"Day Two" - Life after the Transaction

By
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After four long months it's finally over! The wire transfers hit early this morning and the "suits" hit the road last night. Today, your office door opens wide, signaling that your transaction has finally closed.

The calls pour in.

Employees seem anxious, but by noon, their pensive looks give way. The white noise of client conversations and the clicking of keyboards reassure you that the staff is all on board. Today you talked a little coverage with a client and capital gains with your CPA. To reinforce "things will be better now" you drove *directly* home two hours early and left your Blackberry in the car. In all, Day One was a pretty good day. It always is. That's because:

Life Under New Ownership Begins on Day Two

As a serial "Buyer" and two-time "Seller," I have lived the afterlife of Agency/Brokerage transactions. In my youth, a defective gene led me to Underwriting. As my condition deteriorated I sought relief as a Producer, applying cold calls liberally. Eventually, dementia set in and I gave up the good life for the corner office. So believe me: I know. The word "Integration" can still cause riots.

Like it or not (mostly not), the winds of change are building inside those proforma forecasts. Of course, the winds of perceived change are directly proportional to the level of Kentucky Windage distilled into those forecasts. Some Sellers breeze thru an ownership change while others get blown away. That's because:

Sellers Obsess About Day One While Buyers Obsess About Day Two!

Day One sellers typically want one thing: more! I've often heard "you only get one shot," but nothing could be farther from the truth if you're planning on hanging around! OK, it's only natural that the "right-hand column" is a prize (that's the far-right spreadsheet cell entitled "Net Proceeds to Stockholder").

You should obsess about Day Two.

You should be working the room, allaying fears, promoting improvements until everyone sees that you're not really selling out, you're buying in. If you do this, the winds will be at your back. So, if you're thinking about a transaction here's a fun fact from Dan. That Day One feeling lasts

24 hours, maybe longer if you buy a condo in Hawaii. Day Two takes up the rest of your days. Don't focus on the finish. Focus on the beginning. Don't focus on going to Hawaii. Focus on going forward!

The Buyers Agree:

At a recently sponsored M&A symposium, our Buyers panel (Titans, all) agreed on many things. Most notably: **"Get your house in order first!**"

Fair enough; that's sound advice. But the dangling participle in that phrase is: **"So we don't have to!"** If your house is in order life after the transaction will be fine, in many ways better. If you're paying attention to your business, the Buyer will focus on other locations that aren't. Most of you will love life after the sale, recognizing that some in your firm won't. Don't fret too much over that; they're the ones who carp the most now. The sale will just give them new material.

How will life after the sale be?

Start here: Your P&L measures your vital signs. Unless you're investing heavily into a growth strategy (new producers, juiced up new business comp plan, additional resources, you bought a "team" with non-competes, etc.), and your pre-distribution margins are in the teens, your house is *not* in order (regardless what your W-2 says). Think of your P&L as an inversely correlated "misery index" of sorts after the sale. That's a tad harsh but it's also a tad true.

If your house isn't in order and the Buyer bases Day One on the assumption that improvements will be made, then you should assume the Buyer will make those assumptions come true.

That's not just business, it's a Law!

Newton's first law of physics states, *"A particle will stay at rest* (think low-end multiples here) *or continue at a constant velocity* (think happy multiples here) *unless acted upon* (on Day Two, by the way) *by an external force*" (that would be the Buyer's integration and management team). If you're wondering what those influences are going to be, that's easy. You gave the Buyer a list (See: Assumptions and Proforma Adjustments).

If your trend is so-so, then so is your right-hand column. Knowing you can't have that, your Consultant models a logical graph based in reality, albeit a future reality. The graph resembles the Nike swoop. The Buyer is skeptical, but in the end, accepts it because as the phrase goes, "*you* gotta live with it." If you are collaborative and reasonable, open to improvement in certain areas and focused on Day Two, you'll enjoy solid value, lose 15 pounds, forget your cardiologist's first name, and complain more about taxes while you tell your same-age clients at renewal, "It's the best thing I ever did."

I know…the hand-wringing, the dread of slaving over a hot desk in a mean and spitty existence over which you have no control. But, (and here's the really important part) IT'S NOT GOING TO HAPPEN! If that's the reason you're not moving forward then that's not the *real* reason you're not moving forward. Read: "*Who Moved My Cheese?*"

Do you remember the old phrase, "You are what you eat?" Buyers have been living on a steady diet of Producers and Entrepreneurs just like you for decades. There are more of you/us in their cultures than anything else! Sure they have more layers and they are a little more preoccupied with pipeline reports (public companies have onlookers too), but they are generally great folks who love the business. Which leads me to conclude?

You Control the Quality of Life After a Transaction and the Buyer Wants it That Way!

So…

"Clean-up your house first" and "Do it now!"

If you don't know where to start, give me a call (shameless plug). Knowing what to do is simple. Knowing *how to* do it is the key. That's the Broker's Path motto.

Now, don't get the wrong idea. Your Org chart isn't drawn on an etch-a-sketch. You can't simply shake off the old ownership and start anew, declaring, "Our new owners want to change this…that…and…that…and, well…that too," without setting expectations before the sale. It's not only unfair to the Buyer (insert the word "Boss") the staff will feel sold out, as well.

Darwinian forces will kick in. The strong and most capable will pursue other options, leaving behind a weakened production and service environment. The Buyer's credibility tanks and your legacy will be written on the faces of those once loyal to you. The man in the mirror won't like you much, either. Those pre-deal concessions we call "adjustments" await you on Day Two.
It's best to face them before then.

Still, if the scope of change is too daunting, that's OK. Be honest with yourself. If your partners are at odds and things seem polarized, then trying to fix the situation by ignoring the situation usually doesn't work. The employees sense the dysfunction, and in many cases they've learned how to exploit it. Your best employees will welcome the next life and so will you.

The same goes if "Old Joe" really is getting on in years and it's time. *By definition*, it's time. The employees know it's inevitable. They've stayed friendly with your competitors; they'd be nuts not to. What they don't realize is that the Buyer values them more than Old Joe. They'll be fine.
"Clean-up your shop" is good advice from some of the best-of-class Buyers.

BUT!

We're talking about staring down some issues, not melting them down! If you want to take on a group of malcontents who comprise twenty-plus percent of the revenue, or separate with stockholders, or force "Old Joe" out the door, or mess with contracts, then hold on a minute there, Bob Vila. This old house may need a major remodel but drop the chop saw and step away from the building! We need a word with you. Seriously!

Let's talk specifics. If your past reflects your future then let's consider some possible scenarios.

Platform Entities:

If you are a "platform" entity then much of what I've said seems useless because it is (to you). You not only stand alone, you stand tall and cast a shadow.

Management contracts? No problem! The Buyers will probably bring it up first. "Localized" producer comp plan? Probably. If your margins are high, definitely. Don't want to convert your agency management system? Fine – a software bridge it is. Want to keep your same bank? No way! (Just curious if you're still paying attention.) Accounting? HR? IT? Platforms need these kinds of assets close, if not onsite. Unsure? See "allocations" in Webster.

Platform firms have sophistication, capacity to bolt-on others, and a serious commitment to niches and specialization. They grow their own: producers, account managers, claims management, and leaders. They're professionally managed. They're dialed-in to a stressed, but top-notch, loyal staff that clears the runway for new business.

If you're in a Platform agency you are going to love Day One and every day that follows as long as you go to work most days (pay attention) and you don't try to change everything the Buyer does to fit with what you do. The Buyer is a little intimidated as it is.

Platform firms are rare, and rare things get special treatment. Oh, and one last thing. Expect the Buyer to insert a mid-level minion into your Accounting; HR, IT, Claims or Loss Control units (in that order of Buyer preference)…just to get an unfiltered version of what's going on.

Large (whatever that means) Well Run Firms:

If you're considering a sale, then it's likely you've outgrown your ability to cash-flow internal perpetuation and you can't distribute earnings fast enough, issue stock promissory notes big enough, move books around large enough, and internally discount your stock small enough to keep pace with your value. Or, you had no intention of doing any of the above. Either way…

Buyers don't buy something with the intention of breaking it. Buyers *really* want your kind of firm. Like Platform firms, the word "respect" comes to mind when Buyers think of you on Day Two. ("Shaa' shing!" comes to mind on Day One.)

There will be changes, but not at the core level. The same account managers who whined about accounting will grouse about the Buyer's invoicing and posting procedures after the sale.

The "conversion" to their system will be a 120-day hassle, more, maybe less, depending upon how much you actually use the one you have now. Some Buyers may offer an IT bridge and simply roll-up the accounting.

The Buyer will try to get your hunters to stalk bigger game. Producer comp morphs at some point after you true-up the comp calculations for the stub-year prior to the sale (if applicable). Net book growth is the driver, and culling the small accounts is a (necessary) given. Support titles change, because there's some discrepancy between your job descriptions and the Buyer's. To avoid cubicle wars, title inflation is a given.

If you permit premium advances (shame) and give 90 day payment options, then expect a few lumps on the head from the Buyer's accounting department and the affected Producer. You're probably compliant with fee agreements and contingent income disclosures, but just to make sure the Buyer will make you do push-ups. Guaranteed, they'll find the accounts the Producer has been "protecting." Good riddance to your web page which was a constant source of irritation to you.

Managers will be on conference calls a lot more and your inbox will keep you posted on the comings and goings of places you've never heard of.

That's it.

Oh, by the way. Buyers will fall all over themselves to align with you, in some ways even more than platform firms because you'll fit in easier and sooner. Platform firms are exceptions to the norm. Buyers like norms. Your rain-making producers will love the resources. If you're in this situation, go with God! You'll love the next life!

Large and Not Performing Well

Selling is a good idea. It was a much better idea awhile ago!

Your metrics, by definition, are low. You're not spinning-off enough cash to fund internal perpetuation (or much of anything else), so ownership is spread amongst the few. Or just the opposite, it's in the hands of everyone (a la an ESOP) or something very diffused.

Your accounts have been with you forever, which is how long it's been since you booked a lot of new business which, in a way, is nice. New accounts run a temperature and because your clients are loyal, your loss ratios are ridiculously low. That's one thing the Carriers love about you. That, and going to lunch with you because the conversation is seldom business related. How could it be?

You treat your staff well, among which there are two kinds: the ones who've been around since the Nixon administration, and the ones who have been with you less than a year and have no intention of going to the Christmas party (which you still call it). Everyone loves the firm even if they don't care much for each other. Owners would do (and have done) anything for an employee in need.

Most everyone in the firm is honorable, caring and nice, something they have in common with your clientele. Overtime, you've jettisoned the employees and clients who made noise. Most clients are relationship buyers in need of few resources.

Loyalty abounds everywhere and no more bountiful than in the heavily weighted renewal-book compensation plan. Contingent income – not operations – fund owner distributions (or replenish working capital) and little else. The place is civil. The office is nice. Most days the producers' doors are closed. Email keeps everyone connected and offers a safe distance between one another.

Not so?

Then, you were recently quite great – an icon. If so, then you; just lost a vital program, a Mondo account, you specialized in condo-wraps or Med Mal, you had a production team without restrictive covenants bail, had issues with your bank D&O exclusive, or *whatever* and things went south quickly. Maybe you grew through acquisitions and outran your supply lines and your results show it. If you are this firm or the other firm, then either way you won't be this way for long, "Large," that is.

I'll make this easy.

Some Buyers will shy away if you recently imploded. But if you are a legacy firm (above) then most Buyers will be intrigued, because the numbers are big. A Buyer will build things around your younger producers with the most promising skills. Since there is no longer a need to code accounts under your name to justify your compensation, those Producers will inherit the earth. They'll learn to say something new like, "I have an Account Manager who can help you with that." There will be lots of account shifting to offset the impact of the new comp plan, but that went on under your watch too.

"Senior" Producers will commiserate about change over lunch and long for the good ol' days. (Note: your approval rating among the good ol' boys for the good ol' days goes-up dramatically, but eventually tanks because you did, after all, put an end to those days.) The good news is that Buyers suffer fools pretty well, actually. So unless those Producers cause grief, shrink, or lead the resistance movement, they'll be fine. Upset with the new comp plan (that you agreed to), but fine just the same.

Your loyal clients will stick around to "watch." Earnings will soar. Carriers will say: "Wow! The place is really changing." That's code for "It's about time!" Your staff will caw about all the changes. Eventually, the ones who stick it out will come to love how a well-run company functions. They'll love their W-2's too!

Your house (agency) is a fixer-upper's dream and though you won't be around too long, the sunsets in Hawaii make up for it.

The Middle and the Little:

I've lumped these firms together, because there's a limit to how much more you'll read and life for you on Day Two is a really big bell-curve on the continuum of life. If you're a ten-person Benefits shop doing $4mm of revenue, linked to some cool value-add technology generating 43% EBITDA…you're a peach even in today's healthcare debate! (This was written in the fall 2008. For updated forecast see "Friends with Benefits" article written June 2009.)

Life for you looks like it does for the large, well-run firms. In three months, you'll forget you actually sold the firm! We all wish we were you! Buyers want you *because* you're different, special and potentially exportable.

If you're a ten-person mixed P&C generalist shop pushing $190k thru the door each month, half of which is small commercial and personal lines, and you've been around a while, then your world is subject to more change, *especially* if half of the small accounts are coded to you. You'll like Day One, but folding you into an existing location, moving you towards new business production, institutionalizing your smaller accounts, "normalizing" your compensation, and getting the crew to follow the *Buyer's* procedures *will* happen and most Buyers are going to be totally up-front with you about that. They want you to stick it out, so they'll work with you…albeit more firmly.

Not Sold Yet? (Pun intended)

This article is entitled "Life on Day Two." I contend that whatever you are (or aren't) prior to the sale determines in large measure how things will go for you. Now let's talk about why.

Let's delve into a Buyer's psyche.

All Buyers are the same in that they live and die by the success of their integration (that, and they're all mammals, of course). Very little integration goes on with platform firms and a whole lot of risky turmoil transpires with smaller ones. The *Art of the Deal* is such that, today, Buyers are sophisticated, careful about "fit," and obsessed with excellent integration and earnings pointing north.

Buyers are predictable.

If the deals are dilutive, the Board frowns at the CEO who then wallops the M&A team (these days anyway), and the integration team gets sandwiched between the wants and desires of both Buyer and Seller.

Buyers obsess about actually generating the earnings you said they would earn. If they do, they've moved on to court others, leaving in place persistent reminders (and hopefully resources, capital, markets, risk management, producer recruitment, etc.) to grow those earnings by (presumably) growing the top line.

I'll end with this:

On a flight home my wing-man (and COO) turned to me and said: "You know he can't do it? Right? You know he can't get those numbers and turn that place around…right? You know we can't make sense out of his target price…right?! He's relying on us to teach his guys how to sell. He has no clue how to clear the runway, attract talent and drive the process. Their system is a glorified accounting program. He's a yellow-pages guy…you know that…right?"

"Why do you say that?" I muttered, knowing full well we would die a death of a thousand cuts if we bought this firm.

"Because Romain, if he could do it…he already would have."

"Maybe he doesn't know what to do?" I half-heartedly deflected. "Maybe he simply doesn't know how?"

There was a brief pause as my partner reloaded.

"Great…" he sulked with a frown. "Great…Ya know it says here that his base salary would be twice what it should be. He'll make more than a guy with a $700,000 book who is writing new business. His book consists of ten nice accounts which he'll probably lose if we don't buy him. The rest is small commercial. Did you see all those files? The fire-load alone is a hazard! Did you meet his Office Manager? She's one of these," he held up his Bose headphones, "she's nothing more than a noise cancelling device! And, if I'm wrong about that…then tell me again, just exactly what does he do?"

Since I loved it when his veins did that thing they do, I responded with a doubtful look.

"Great…fine…I'll just have HR put '*must be told what to do and how to do it'* in his Employment Contract and Results Expected," he said, dripping in a pool of sarcasm.

"His 'stretch goals' might be kind of fun to come up with!" I smiled, confirming I wasn't entirely out of my mind, at least that day.

Weak results over time result from weak leadership. Strong begets strength. With an overtaxed management team and no clear person to insert into the leadership role, we passed. If we hadn't, we would have had to change almost everything and everyone would have been miserable…which is what happened.

The folks who convinced themselves to buy the agency finally called "time of death" around 40 months later, unwilling to operate any more.

If you run a good shop, have good margins and a promising outlook on the future, you are going to love the kind of treatment you receive on Day Two…after celebrating on Day One!

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