Agency Consulting Group PIPELINE For Independent Agents

PLEASE VISIT OUR WEBSITE: WWW.AGENCYCONSULTING.COM

Volume 35 ***July 2017*** ***Issue 7***

Welcome to The PIPELINE, the premier newsletter for agency owners and principals published by Agency Consulting Group, Inc.

ACG

"Your Road to Success Begins With Agency Consulting Group!"

IS EBITDA A VALID WAY OF LOOKING AT INSURANCE AGENCY VALUE?

Many agents have asked us why we categorize EBITDA as one of the "Valuation Voodoo" methods of valuing agencies. Here is the background and reasons that if we cast EBITDA calculations, we do so only as one of many valuation methods and never one of comparison with other agencies; or as a measure of quality or final value of an agency.

EBITDA, (Earnings Before Interest, Taxes, Depreciation and Amortization) has generally fallen out of grace since its introduction as a measure of value early in the 1980's. Originally intended to identify true value of leveraged buy-outs, it gave investors the knowledge of whether a company could meet its short-term financial obligations.

As the concept of EBITDA spread to a wider range of businesses, many people began equating EBITDA with cashflow, although the two are not exactly the same. These business people said that EBITDA could more properly reflect true company performance when eliminating arbitrary calculations, like depreciation and amortization. EBITDA shows more profit than just actual operating profits, and this is important for the dot-coms and any industry where profits are harder to establish because of continuous investment in infrastructure and technology.

Here are the problems with EBITDA as a calculation of value:

1. EBITDA is not actually equivalent to cashflow. Taxes and interest are REAL cash expenses, not operating expenses. It ignores capital expenditures. While not as urgent in the insurance agency industry as in other types of companies, technology and telecommunications are drains in many progressive agencies on a fairly regular basis.
2. EBITDA makes a company look like it has more money than it really does to make interest payments. Those agencies that are heavily leveraged can reflect a strong EBITDA and be totally underwater considering its interest obligations.
3. Earnings can be easily manipulated. How good is EBITDA if a smart agent simply inflates revenues or changes his compensation to make earnings look strong?

EBITDA has never been accepted as a generally accepted accounting principle, so companies can report EBITDA in whatever fashion they wish. It doesn't give a complete picture of the company's performance. We recommend that you, like we, consider EBITDA, but only as one of a number of measures of agency value. Remember the dot.com bubble some years back? It caused so many investors to put money into companies that had no chance of earning legitimate profits and it was EBITDA that showed profit potential in companies that couldn't support those projections and were functionally bankrupt.

As we do in our valuations and teach agents for their valuations, Operating Cash Flow is a better measure of how much cash a company is generating. It's better because it not only adds depreciation and amortization back to net income but it also includes changes in working capital that also use or provide cash. The Working Capital is largely ignored by all but professional appraisers, but it will tell you whether or not the company is making enough sales to make money.

WHY DO YOU NEED A CONTINGENCY BUY/SELL AGREEMENT AND A SUCCESSION PLAN

We received calls from two agents almost back to back illustrating the need for contingency buy/sell agreements.

The first agent called said that his partner had died suddenly of a heart attack immediately after some minor surgery. They both agreed that a Contingency Buy/Sell Agreement was a great idea just two months earlier, but the partner passed away before they were scheduled to meet with the attorney to draw up the Buy/Sell Agreement.

This was an unfortunate failure in perpetuation planning because for a few reasons. The partner's wife, with whom the remaining partner had a good relationship, was not the party with whom he was negotiating for the disposition of the agency. And the attorney for the estate was definitely NOT the remaining partner's friend. His fee came from a percentage of the estate. For that reason, the attorney was certain that the agency was undervalued and was demanding a much higher valuation.

Soon after the first call, we received another call from an agent who lost his partner. The partners had an outmoded Agreement that would not bear the scrutiny of any court or heir. The two decided to revise their agreement, but his partner also suddenly died of a heart attack before the agreement could be updated.

This was several months earlier, and the remaining partner was confronted with the worst case scenario. He tried, to live up to his original Agreement for the Buy/Sell that the two signed some thirty years ago. Since the agencies were relatively small and both had young families when the agreement was originally drawn, the terms were for a multiple of revenues as the basis of value. Further, to make it easy on the remaining partner, the terms called for a long term payout over the course of fifteen years. The attorney for the deceased partner's wife insisted on a cash payout with no discounting from the value established by their agreement. And to complicate matters, additional claims were made by attorneys for the deceased partner's wife and adult children from a previous marriage. They also wanted their fair share of the agency value as assured to them by their deceased father.

The litigation defense in both of these cases will be nightmares, expensive and could have been completely avoidable by taking the following steps:

1. Execute a simple, direct Contingency Buy/Sell Agreement that is sensitive to the Fair Market Value of the agency at the point in time that the Agreement is triggered.
2. Make sure that the signatures on the Agreement include both the agency owners and their spouses.
3. Fund the Buy/Sell with life insurance in the case of death and a timed buy-out in case of disability.

A Contingency Buy/Sell Agreement need not be complex or expensive. It **does** need the credibility of an attorney in your state to make sure it is legally correct and binding. It basically states that the partners will guarantee the buyout of a deceased partner payable with the proceeds of a life insurance policy owned by the beneficiary to an amount equivalent to the Fair Market Value of the insurance. It also provides for a timed buyout of the agency in case of total and permanent disability.

Gaining the signatures of the spouses of the agency owners cements their agreement to the terms and makes it difficult to alter or argue about the document after the incident.

Spelling out a term buyout for a disabled owner allows for continued support of that owner through the recuperative period, guarantees a continued income stream to support his family during his period of diminished capabilities and spells out the use of the disabled owner's prior productive salary as the normal limit of the payout with the timing being as long as that payout does not achieve the total value of his portion of the agency's ownership.

Using a "Fair Market Value" statement with a requirement that the value be completed by a valuer of insurance agencies assures the seller's estate that a competent valuation will be completed and that neither by the buyer or seller will be disadvantaged in the process.

One of the agency owners in the example above estimates that he will be spending a six-figure amount to defend and maintain the ownership of his agency. All for the lack of a professionally prepared and valued Contingency Buy/Sell Agreement that both owners assumed could wait until a 'better time.'

Please be aware that anyone, young or old, single or married, male or female, could have a heart attack at any moment. Complete your Contingency Buy/Sell NOW, or call us at (800) 779-2430 if you need help.

Live today like it was your last day ---
Plan for tomorrow as if you'll live for another thirty years

WHY SHAREHOLDERS AGREEMENTS ARE CRITICALWHEN THERE ARE MULTIPLE OWNERS

Scenarios without a Shareholders Agreement:

1. You got along great with your partner. You were both amenable to the ways you wanted to run the agency. He died. You find yourself explaining spending decisions to his wife (with whom you have a cordial relationship) and, unfortunately to his wife's attorney (who is NOT paid to be your friend).
2. Your partner dies and leaves his stock to his 25 year old son who is just starting in the business. Now you are an equal partner with him. What fun!
3. You adopted a new partner in expectation of him doing wonderful things for your agency. He hasn't. How do you get rid of him without getting your "assets sued off"?
4. All of your partners but one are in agreement about the sale or merger of your agency. The buyer/merger partner insists on 100% conversion. Your recalcitrant minority partner now dictates the future of your agency.
5. You and your partner agreed to be "equals" when you began the agency. Now, 20 years later you have generated a majority of the business but still "own" only 50% of the agency. When disputes occur, how are they settled?
6. You die or become permanently disabled. Without a well-worded Shareholder's Agreement, who decides if and when a buyout will be done, for how much and/or the terms of continued compensation?
7. Same as 6 except your partner dies. His estate may force the sale of the agency while you have many years left to work and not enough assets to purchase his share of the agency.

A well-crafted Shareholders' Agreement solves all of these and many more potential problems by pre-agreeing on the terms of the ownership interests. It does not threaten anyone - it simply protects each of the owners AND their families.

The components of a Shareholders' Agreement include:

1. MANAGEMENT CONTROL - **Control** does NOT necessarily equate to **equity ownership** or to **compensation equity**. Control defines who has the authority (and defines how much authority) to spend money, hire and fire, manage the organization, and make decisions that will impact the future of the agency (merger, sale, acquisition). Some decisions may be made based on stock or equity ownership (like those changinacgacg the Company in any way). While others may be limited to financial, sales, marketing and admin issues that should be controlled by a straight Board vote or should be the decisions of local management. Management Control defines how disputes are handled in a way equitable to all.

2. VALUES - never use "mutually agreed upon price and terms" in an Agreement. What if the participants don't "mutually agree" at the time of an event? And using a multiple (of anything) to define the value in the event of a required redemption is like Russian Roulette not knowing which end the bullet will come from. It is likely to cheat the buyer, the seller or the agency by defining the value based on a simple multiplier instead of by the measured cashflow potential of the equity being redeemed. If you can't use Agency Consulting Group, Inc. for your valuation needs, we recommend the Agreement use a member of AAIMCO (American Association of Insurance Management Consultants) to cast a valuation at the time of need. Members of AAIMCO adhere to the Standards & Guidelines

for Appraising Insurance Agencies/Brokerages (an AAIMCO publication) and avoid 'shortcuts' in the valuation process.

3. TERMS

   A. Non Solicitation and Non Piracy clauses should be defined even if a Non-Competition clause is questionable in your state. No one (including owners) should leave the agency and be permitted to take its clients if paid in accordance with the Agreement for his equity. Imagine that the value is defined based in large part on the agency's ability to sponsor the cashflow and then part of the cashflow is taken away by the person who redeemed the stock.
   B. Down Payment, interest and payout terms - should be flexible for internal buyouts with minimization of down payments to the amount required by the seller to keep him from going into his own pocket to find cash to allow him to sell his portion of the agency. Payout terms should consider cashflow (after tax) expectations after the departure of the seller. Interest on internal transactions should be pegged to the minimum allowable interest by the IRS related to installment sales. This still provides a return to the seller beyond what he could get from a bank or secured investment but less than the buyer would have to pay to a financial institution.
   C. Asset vs Stock - Unless you are guided by wise, experienced counsel in the transfer of ownership of insurance agencies internal transfers should be stock-based, paying Uncle Sam his due on the growth of value of the business. A variety of strategies are available to minimize taxation but they represent very specific conditions to which each applies. Casual use of these tools without proper analysis is like waving the red flag around the IRS "bull".
   D. Exit Strategies - Whether through agreements to separate, forced buyouts or forced redemptions as well as for retirement planning, a Stockholders' Agreement should absolutely have a series of exist strategies defining what is expected to occur in the event of the desired or required departure of an owner of the agency. No single exit strategy is sufficient to allow for the variety of situations that will occur in a business with multiple owners. Here are some of the issues that should be addressed;
      1. Death Buyouts
      2. Agency wishes to eliminate an owner
      3. An owner wishes to leave the agency
      4. Cross-Purchase Agreements vs. Stock Redemption
      5. Rights of First Refusal (usually a 'cop out' and not a good strategy)
      6. Mandatory retirement of stock (not necessarily retirement from the agency)
      7. Cashflow payouts - extends the period of time of the payout but assures the agreed-upon principal with interest enhancing the total amount paid to the seller.

As you can see, there are dozens of issues that must be addressed when an agency is owned by multiple owners. Not having a Shareholders' Agreement is as foolish as foregoing repairing leaks in your boat by closing the hatch and not paying attention to the rising waterline. Eventually something bad will happen. Consider creating a Shareholders Agreement if you don't have one yet and revising the Agreement to avoid disappointment when the time comes to trigger its clauses.

COMMUNICATIONS WITH YOUR PROSPECTS AND CUSTOMERSTHE KEY TO SELLING MORE INSURANCE AND KEEPING YOUR CUSTOMERS

Will you acknowledge that insurance is not the most desired topic of conversation for pretty much anyone?

Neither is the stock market or our own mortality---

No one is keen to speak of their demise even though we all know it WILL happen. But we don't want our local mortician to remind us by sending us marketing for his services.

When our broker calls us it is usually to ask for money for an investment or to break some bad news to us - also something that puckers us up when the call is announced.

And few of our clients (and no one else) is keen on hearing from the insurance agent - they assume every call will cost them money.

So how do we keep familiar enough with our clients to make sure they call us when an insurance topic arises?

How do we get them to feel good enough that we're their agent to refer all of their friends to us if they need insurance?

And, most of all how do we get prospects for our services to know our name and acknowledge that we are the "insurance pros' in the area for when they are ready to make a move?

Familiarity Breeds Contempt?? Only if it's bothersome or nagging.
Otherwise - Familiarity Breeds Trust!!

Your job is to be familiar with your clients resulting in a trusting relationship similar to their relationship with their family doctor.

We get a postcard from our realtor every month or two -FOR THE LAST TWENTY YEARS - simply stating that they sold another house in our area, posting a picture of the house they sold and the price they got. No solicitation - No demand - just the fact and their phone number for when we need them again. And they still send us a business card with magnetic calendar attached showing us who they are.

What did it tell us?

It told us they were familiar with the homes in our area and an idea of the selling price as houses were sold. Are we likely to use another realtor when the time comes that we need to buy or sell? Not likely - we have his magnetic calendar on our fridge and he reminds us of who he is without any hard-sell.
We get solicitations from insurance agencies and companies about every two weeks. What do we do with them? Why, what everyone else does with them of course-throw them into the trash can that sits next to our front door! They never get opened let alone considered. Nor do we remember who sent what solicitation.

The realtor appealed to an interest without an obligation, telling us for how much houses in our area are selling. The insurance entities were all touting, "We can get you insurance cheaper." There were no demands made to us by the realtor - just remember who we are when you need us. In order to accommodate the insurance requests, we have to purposely leave our current carrier and agent and we have to find all of our data and go through the trouble of filing an application for a quote - something like the Spanish Inquisition - presumably for our own good!

YOUR CUSTOMERS:
The greatest benefit you have as an independent agent is that you are the "local" professionals - you know both insurance and the area. When you communicate with your customers bring them local news, whether it's the local high school or college sports schedule, highlights and scores, upcoming events within 50 miles in the next week, or even the weather forecast (especially in farm country).
By all means include a short synopsis of one of the many coverages you offer with a phone number for inquiry in case they need it. Concentrate the meat of your communications on what interests the customers, not what interests YOU.

YOUR PROSPECTS:
Your goal should be for all of your prospects to know who you are, your credentials and your history. You want them to know you even if they are not insured by you. Build a reputation for service to the community, whether insured with you or not. You are at your strongest if the individuals and businesses in your area think of you as a community service more than a purveyor of insurance products. Build your reputation as always being available to answer any insurance questions regardless of whether they person is insured with you.

THE ASSET PROTECTION MODEL OF SALES (APM)
We began using the principals embedded in the APM over 20 years ago when we noticed that the most successful agencies shared the same common traits with respect to the treatment of the customers. All of them were more interested in the well-being of their clients than they were in selling insurance. As a result they not only had the most loyal customers (their friends) but they also sold more new insurance every year as well. Invariably they were NOT price-sensitive salespeople, although they acknowledged that they had to have competitive pricing. But since they were service-centered, they and their customers recognized that if they were a few dollars more expensive than their competitors, there was much more that the customer got from the relationship than simply the cost of the insurance.

I know this doesn't sound exciting or tout the most current internet marketing methods. Those are useful as tools, not to familiarize people with who YOU ARE. Remember the song from 1985's "All That Jazz", 'Everything Old is New Again!'

Let us know if you would like more information about the APM and if you would like to convert your agency back to where it was a generation or two ago when it was truly Customer-Centric. We have the tools that will train you and your staff into that role. The sales made will be longer and to get but will last longer as will your relationship with your clients. 856 779 2430 - al@agencyconsulting.com

Monday Morning Markets

Do you want exclusive access to 200,000 prospects who need all types of insurance? Take advantage of the free adoption of Monday Morning Markets, the

newest vehicle for agency differentiation and access to over 700 specialty programs.

MONDAY MORNING MARKETS

In mid-2016 George Nordhaus and I began a new company, Monday Morning Markets. He's the Chairman and I'm the President. That means he was smart enough to think up this concept and I was asked to help make it happen. What is it?

Monday Morning Markets gives you exclusive rights to put over 700 specialty markets on your website for as many as 200,000 people who live around you. If they need a specialty program, your agency will be the only one that is permitted to have these programs available in the Monday Morning Markets concept. The concept includes featured programs for which the program manager and George develop video content explaining their program and access to the 700+ markets available on Rough Notes Marketplace.

Once at territory is granted to an agency, no other agency will be given Monday Morning Markets (as long as the Monday Morning Markets agency posts Monday Morning Markets on their website - we'll give you all the directions you need to get that done). Please act NOW!! Link here to access Monday Morning Markets and register for the program.

We at Agency Consulting Group, Inc. have been encouraging independent agencies to show their prospects and clients points of differentiation that adds value to an association with the agency. Here is one such point of differentiation. Remember, every one of the 200,000 residents you will reach needs almost every line of insurance that you have available.

Al Diamond Agency Consulting Group, 507 N. Kings Highway, Cherry Hill, NJ 08034