



Mercer Capital

Insurance Agency Valuation in Uncertain Times

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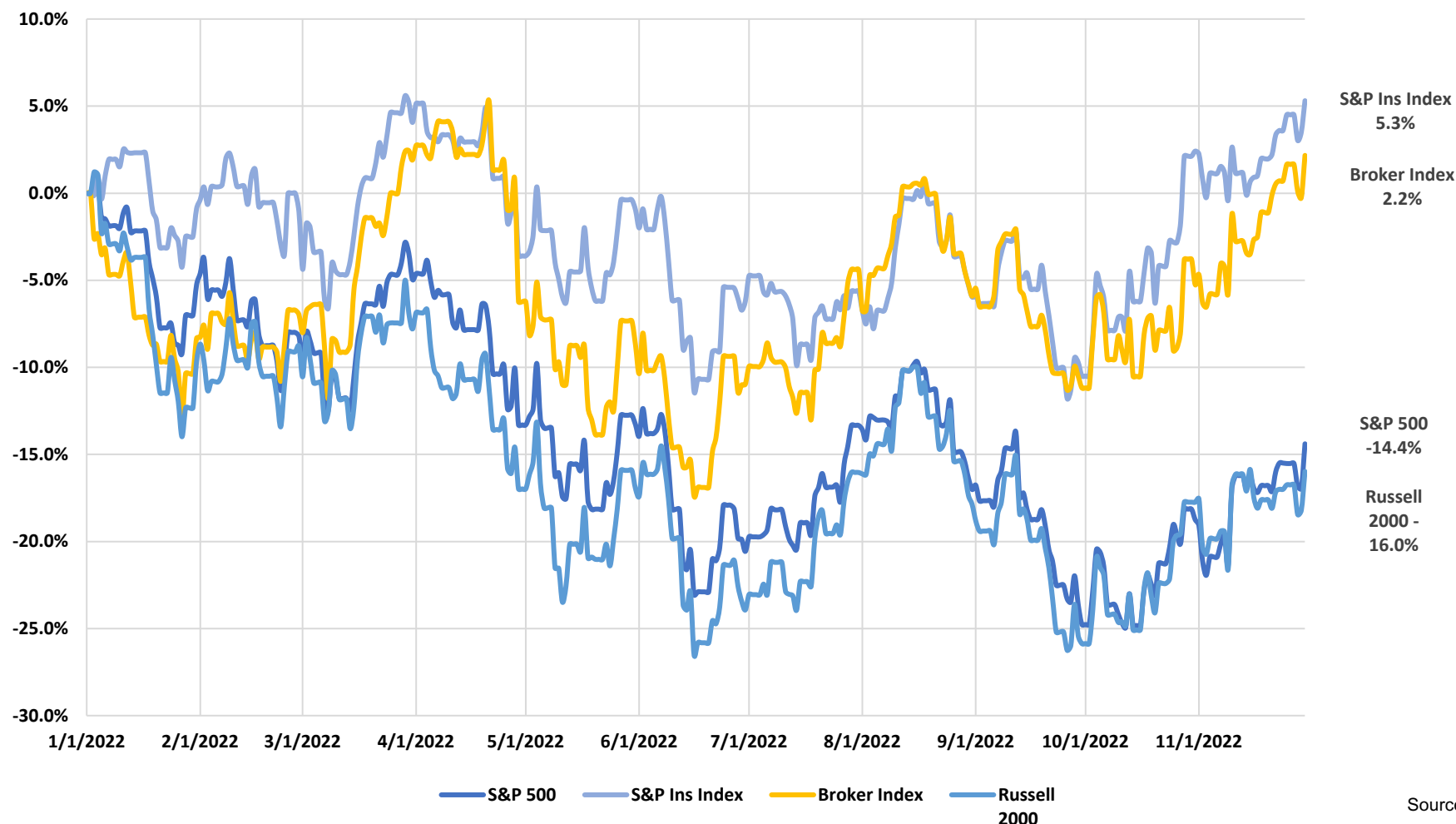
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Market Backdrop

Public Market Performance Year-to-Date 2022



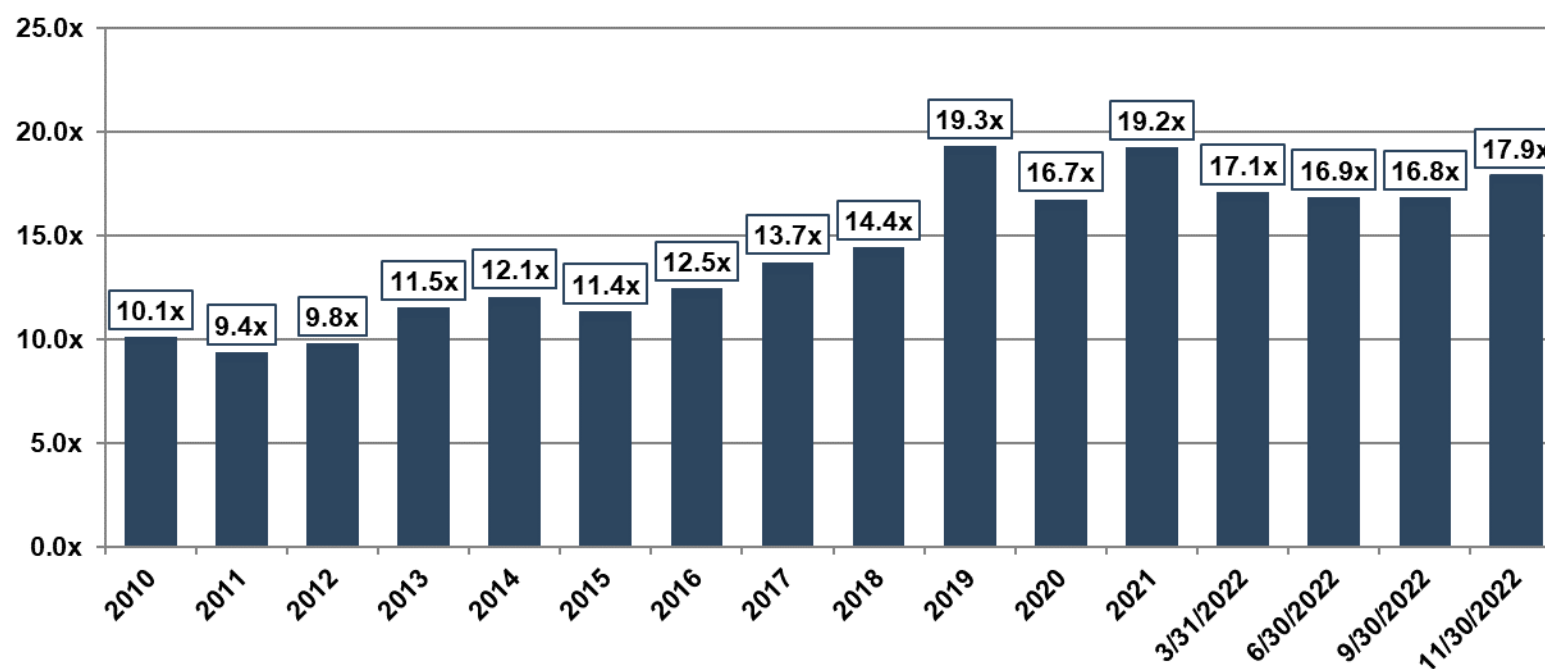
Source: S&P Capital IQ. Broker index includes AON, AJG, BRO, MMC, WTW, BRP

Market Backdrop

Public Broker Valuation Multiples

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

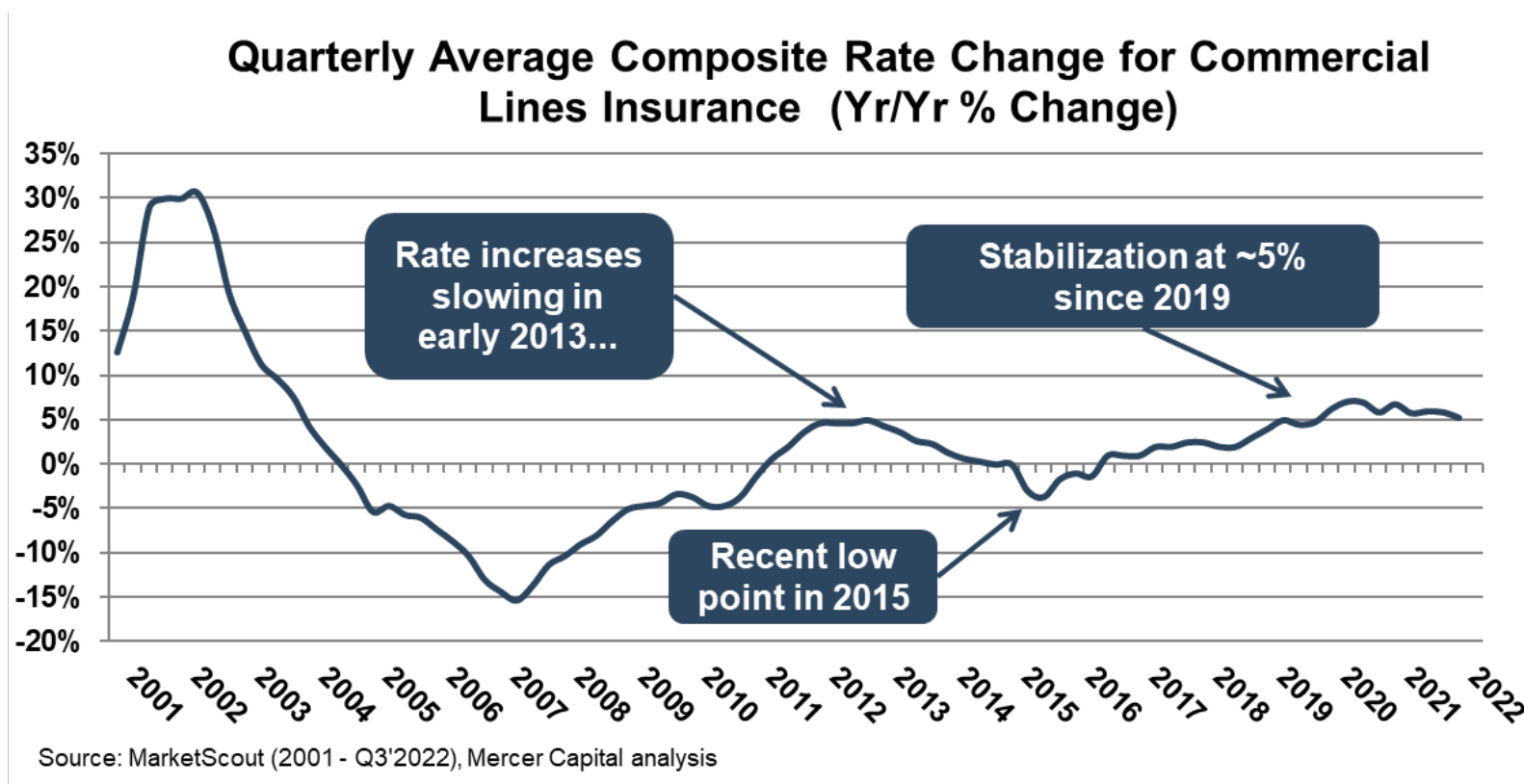
Public Broker Multiples (EV/EBITDA)



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

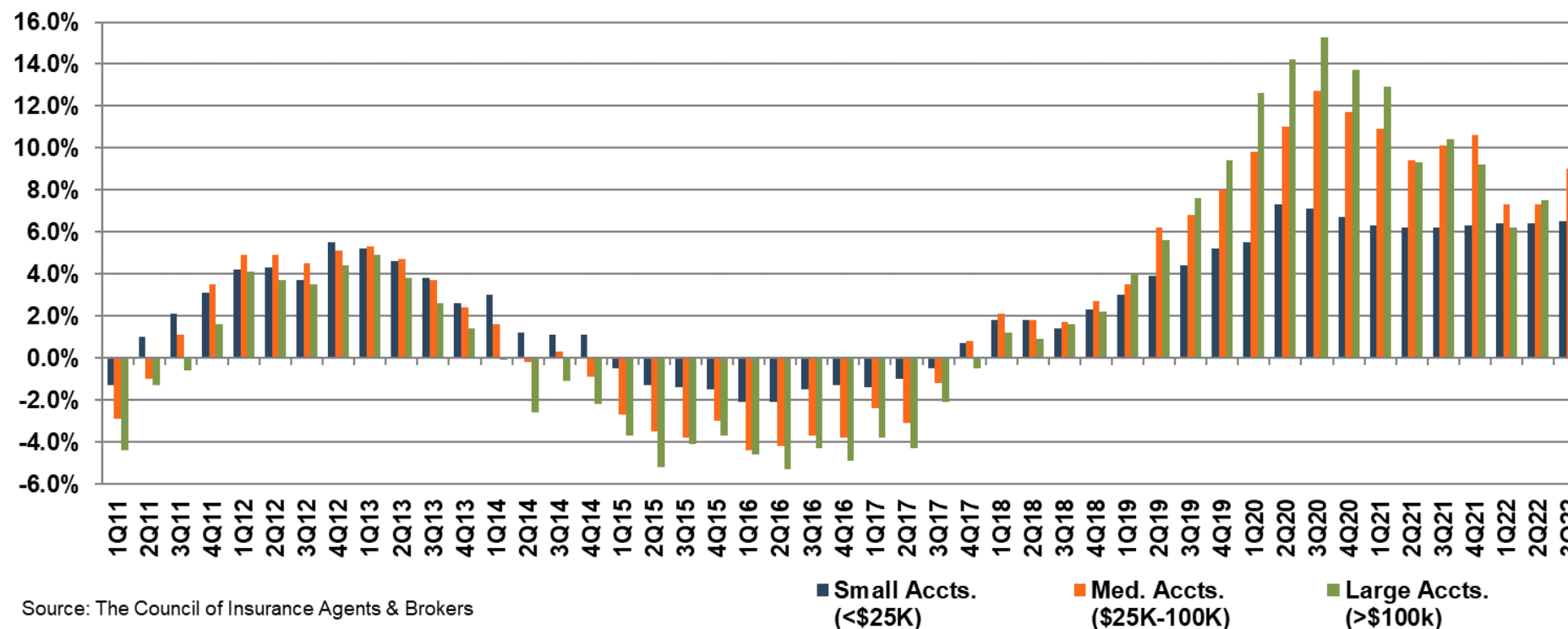


Market Backdrop

Insurance Cycle in Perspective

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

Commercial Insurance Rate Changes by Account Size

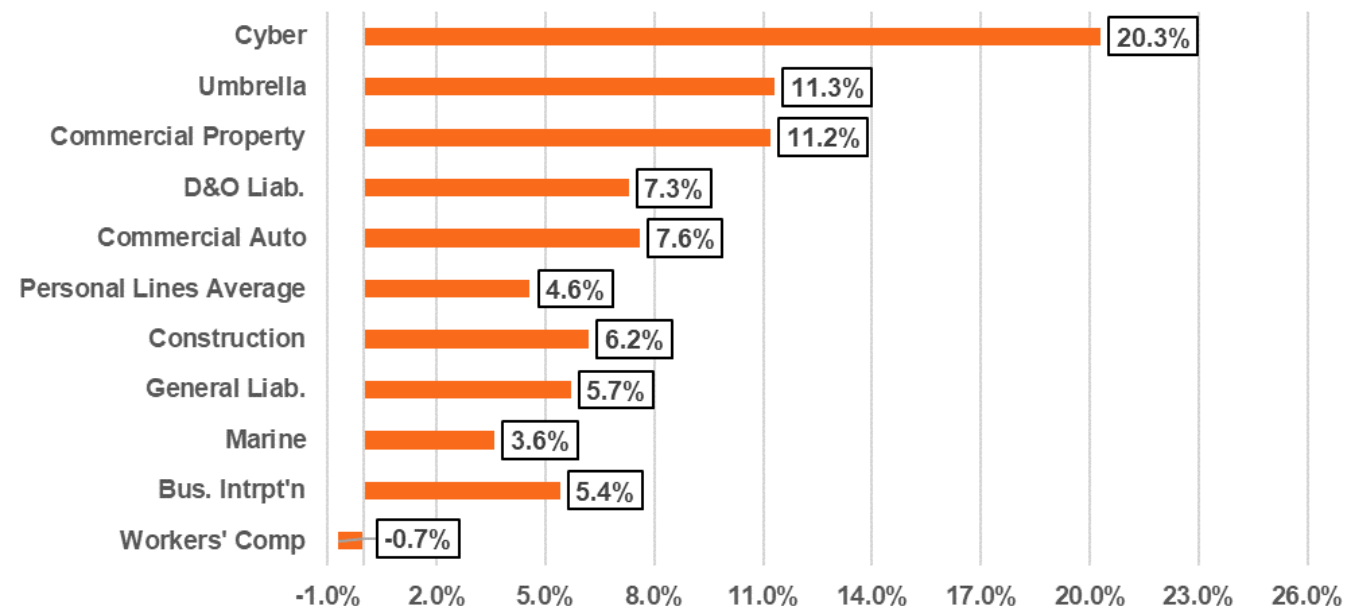


Market Backdrop

Rate Changes by Line of Business

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

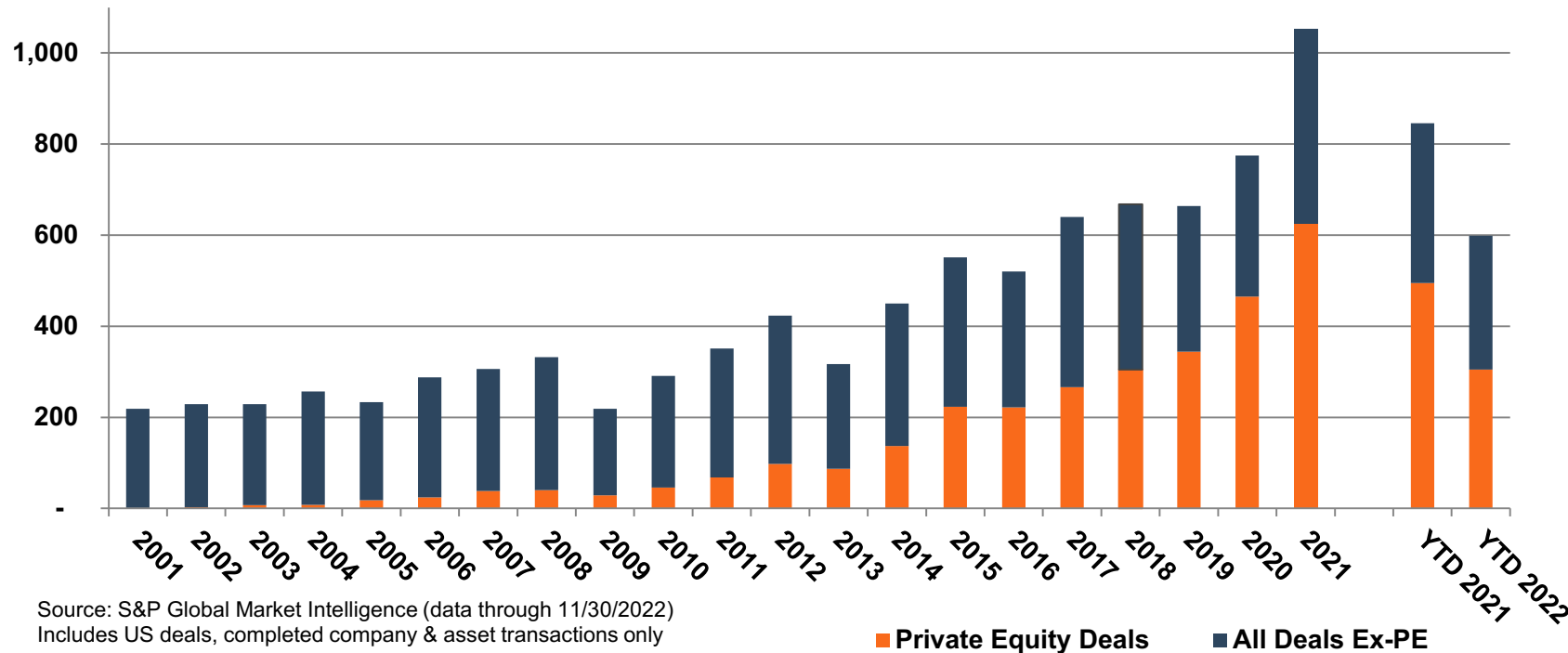
Q3-2022 Rate Changes by Line of Business



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

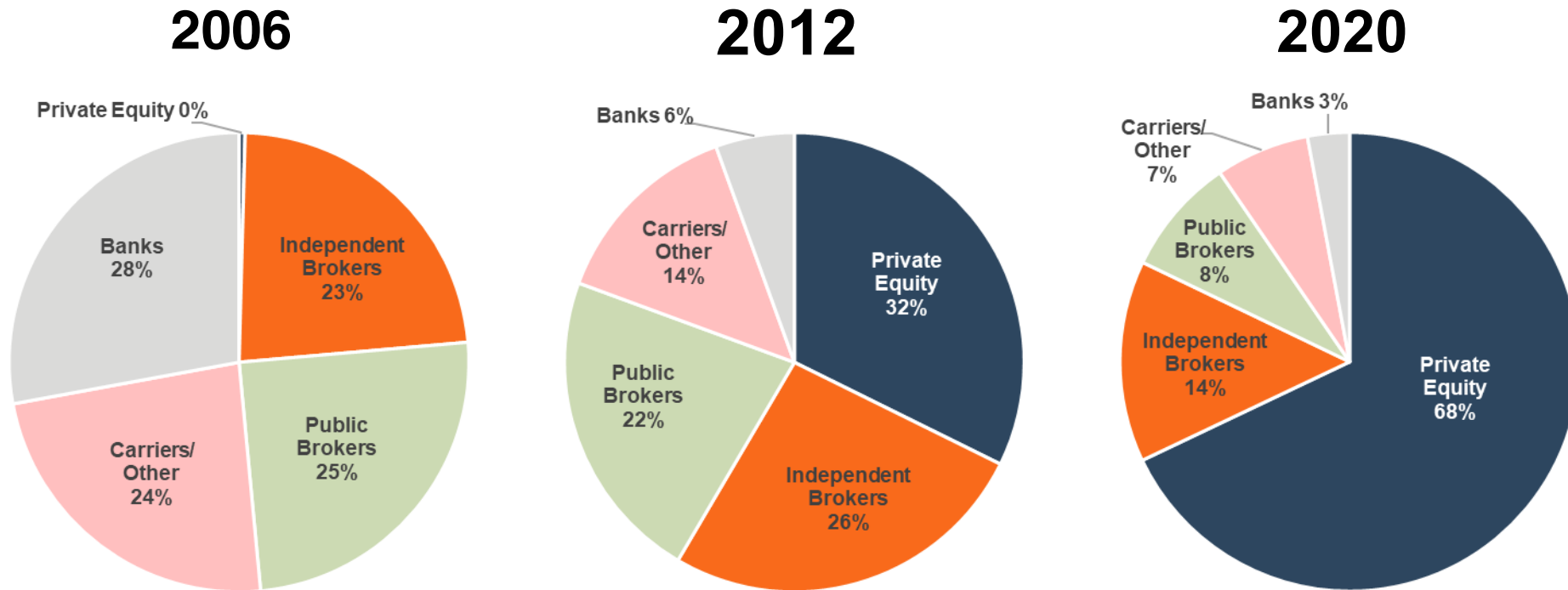
- Catch-up from 2020 deferrals
- Tax-motivated sellers
- Low interest rates
- Dry powder at PE firms

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
= Pro Forma EBITDA

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

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

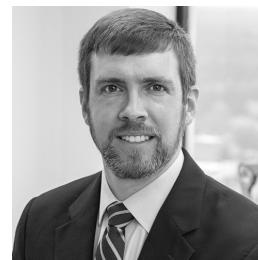
Family-owned and privately held agencies may have a unique opportunity to transition/gift ownership in the current market

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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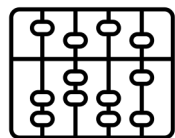
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Services for Insurance Agencies

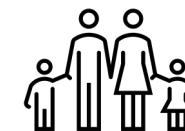
Mercer Capital provides valuation and advisory services to insurance agencies. We also work with brokerages, underwriters, insurtech companies, third-party administrators, and other industry service providers.

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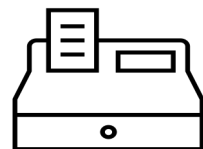
Corporate Valuation



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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