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Some Thoughts on Brokerage Values
Mike Berris, C.A.

We have observed the selling price of brokerages rise significantly over the past six months. Will these strong prices continue? We don't know. But if I was planning to sell my brokerage in the next five years, I might consider moving up the timeframe to take advantage of current market conditions. If you have no current plans to sell, it's important to manage your brokerage in a manner that will make it very attractive to potential purchasers in the future.

Before giving you my thoughts on the current state of broker valuations, I think it is only fair to let you know that my perspective is generally of a conservative nature. Over the years many of our clients have enjoyed very good returns on brokerage acquisitions that, at the time, seemed far too expensive.

I think it is important for the sellers of brokerages to clearly understand the concept of “Fair Market Value” is not a technical exercise based on commission multiples, rates of returns, cash flow or strategy. It is merely the highest price that one can get in an unrestricted free market given current industry conditions.

At the moment there are conditions in the marketplace that have created increased demand for good books of business. Some of these conditions include:

- Good profitability due to increased premium levels over the past four years,
- Barriers to entry in jurisdictions with public automobile insurance,
- Excess capital held by Insurance Companies, and
- The Canadian insurance market is not expected to grow at a rate greater than the economy thus creating strong competition for market share.

The position of the purchaser is somewhat more difficult. She has to decide if the price that is being offered makes sense given her particular business circumstances. It is all too easy to get caught up in the belief that “If I don't buy it today, it will be even more tomorrow so I better buy it and work out the details later”. This reminds me of Shakespeare's famous line in the Taming of the Shrew that goes something like this; “Married in haste, may you repent in leisure”.

It is our position that over the medium and long-term, cash flow and quality of the book will ultimately set the value that the market will be willing to pay. Therefore it is worthwhile to consider that the Insurance Bureau of Canada has predicted that the industry has entered a five-year period of decreased returns on investment and downward pressure on premiums. Whether this happens or not, remains to be seen, but whatever happens will have an effect on the value of brokerages.

Whether you decide to sell sooner or later, you should understand who potential purchasers may be and make a business case as to why they should pay a premium for your particular book of business.

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