exchange Networks?

Contact Tommy McDonald today at
Tommy.McDonald@MarshBerry.com

WE WANT TO HEAR FROM YOU!

We want to make sure we're providing the content you want to read and want feedback on the articles we're publishing.

Send an email to us at Editorial@MarshBerry.com and let us know your thoughts!

■ **Specialist producers are recognized experts and can get meetings that a generalist cannot.**

These producers speak the language of their focus area and know the players in that market, thus their referral list and credibility grows, while their client loyalty increases. These specialist producers are not confined to the 150-mile driving radius around their office — they often become regional and perhaps even national once their reputation gets out.

■ **Specialists have the support of their markets, who know the specialist agent will 'pre-underwrite' an account and be able to sell complex insurance programs with the proficiency of someone who's been down this road before.**

The top markets are able to provide the right mix of pricing and value added services to assist the agent in winning or retaining an account when they have the confidence that their specialist agent partners will deliver.

The Takeaway

A specialist agency considering a potential sale should highlight the characteristics that make it valuable and will want to seek buyers that appreciate its expertise. Some buyers will recognize when a specialist has the support of the leading markets in its space, but even these buyers still need to be educated on the depth and breadth of an individual agency's services.

The specialist agency needs to *highlight the quality of its producers* and the market reputations of those producers.

The specialist needs to demonstrate its ability to produce above average profits in order to show buyers that they believe their firm deserves specialty valuation in a transaction. ■

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The Value of Trading Down Small Accounts

by **Zack Pittman**,
Sales Performance
Consultant
440.220.4100
Zack.Pittman@MarshBerry.com

For many producers, the idea of trading down a small account out of their book of business is unthinkable. These are the clients they've hunted on, opened the door to, built the relationship with, and closed. After all of that work, they're supposed to just give them away?

As an agency executive, this can look like a difficult conversation to have with the producer, because the skeptical sales people that they are, only focus on the negatives to "giving up" their hard earned clients. Is there a way to articulate this conversation to highlight the positives?

Short answer: yes. A strong assumption in our longer answer is that the producer we are referring to actually wants to hunt and close more new business. **Long answer:** as long as you establish the long term vision of creating time and capacity for the producer to hunt more new business to grow a larger book of business, the conversation is relatively easy because data validates your decision.

A common misconception is that trading down smaller accounts will have significant W2 impact on the individual producer. Typically, according to MarshBerry's experience, we've found that the bottom 20% of a producer's book of business only represents 1-3% of their revenue and the bottom 40% only represents 4-6% of their revenue. In comparison, the top 20% of the producer's book of business represents 80% of their revenue. As the producer then begins to hunt on new, larger opportunities, the number of closed accounts needed to replace the revenue of the transitioned accounts greatly decreases. The figure above shows a book of business breakdown of an actual producer that has supplied us data on their book of business.

BOOK OF BUSINESS ANALYSIS
TOTAL NUMBER OF ACCOUNTS = 274

	# of Accounts	Book Revenue	% of Total Book \$
Top 20%	55	\$755,591	78.3%
21% - 40%	55	\$124,942	13.0%
41% - 60%	55	\$50,284	5.2%
61% - 80%	55	\$23,340	2.4%
Bottom 20%	54	\$10,887	1.1%
TOTAL	274	\$965,044	100.0%

Total Book Average Account Size	\$3,522
Top 20% Average Account Size	\$13,738
Bottom 20% Average Account Size	\$202
Career Account Threshold	\$3,892

Source: MarshBerry Producer Benchmark Report; individual results may vary.

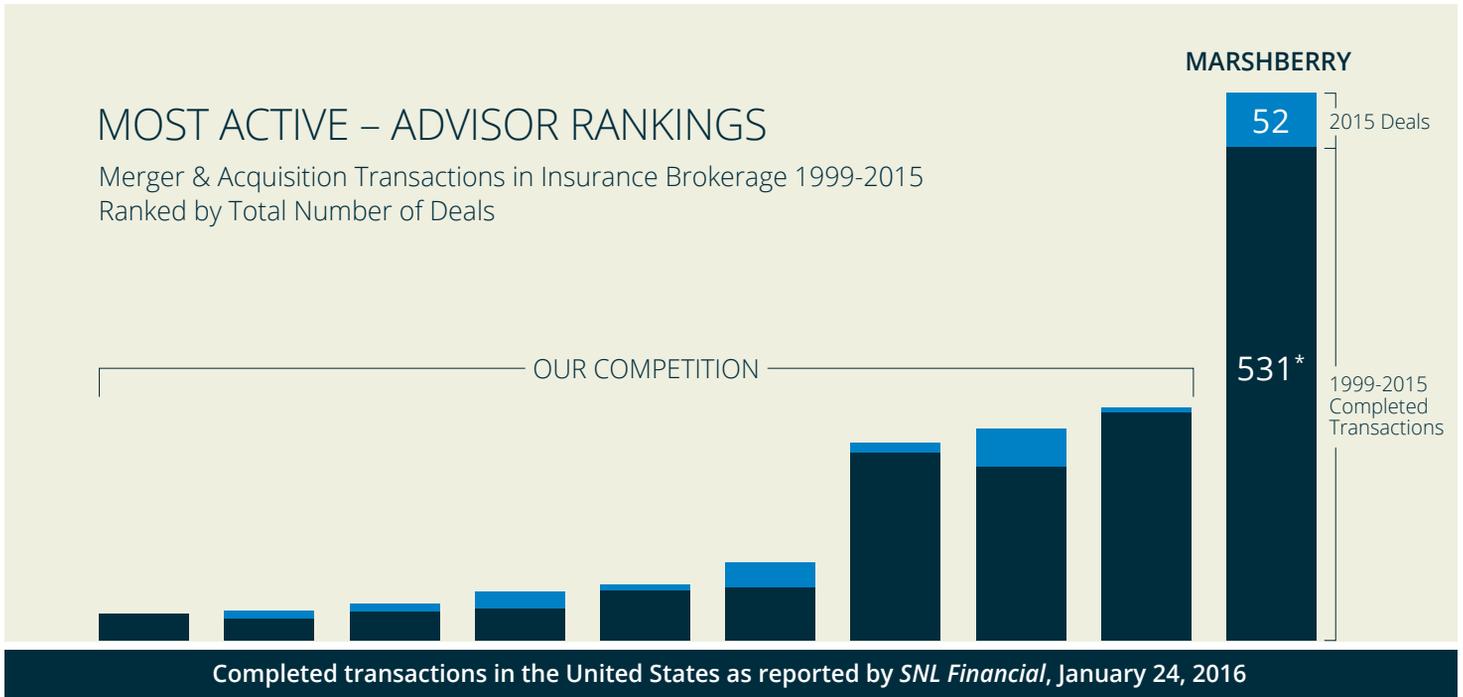
Trading down smaller accounts should become a process for all producers, *not simply a one-time event.*

At the end of the day, trading down accounts in to a Small Business Unit (or transitioning it to a house account) doesn't mean the producer has to cease the relationship with the client. The time spent not servicing the account can be reallocated to bringing on more new business that will grow their book of business — and income. ■



MARSHBERRY
35TH ANNIVERSARY

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This data displays a snapshot at a particular point in time of the number of deals as reported by *SNL Financial*. It has not been updated to reflect subsequent changes, if any.

- 531* total Merger & Acquisition (M&A) transactions advised on since 1999, representing 29% of total advised deal flow as tracked by *SNL Financial*
- \$2.7B in advised transaction value since 2012**
- Over 285 M&A transactions since 1995 with the 100 largest brokers of U.S. business as identified by *Business Insurance*, and over 185 Bank Insurance M&A transactions since 1997
- Completed more than 250 diagnostic and confirmatory due diligence projects over the last twelve years

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* These totals include certain transactions completed by Marsh, Berry & Company, Inc. professionals while employed at another firm, whereby substantially all of the assets were acquired by Marsh, Berry & Company, Inc.

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** Based upon maximum possible purchase price; MarshBerry advised deals through 12/31/15.



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ON THE HORIZON

OCTOBER 2016

- 10.06 SalesPro Producer Training**
Cleveland, OH
- 10.17-18 Organic Growth Seminar**
Nashville, TN

NOVEMBER 2016

- 11.09 SalesPro Producer Training in partnership with Grange Insurance**
Columbus, OH
- 11.09-10 10th Annual SNL Insurance Brokerage Summit**
Washington D.C.
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MarshBerry's 2016 Market & Financial Overview report is now available. Learn more at www.MarshBerry.com/2016MarketFinancial

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