



Mercer Capital

# Insurance Agency Valuation in Uncertain Times

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# Table of Contents

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Market Backdrop and Industry Landscape

Agency M&A Trends

Impact of Inflation and Recession

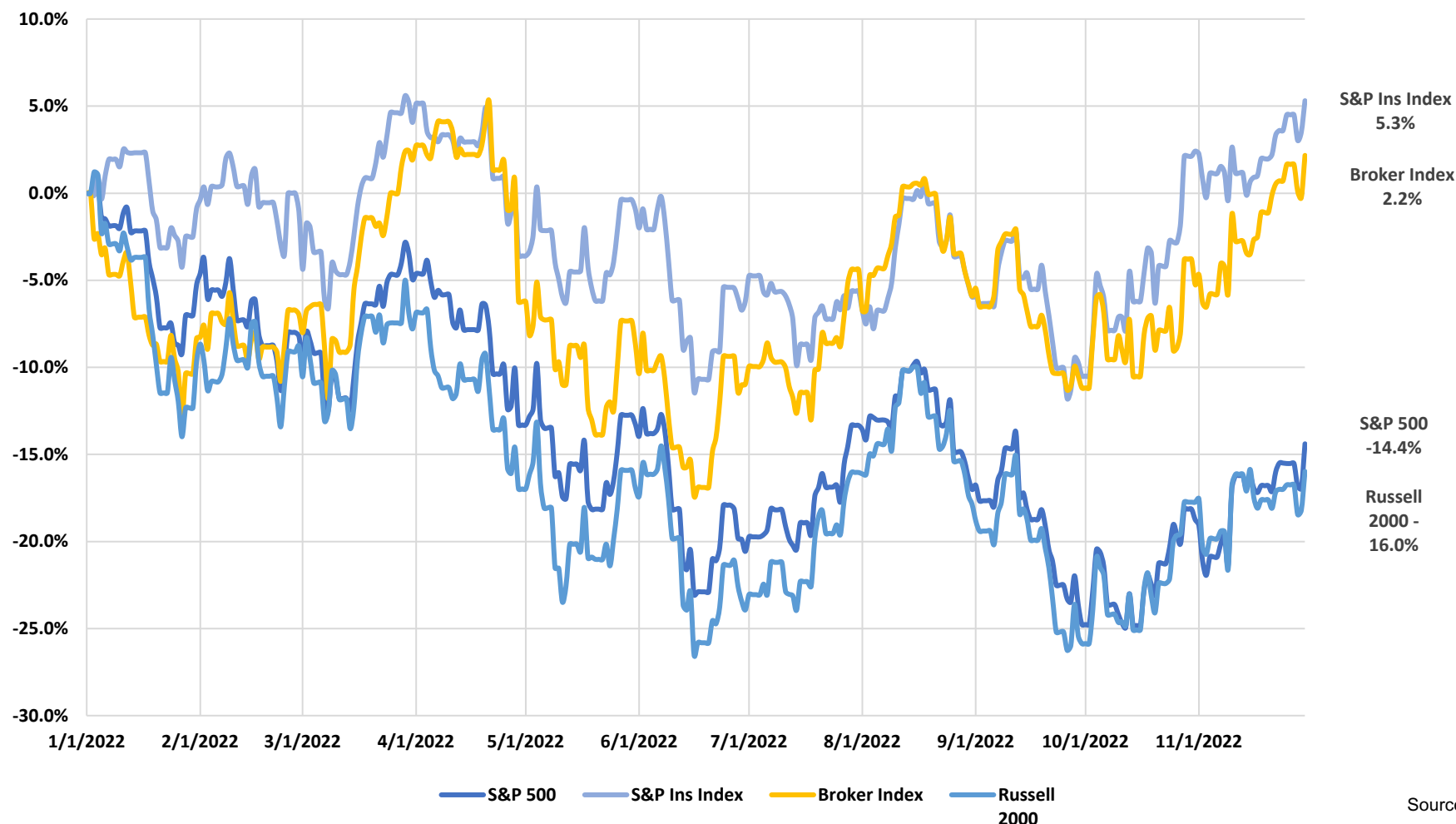
Agency Valuation Considerations

Considerations for Family-Owned Agencies



## Market Backdrop

# Public Market Performance Year-to-Date 2022



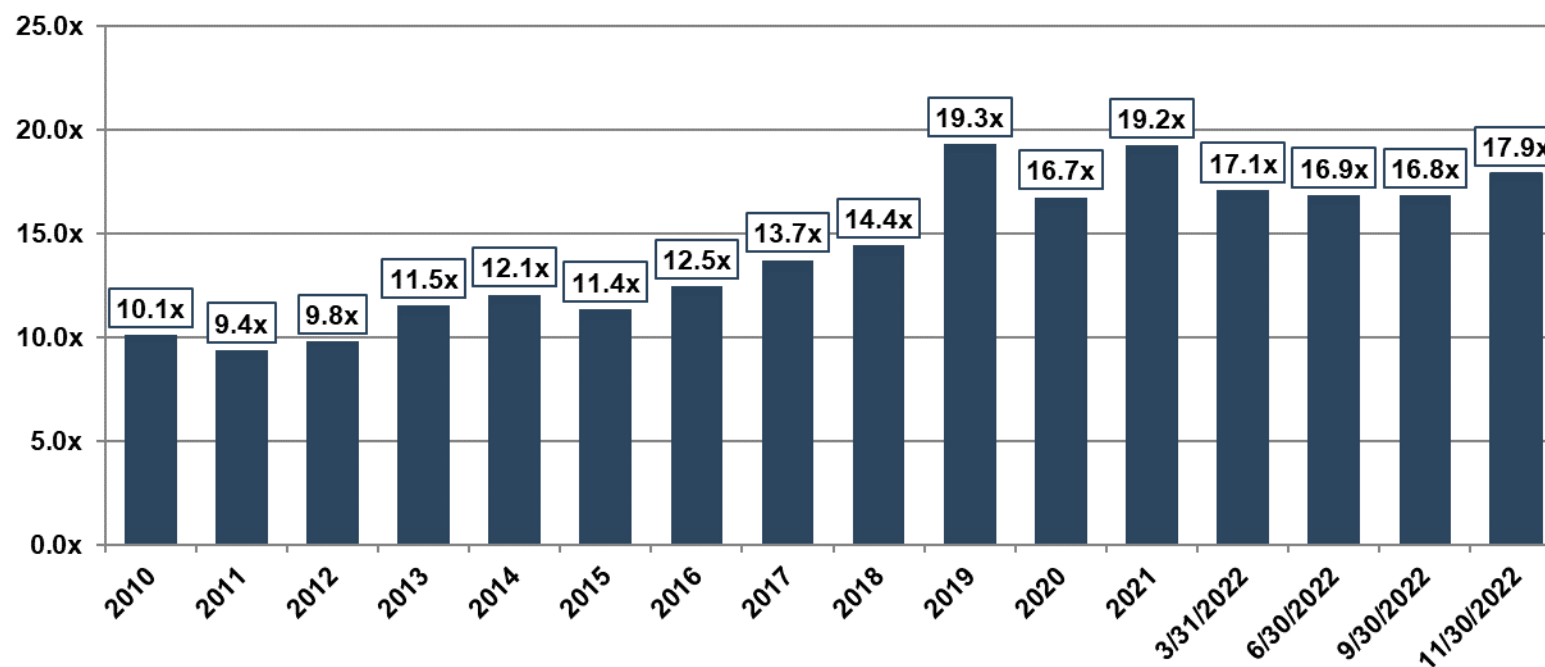
Source: S&P Capital IQ. Broker index includes AON, AJG, BRO, MMC, WTW, BRP

## Market Backdrop

# Public Broker Valuation Multiples

Enterprise Value / Last Twelve Months EBITDA [earnings before interest, taxes, depreciation, amortization]

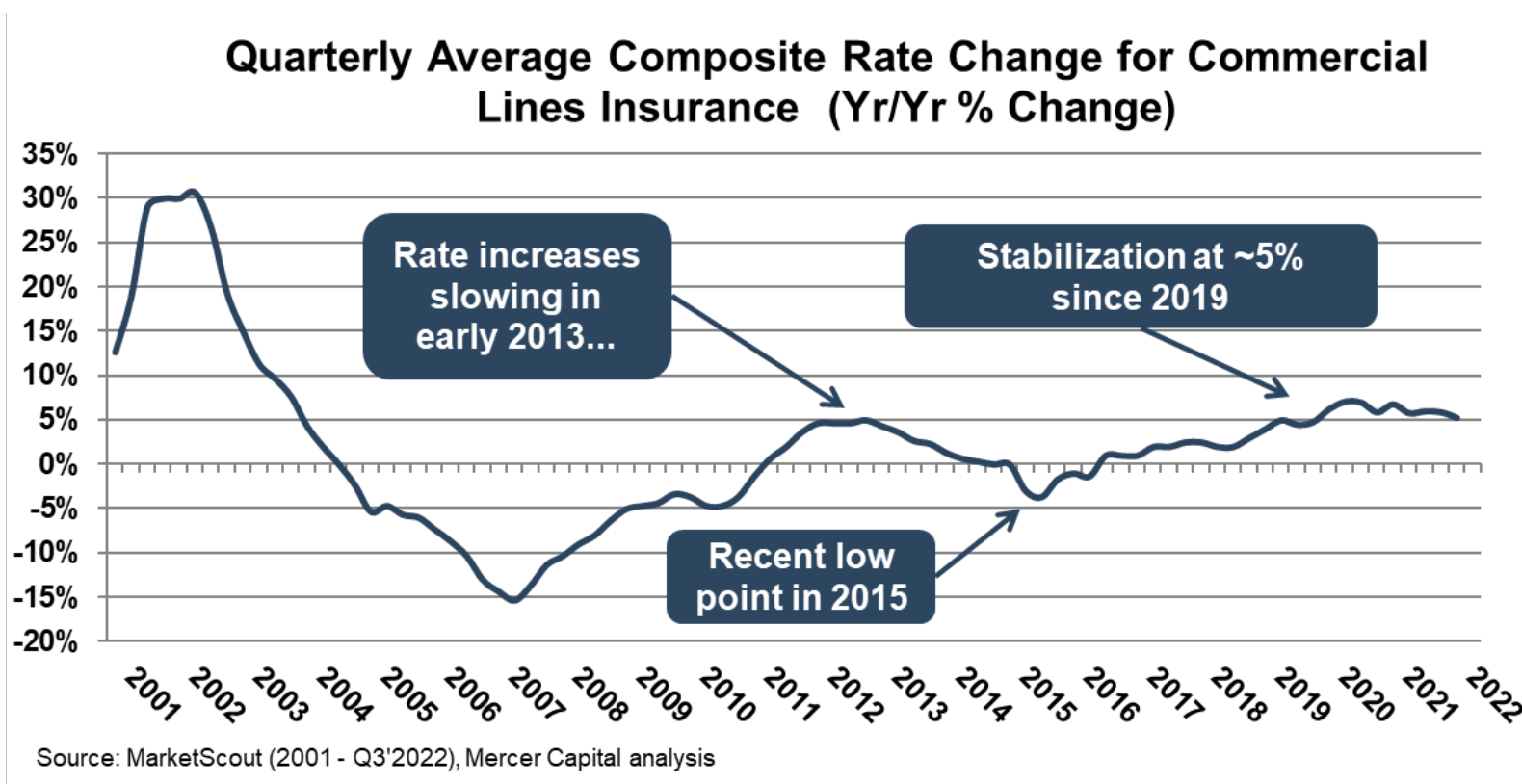
**Public Broker Multiples (EV/EBITDA)**



Source: S&P Global Market Intelligence, Mercer Capital analysis. Median multiple of Enterprise Value (EV) to Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA). Includes AON, AJG, BRO, MMC, WTW

## Market Backdrop

# Insurance Cycle in Perspective

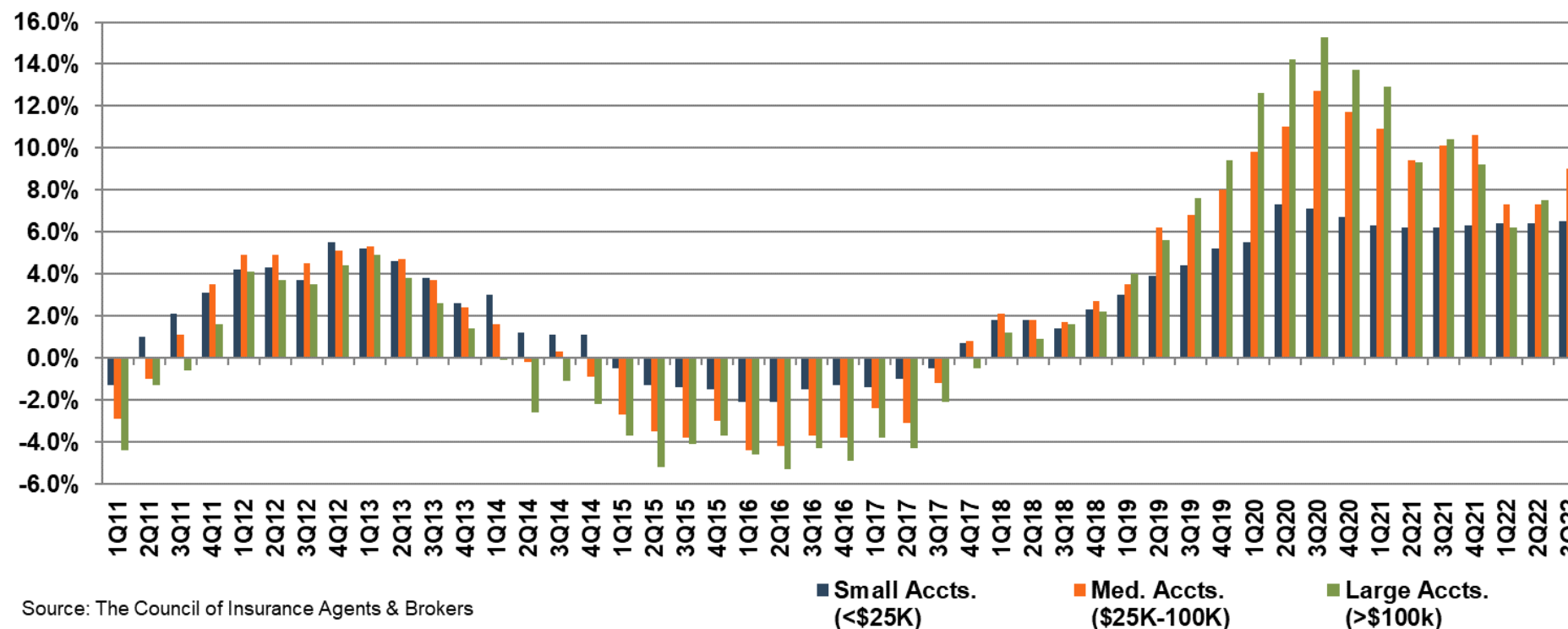


## Market Backdrop

# Insurance Cycle in Perspective

Greater competition for larger, higher-premium accounts. Smaller accounts less volatile.

### Commercial Insurance Rate Changes by Account Size



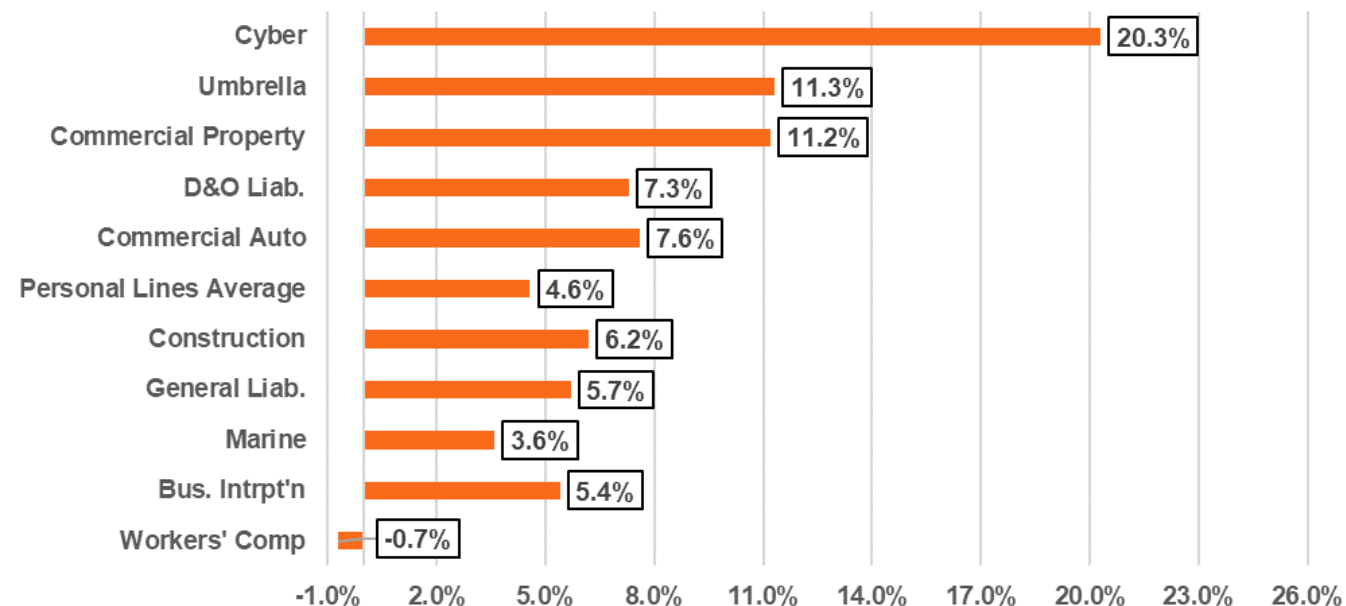


## Market Backdrop

# Rate Changes by Line of Business

Moderation continued for most lines of business; Cyber continues to present a challenge.

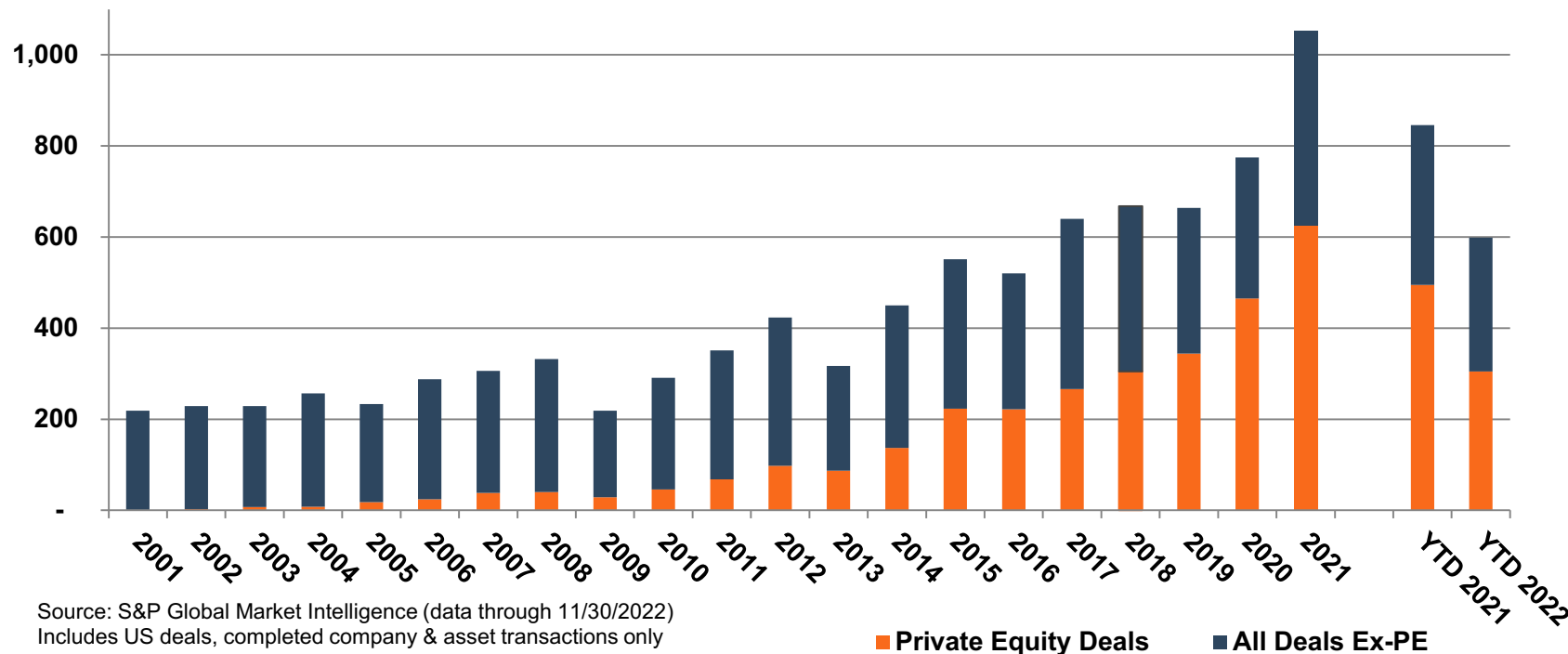
**Q3-2022 Rate Changes by Line of Business**



Source: The Council of Insurance Agents & Brokers, MarketScout

# 2021 Set an M&A Record 2022 ... Maybe Not?

Insurance Brokerage Transactions (2001 - 2022)



## The 2021 Story

- Catch-up from 2020 deferrals
- Tax-motivated sellers
- Low interest rates
- Dry powder at PE firms

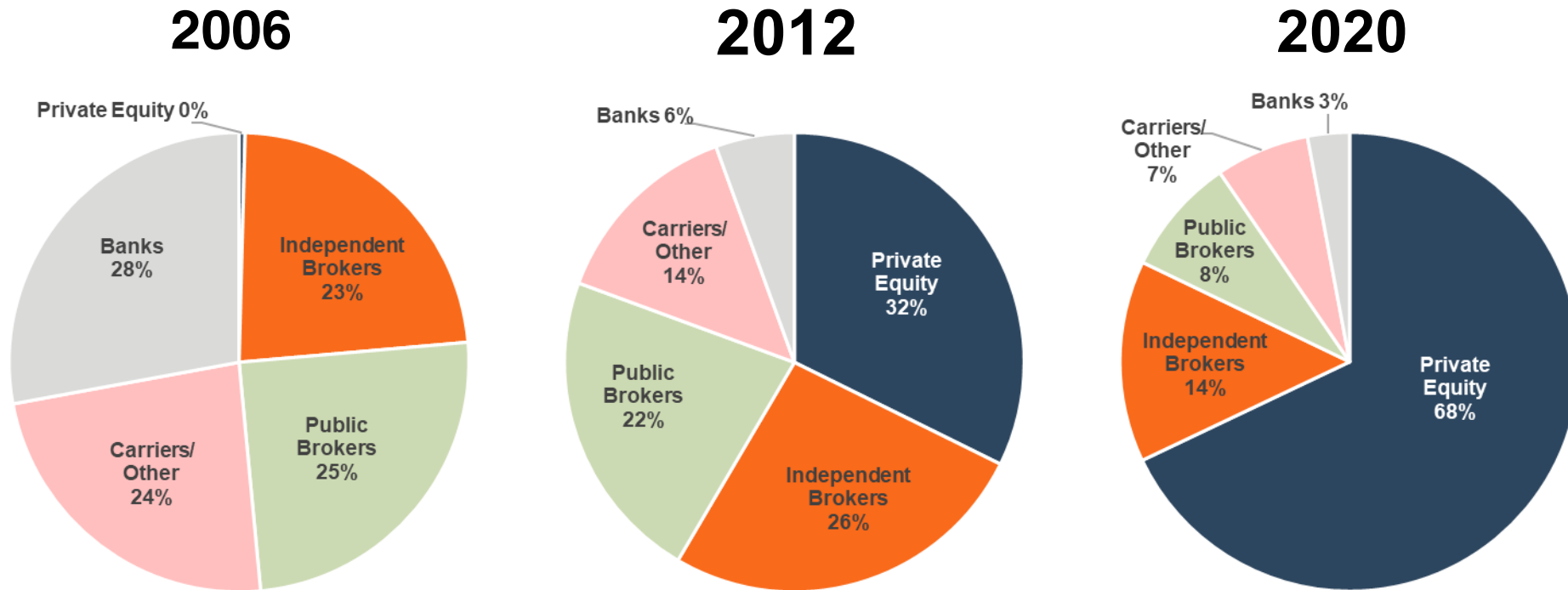
## The 2022 Story

- Fewer, but larger deals for some larger acquirers
- Macro/recessionary concerns
- Higher interest rates put pressure on acquisition financing
- Cyclically high pricing environment



# Changing M&A Landscape Over the Last 15 Years

Percentage of annual M&A by buyer type



Source: CIAB Leader's Edge, MarshBerry, and Mercer Capital analysis

# Who Have Been the Top Insurance Agency Acquirers?

Private equity leads the way

<i>All Transactions (2021)</i>				
Rank	Firm	Current Sponsor	Prior Investors	# of Deals
1	Acrisure	Blackstone, others ('18)	Mgmt ('16), Genstar ('13)	127
2	PCF Insurance	Owl Rock, mgmt ('21)	HGGC ('20), BHMS	99
3	High Street Partners	ABRY ('21)	Huron Capital	71
4	Hub International	Hellman & Friedman ('13), Atlas	APAX take-private deal ('07)	61
5	AssuredPartners	GTCR ('19)	APAX ('15), GTCR ('11)	52
6	World Insurance Associates	Charlesbank ('20)	n/a	50
7	Alera Group	Genstar, Carlyle ('19)	Genstar ('17)	45
8	BroadStreet Partners	OTPP, Century Capital ('12)	State Auto	45
9	Relation Insurance	Acquiline ('19)	Parthenon ('12)	33
10	Patriot Growth	GI Partners ('21)	Summit Partners ('19)	31

<i>Public Company Transactions (2021)</i>		
Rank	Firm	# of Deals
1	Arthur J. Gallagher (AJG)	24
2	Brown & Brown (BRO)	11
3	BRP Group (BRP)	16
4	Marsh & McLennan (MMC)	6
5	Willis Towers Watson (WTW)	3
6	Aon, plc (AON)	2

Sources: Optis Partners, S&P Global Market Intelligence, and Mercer Capital analysis.

# Impact of Higher Inflation on Agency Valuations

Valuation is a function of (1) Cash Flow, (2) Risk, and (3) Growth

## Cash Flow

- Revenue is a function of exposure units and rate
- Expense/wage inflation impacts margin and profitability
- More difficult to forecast and budget

## Risk

- Higher capital costs (equity and debt) lead to lower valuations
- Concentrations in affected industries concern buyers
- Customer churn risk (shopping and/or reducing coverage)

## Growth

- Hard markets can boost organic growth
- Rising expenses can offset real profit growth
- Potential pull-back in discretionary purchasing and investment

# Valuation 101:

## It's All About Pro Forma EBITDA

Agency Revenue
- Operating Expenses
= Pre-Tax Earnings
- Taxes
= Net Income
+ Interest Expense
+ Taxes
+ Depreciation & Amortization
= EBITDA (Earnings before Interest, Taxes, D&A)
+/- Normalizing or Pro Forma Adjustments
<b>= Pro Forma EBITDA</b>

As a seller, you are presenting (and defending) your pro forma EBITDA

As a buyer, you are evaluating (and scrutinizing) someone else's pro forma EBITDA

- For a fast-growing agency, might be normalizing run-rate adjustments
- For a smaller, closely held agency, might be non-operating / non-business expenses to be added back
- Consider owner/officer compensation adjustments

# Impact of a Recession on Family-Owned Agencies

Questions and considerations through the framework of (1) Cash Flow, (2) Risk, and (3) Growth

## Cash Flow

- Do we understand the effect of rising prices and wage pressures on the business?
- Are there discretionary/family expenses that need to be reevaluated in light of current events?
- Is lower profitability going to reduce cash flow that would otherwise be available for debt service or distributions?

## Risk

- What lines of business are recession proof?
- What strategies do you have to counteract the negative effects of a broader economic slowdown?
- All else equal, rising interest rates puts downward pressure on the value of all financial assets.

## Growth

- Would a downturn cause you to defer a needed technology or capital investment, and what would that do to your growth plan?
- Could a slowdown allow you to capture market share from financially-weaker competitors?

# Estate Planning Opportunities for Family-Owned Agencies

For agencies contemplating long-term intrafamily transfers and gifting plans, **a market downturn represents an opportunity to reduce estate and gift tax exposure by considerable margins.**

How does this benefit privately held and family-owned agencies?

- 1) If the transfer is a gift, the debit against the lifetime estate and gift tax exemption of the gifting party is reduced, leaving more room to make future gifts (both estate and gift) tax-free. Since the ownership percentage transferred remains the same, the receiver's resulting ownership percentage is unchanged.
- 2) If the transfer is a sale, the buyer (likely a younger generation) can buy into the business at a more favorable price.
- 3) Both of these strategies reduce the transferer's total estate by a larger amount, assuming measurement of the estate (i.e., at death) comes later once the company's valuation has recovered.
- 4) The transfers might help address (or solve) preexisting perpetuation and/or ownership challenges.

# Practical Considerations for Operating in an Inflationary Environment

## Short-Run Considerations

- Proactive client management to prevent sticker shock at renewals
- Diligent expense management
- Shift to more real-time budgeting and forecasting

## Long-Run Considerations

- Is our agency focused on the right lines of business?
- Is our expense structure too rigid?
- Evaluate the agency's use of debt financing
- Evaluate the agency's dividend/distribution policies and how they affect reinvestment and/or growth strategies



# Closing Perspectives for Uncertain Times

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Public valuation multiples have rebounded slightly since March, but M&A transaction volume is down 29% relative to last year

Combination of inflationary pressures and broad market recession concerns are weighing on the industry

However, demand (and available capital) remains high for quality, profitable agencies

Family-owned and privately held agencies may have a unique opportunity to transition/gift ownership in the current market

As a business and an industry, insurance brokerage remains highly attractive and opportunistic for agents and investors

# Insurance Industry Team

## Additional Resources

- [How to Value Your Insurance Brokerage](#)
- [Employee Benefits Agency Consolidation and Valuation](#)
- [Hidden Tax Traps Commonly Unearthed During Business Due Diligence](#)
- [Three Considerations Before You Sell Your Business](#)
- [Real-World Tips For Family Business Succession](#)



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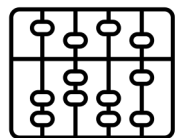
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# Services for Insurance Agencies

Mercer Capital provides valuation and advisory services to insurance agencies. We also work with brokerages, underwriters, insurtech companies, third-party administrators, and other industry service providers.

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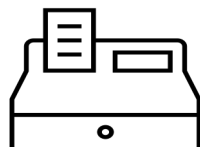
**Corporate Valuation**



**Financial Reporting**



**Family Business  
Advisory Services**



**Transaction Advisory**



**Litigation Support**

# About Mercer Capital

**Mercer Capital is a national valuation and financial advisory firm. Clients include private and public companies, financial institutions, high-net worth families, and private equity/hedge funds.**

**Industries served fall into three broad categories:**

- Operating Companies
- Financial Institutions
- Asset Holding Companies

Our suite of services encompasses two integrated service areas: valuation advisory & opinions and financial advisory services.

## **Valuation Advisory & Opinions**

- Corporate transactions
- Tax compliance and reporting
- Employee benefit plans
- Financial reporting
- Litigation support

## **Financial Advisory**

- Corporate and strategic advisory
- Mergers and acquisitions
- Fairness opinions
- Solvency opinions
- Litigation support

The valuation advisory & opinions and financial advisory service lines are interrelated. The technical discipline of providing well-grounded valuation opinions is buttressed by real world experience gained in providing advisory services. Likewise, the market-centered orientation of financial advisory services has as its foundation a keen understanding of valuation drivers.

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