



**SUCCESSION PLANNING  
ON YOUR TERMS**

*Todd Gray, Chief Financial Officer  
Oak Street Funding*

1. Agency principal between 50-80 years old
2. Children or long term key employees active in the agency
3. Desire to provide employees and customers long term opportunities
4. Predictable commission stream
5. Desire to create some level of liquidity

...Is this you?

If this is you, you're not alone.

“A disturbing reality is that the insurance industry is aging, with the average age of agency principals at 51, and the average age of the agency customer base at 53.

Current statistics indicate that there are 2.3 million workers in the insurance industry, and more than 1.0 million of these workers will reach retirement age in the next 10 years.”

*Source: Independent Insurance Agents & Brokers of America-Trusted Choice*

What it means is that you have 2 very broad choices...



**Do  
Something**



**Do  
Nothing**



## Do Something (Succession Planning)

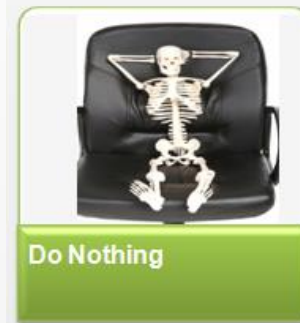
- Plan to sell externally
- Plan to sell internally
- Other: Estate planning

### Results/Consequences

- Maximize value for owners through an orderly plan to create liquidity
- A conscious decision is made with respect to succession
- Internal-leadership is transferred to a trusted team member
- External-Became part of another organization
- Business associates' future gains some clarity

## Do Nothing

- Maintain control indefinitely
- No plan for liquidation or wealth transfer
- Potentially die in the chair



### Results/Consequences

- Potentially dilute value-Estate taxes could force a fire sale
- Business associates may be at risk
  - Employees
  - Carrier markets
  - Sub-producers

## Sell Externally:



Sell to an  
Aggregator

1



Sell to a Private  
Equity Firm

2



Sell to a Carrier

3



Sell to a  
Competitor

4

## Sell Internally:



Sell to the  
Employees  
(ESOP)

5



Management  
Recapitalization

6

SECOND CHOICE  
IF YOU CHOOSE TO DO SOMETHING

***SELL EXTERNALLY***

# Sell to an Aggregator

1

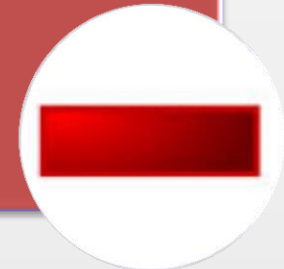
- **Liquidity**
- **Taxes**-Favorable tax treatment (Capital Gains)
- **Growth**-Possible source of growth capital
- **Efficiencies**-Possible with common platforms
- **Markets**-Greater access
- **Valuations**-Generally higher, but will likely include a significant earn-out component
- **Participation in Future Success**-possible through the “earn-out” as well as incentive compensation
- **Long Term Investment Horizon**-generally not a 3-5 year hold (longer view)
- **Business Understanding**-More tolerant and understanding of market cycles

Aggregator  
Sale



- **Loss of a Certain Amount of Autonomy** – Decisions are no longer made exclusively by the agency owner. Now have a boss, which is sometimes difficult.
- **Growth & Profitability Expectations**-Under the spotlight with significant return on investment expectations (both growth & profitability)
- **Turnover**-May not appeal to current staff as succession opportunities may appear to be minimal
- **Existing Markets**-May not fully embrace, they may feel at risk
- **Potential Cultural Clash**

Aggregator  
Sale





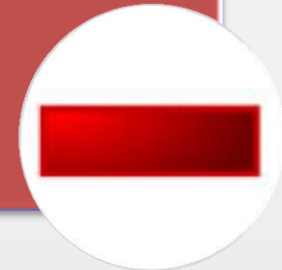
- **Liquidity**
- **Taxes**-Favorable tax treatment (Capital Gains)
- **Growth**-Possible source of growth capital
- **Participation in Future Successes**- Participation can be meaningful, often 10-20% common equity ownership (after satisfying P/E firm's carry)

P/E Sale



- **Loss of a Certain Amount of Autonomy** – Decisions are no longer made exclusively by the agency owner. Now have a boss, which is sometimes difficult.
- **Growth & Profitability Expectations**-Under the spotlight with significant return on investment expectations (both growth & profitability)
- **Markets**-P/E Owner will not generally bring new markets
- **Turnover**-May not appeal to current staff as succession opportunities may appear to be minimal
- **Investment Horizon**-Generally short (within 3-5 years)
- **Business Understanding**-Often no real understanding of the business, its simply an investment. Some owners are better than others-screen carefully.
- **Potential Culture Clash**

P/E Sale



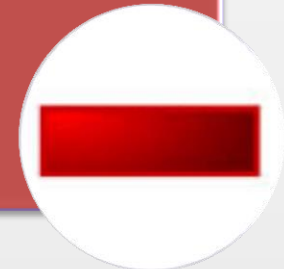
- **Liquidity**
- **Taxes**-Favorable tax treatment (Capital Gains)
- **Growth**-Possible source of growth capital
- **Efficiencies**-Possible with common platforms
- **Strategic Alignment**-Can be viewed as a “defensive play” for carriers
- **Understanding**-More tolerant and understanding of market cycles
- **Long Term Investment Horizon**-generally not a 3-5 hold (longer view)

## Carrier Sale



- **Loss of a Certain Amount of Autonomy** – Decisions are no longer made exclusively by the agency owner. Now have a boss, which is sometimes difficult.
- **Access to Markets**-Could be “challenged”
- **Business Models**-Differences between agency & carrier models can be meaningful
- **Bureaucracy**-Typically increased
- **Price**-Generally not paid for U/W profit (as capital is needed to support U/W profit)
- **Capacity Decisions**-May have competing agendas with other lines of business
- **Turnover**-May not appeal to current staff as succession opportunities may appear to be minimal

## Carrier Sale



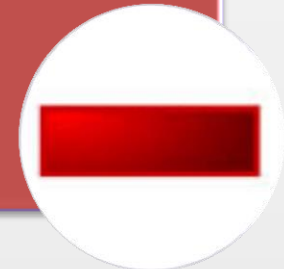
- **Liquidity**
- **Taxes**-Favorable tax treatment (Capital Gains)
- **Growth**-Possible source of growth capital
- **Efficiencies**-Possible with common platforms
- **Understanding**-More tolerant and understanding of market cycles
- **Long Term Investment Horizon**
- **Access to Markets**

## Competitor Sale



- **Loss of a Certain Amount of Autonomy**  
– Decisions are no longer made exclusively by the agency owner. Now have a boss, which is sometimes difficult.
- **Turnover**-May not appeal to current staff as succession opportunities may appear to be minimal
- **Potential Cultural Clash**-May result in customer and employee dissatisfaction (screen carefully)
- **Growth & Profitability Expectations**-  
Under the spotlight with significant return on investment expectations (both growth & profitability)

## Competitor Sale



***SELL INTERNALLY***

# Sell to Employees Through an ESOP

5

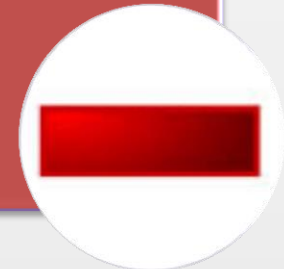
- **Liquidity** – ESOP's can create a liquid market for stock of privately held company.
- **Tax Benefits** – There are both tax-deferral opportunities and tax-deduction opportunities.
- **Employee Motivation/Performance** – Employee retention, production and satisfaction may result from the stock ownership opportunity.
- **Autonomy**-Completely maintained
- **Culture**-Completely maintained (if not enhanced)
- **Planned Exit**-Business is sold and transitioned on mutually beneficial terms
- **Succession**-Positions future shareholders for longer term value
- **Business Continuity/Turnover**-Business retains current team

Employee  
Purchase  
ESOP



- **Cost and Complexity**– Establishing and maintaining (administratively) an ESOP can be expensive and complex.
- **Potential for Lower Pricing Multiple** – Seller may not realize as high of value with an ESOP. Additionally, they may be required to hold a portion in a seller note structure or be required to provide a personal guarantee to the lender.
- **Fiduciary** –Liability associated with the ESOP.
- **ESOP Debt**-ESOP generally has to borrow (incur debt) to purchase ESOP shares.

Employee  
Purchase  
ESOP



SELL TO EMPLOYEES THROUGH AN ESOP

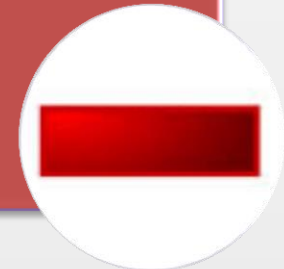
- **Liquidity**
- **Taxes**-Favorable tax treatment (Capital Gains)
- **Business Continuity**-Business retains its current team
- **Planned Exit**-Business is sold and transitioned on mutually beneficial terms
- **Succession**-Positions future shareholders for longer term value
- **Participation in Future Successes**-If staged over time current owners participate
- **Employee Motivation/Performance**
- **Autonomy**-Completely maintained
- **Culture**-Completely maintained
- **Ongoing Agency Profits**-Pay for the purchase

## Management Recap



- **Debt-Service/Covenants**-Ongoing until debt is satisfied
- **Personal guarantees**-Required to complete transaction
- **Assets Secured**-Senior lien on agency assets
- **Growth Capital**-May be somewhat limited as debt capacity may be filled.
- **Cash Flow Impacted by Debt Service**

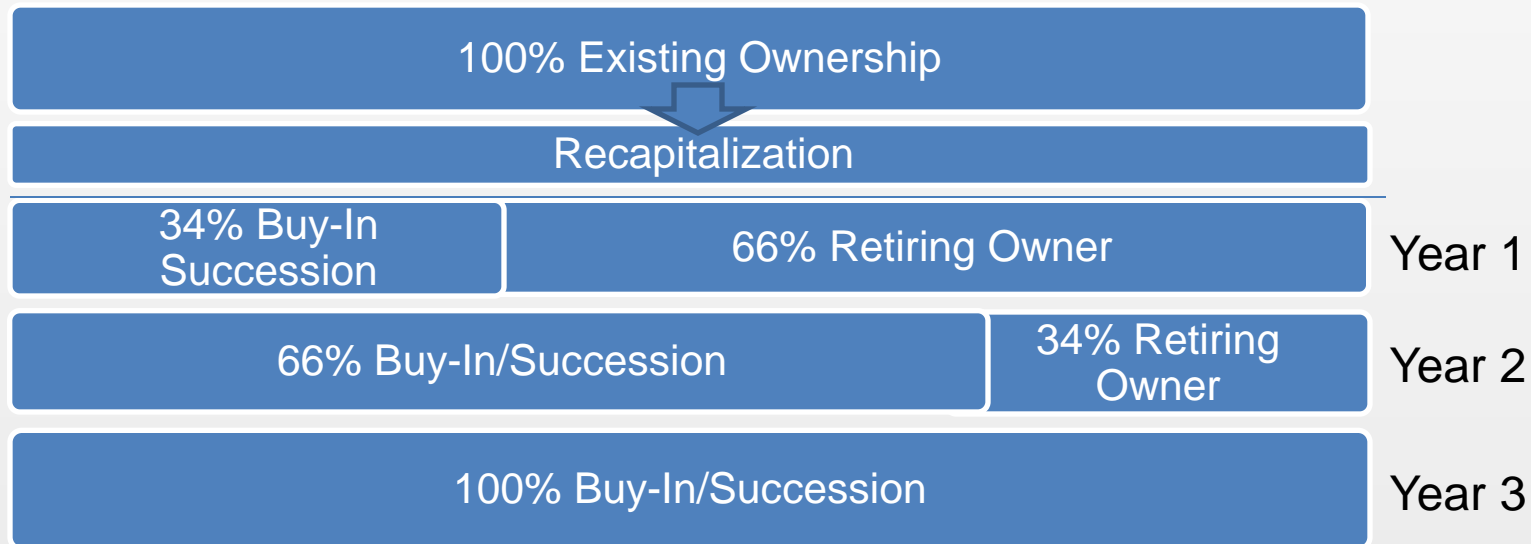
## Management Recap



- Transfer of company ownership over time to:
  - Family
  - Key Employees
- Provides seller with exit cash/and favorable tax treatment while ensuring continuity of the business and its legacy
- Business is sold and transitioned on mutually beneficial terms
- Positions future shareholders for longer term value (Succession)
- Autonomy and culture (2 big variables) are maintained
- Turnover and employee empowerment are favorably impacted.

# Succession & Recapitalization Loan

- Proceeds from each loan draw are used by the agency to begin repurchasing the owner's stock using a treasury stock approach.
- Equity is redistributed among succession owners after each draw.





# Case Study

## RECAPITALIZATION EXAMPLE



**TexCap-Concord**  
Insurance Services, LP

OAK STREET  
FUNDING 

## Recent Example:



**TexCap-Concord**  
Insurance Services, LP

### Recapitalization Summary

- Succession for majority owner had been discussed for a number of years without any action
- Owner had previous offers to sell, but wanted agency to remain intact and independent
- Strong management team with extensive experience & relationships wanted to control their own destiny
- Rather than selling out, management buyout/recapitalize proposed

### Agency Makeup

- Agency reputation was superb but new business growth challenged
- Management team had worked together 20+ years
- Contracted with great carriers
- Needed capital to create liquidity for majority owner
- Needed capital to grow



OAK STREET  
FUNDING

## **The Transaction:**

- **Multi-Million Succession/Recapitalization Loan for Agency**

## **The Results:**

- **Majority owner able to create liquidity**
- **Active management now control 100% of all stock**
- **Management & staff were retained and are now fully empowered**
- **Debt is serviced by the agency's ongoing profits**
- **Existing carriers are happy as none were displaced**
- **Additions to team have been made as a result of employee ownership (equity is contemplated for some of these future hires)**
- **More NEW Business in the first 6 months of 2013 than previous 2 years combined!**



## **PREPARING TO SELL/EXIT**

*You've heard it before-*

*Failing to plan is essentially planning to fail!*

Regardless of who the ultimate buyer becomes the following are relevant steps in the preparation process:

- Allow yourself time (2-3 Years) to get “house in order”
  - Honestly & thoroughly assess your strengths & weaknesses
  - Develop a comprehensive growth and profit plan
  - Maintain accurate financial statements (review/audit)
  - Minimize personal type transactions-get a clean “run rate”
  - Continue to improve renewal and profit trends
  - Grow the business-improves multiples in valuation
- Secure advisor team
- Understand your current valuation
- Targeting buyers
- Understand structural components of a typical transaction

**3 Years  
Before**

- Secure team of advisors
- House in Order
- Compilation Review-Accounting

**2 Years  
Before**

- Maintain/Improve Profitability
- Reduce Debt
- Exhibit Growth-Better Multiples

**1 Year  
Before**

- Secure Sale Advisor Team
- Know Fair Market Value of Agency
- Advertise/Seek a Buyer

# Secure your support team of professionals:



- What really drives valuation?
  - Future cash flow\*\*\*
  - Growth trends
  - Quality/Consistency of underwriting results
  - Predictability of results
  - Team
  - System/Infrastructure
  - Markets maintained by agency
  - Potential cost efficiencies
- Understand Your Valuation-An independent valuation can be conducted quickly & efficiently by:
  - Consulting Firms
  - Brokers
  - Investment Bankers



- Assess current staff for succession candidates
- Consider carrier markets (defensive strategy)
- Utilize a business broker/banker
- Reach out to competitors/aggregators/P/E firms
- Take advantage of free listing sites:
  - Agency Exchange (Oak Street's free service)
  - AgencyEquity.com
  - Broker Sites



- Typical Structure
  - Cash at Closing
  - Earn-out
  - Non-Competes/Non-Solicitation
  - Ongoing Employment Agreements
- Financing Components
  - Equity
    - Buyer
    - Investors
  - Senior Debt
  - Subordinated Debt
    - Seller Financing
    - Earn-out
    - Mezzanine Debt

	Equity	Mezzanine Debt	Senior Debt
Typical Structure	Pref/Common Stock	Debt with Warrants	Revolving Debt
Horizon	3-7 Years	3-7 Years	5-10 Years
Risk Tolerance	High	Medium	Low
Cost	30-35%	18-25%	<10%
Hidden Costs	Potential Loss of Control	None	Personal Guarantees
Customization	Flexible Standards	Flex Standards May Exist	More Structured
Senior/Security	Unsecured	Junior Lien	Senior Lien
Equity Dilution	High	Low	None

## SENIOR DEBT

	SBA	Bank	Oak Street Funding	Mezzanine	Equity
<b>Source</b>	Large & community banking institutions	Large banking institutions with industry presence	Specialized lending facility to insurance industry	Typically large institutions with industry presence and/or mezzanine equity funds. Limited Liability.	Private equity individual investors and funds
<b>Description</b>	Senior credit, likely to incl. liquid & other personal assets as collateral	Senior credit facility, may require liquid collateral	Senior debt product based on intangible assets	Hybrid between debt and equity, subordinated to senior debt	Common or convertible preferred stock, generally with coupon rate
<b>Collateral</b>	Secured interest in all business assets & likely personal assets	Secured interest in business entity	Secured interest in business entity	Secured interest in business entity, warrants for equity purchase	Ownership
<b>Terms</b>	7 yrs working cap, 10 yrs hard assets, 25 yrs real estate	5 - 7 years amortization	7 - 12 years amortization	5 - 7 years amortization	Coupon payments and expected liquidity event
<b>Interest Rate / Cost</b>	Varies - Fixed & Variable	Varies	Varies - Preferred and Standard pricing	15% with warrants, Target 20% IRR	+25% Target IRR
<b>Origination Fees</b>	Varies - 2-5%	Varies - 1-3%	Around 3%, may be financed	Varies	Varies - 0-7%
<b>Personal Guaranty / Assets</b>	Varies, may include specific security in personal assets	Varies, may include specific security in personal assets	Varies	Varies	None
<b>Equity Interest</b>	None	None	None	Warrants or convertible rights	Ownership
<b>Control</b>	Lender	Lender	Borrower	Borrower	May include board seats & shareholder's rights
<b>Qualification</b>	Due diligence	Due diligence	Due diligence	Due diligence	Due diligence
<b>Covenants</b>	Controlling / Extensive, Heavy red tape	Controlling / Extensive	Passive / Protect collateral	Extensive	Shareholder's Agreement
<b>On-going Surveillance</b>	On-going reporting required	On-going reporting required	On-going reporting required	On-going reporting required	Board participation
<b>Exit Strategy</b>	None - pay off	None - pay off	None - pay off	Pay off or liquidity event	Liquidity event: Sale, recapitalization or public offering



***QUESTIONS?***