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## **SMALL-TOWN FOCUS — BIG-TIME POTENTIAL**

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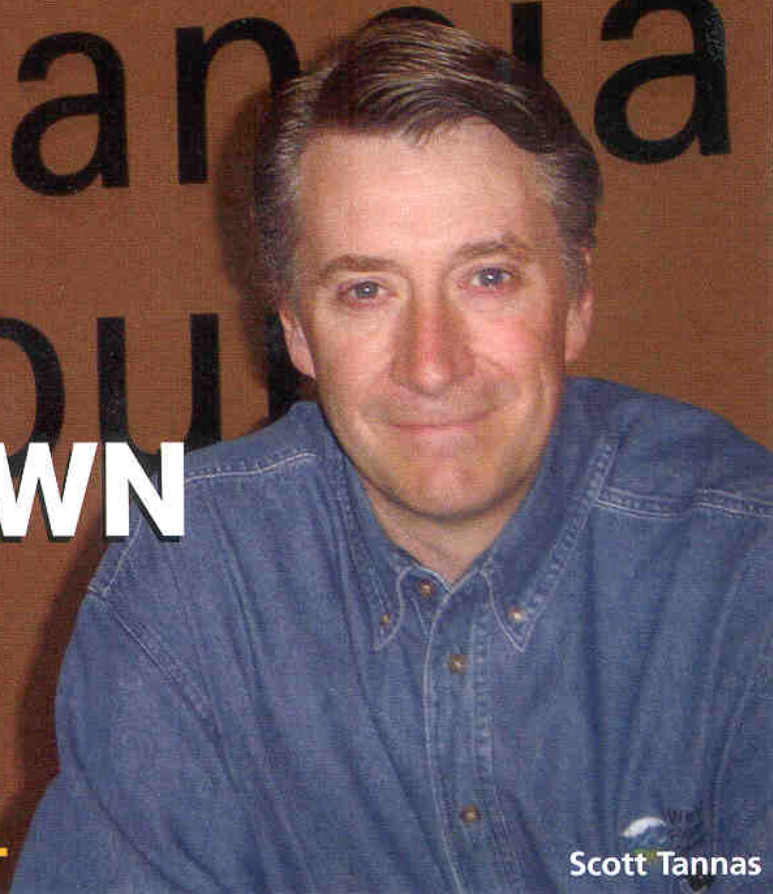
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Western  
Financial  
Group

## SMALL-TOWN FOCUS— BIG-TIME POTENTIAL



Scott Tannas

### WESTERN FINANCIAL GROUP CONTINUES TO EXPAND IN SMALL TOWNS ACROSS THE PRAIRIES

By Barbara Aarsteinsen

Only a few years into his insurance career, Scott Tannas got his wake-up call. Shocked when his brokerage was cancelled by a market with which it had had a relationship for more than half a century, he vowed to never again be at the mercy of insurance companies.

"We had a real slap in the face that made things clear to us," Tannas relates. "A company that we had dealt with for 50-odd years sent a guy down who we had never met to cancel us. It was a very short meeting. He told us that we did not

have enough volume and that the company had drawn a line and everybody below that line was being cancelled — no hard feelings, it's just business. And he walked out the door. That really brought my thinking into focus."

To make sure he always had buying power, and because he was also worried about the incursion of banks and the rising cost of technology, Tannas decided that one way or another he had to expand his operations. That small-town brokerage, Hi-Alta Agencies, has now evolved into Western Financial Group, a broker-

age and financial services company with aspirations to become an empire.

Since 1996, the High River Alta.-based firm, which is publicly listed, has acquired 58 offices in Alberta, British Columbia, Saskatchewan and Manitoba to create the WFG Agency Network — the fourth-largest p&c broker in Canada. It is also the minority partner in some regional chains in B.C. that cover another 20 communities; ultimately, it aims to own those offices outright. Tannas estimates that there are 210 communities in Western Canada outside metro markets that are growing from a population and an economic activity point of view, and he intends to be in at least 200 of them by 2010.

"When we are, then we will feel that we will have built out our marketplace. We will have the coverage in Western Canada that allows us to say we're done with that era of acquisitions and we can

Photo: Barbara Aarsteinsen



focus more on selling more to our customers and we can increase our market share. By 2010, we will have been 15 years growing our business.”

Under the WFG umbrella as well is Bank West, a chartered bank, Western Life Assurance Co., which sells life and health products, and a group of six travel agencies that operate as Marlin Travel. Further, the company has a 29.7-per cent stake in Jennings Capital Inc., a Calgary-based investment dealer. It has just moved into a new 3,500-square-foot headquarters and publishes its own magazine, *West*. Indeed, by 2020, says Tannas, WFG is looking to become nothing less than the strongest financial institution in the West, akin to what National Bank and Desjardins are in Quebec.

“The company is a pretty good proxy for what is going on in Western Canada,” says Brian Pow, an equity analyst and vice president of research at Calgary-based Acumen Capital partners, who initiated coverage on WFG earlier this year with a “buy” recommendation on its stock. “The company has grown from grass roots and is successfully taking advantage of opportunities, establishing one of the first chartered bank in Western Canada and meeting the needs of a growing, diversified Western Canadian economy.

“We may be living in an electronic world but personal relationships in the insurance business are still important, and that’s one thing they’ve really got going for them — a personal touch,” he says. “When you look at the bank and lending side, they have been able to take advantage of all the people looking to buy second homes and recreation vehicles. They have been able to cater quite well to that market.”

While Western Financial is determined to get even bigger, Tannas is emphatic that it has no intention of giving up its small-town, Western focus. He says that WFG will continue to target small communities located in the Prairies and has no inclination whatsoever to tackle urban areas. He says the firm prospers quite nicely in towns of 300 to 500 people. Its biggest market is Kelowna, B.C., population 100,000.

“I was always convinced that small towns would be different,” explains

Tannas, who was born and raised in High River. “Look at how insurance is sold in a small town: It’s retailing. You don’t see small town insurance brokers on the second floor or off in an industrial area; they’re on the main street. Our retail offices are right downtown. If you go into the city, I daresay that the majority of brokers are in industrial areas or in second-floor offices. It’s a different way of doing business. So I felt we ought to focus on one way of doing business and one way of thinking about the customer.

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“Kelowna is the big city for us. We have offices in places like Clyde, Alta., or Willowbunch, Sask., that are in tiny villages and yet we do just fine. We make money, we provide a good service to the community and we get the support we need to stay there. We’re very comfortable in smaller communities.”

According to Ken Hughes, one of the first investors and directors of WFG, the fact that Western Financial has maintained its focus squarely on secondary markets has been key to its success. Hughes later left the company to establish Alpine Insurance and Financial Inc.

but he says he and Tannas remain “very friendly competitors” because he has taken the opposite tack and is concentrating on larger centres in Alberta.

“They have stuck to their strategy and that has protected them from some of the competition that takes place in the bigger urban areas,” he says.

Once WFG runs out of desirable acquisitions in the Prairies, Tannas says that the firm will look to western U.S. states like Wyoming and Montana instead of heading further east in Canada, where his interest stops at the Ontario-Manitoba border. He figures he’s more attuned with the mindset in such neighbouring regions than he would be out in Ontario and beyond.

“We always knew we wanted to be in the West. We think that there is a set of customer demographics, of economic drivers and industry sectors that are common in Western Canada,” he explains. “They centre around commodities, around a high proportion of rural people in proportion to metro. If you’re truly responsive to the customer, then you’re going to follow that customer dynamic around. You’re going to expand until you run out of customers that fit that dynamic. For us, in Canada, we think that’s the Canadian West.

“Now I’ve had lots of folks tell me that I’m limiting myself, that Western Canada, after all, isn’t really that big; it has only 10 million people while all of Canada has 30 million,” Tannas acknowledges. “But thinking of our customer dynamic, there are the Plains states and the Pacific Northwest. If you start drawing a circle around that, then you have a market that is larger than Canada. So nobody can tell me that I’m limiting myself by not being in Toronto.

“It’s about the customer being the same. We have more in common with somebody in North Dakota than we do with somebody in North Bay.”

#### ENTREPRENEURIAL GENE

Tannas’ decision to focus on Western Canada has not been just a business decision but a personal, lifestyle choice as well. Except for two years when his school teacher father took the family to Africa as part of a government foreign aid project, Tannas spent all of his younger years in High River, a small



community about an hour south of Calgary, and he had happily planned as a teenager to stay in his hometown forever. He had come up with business ideas since he was 13, starting with a disc jockey service, with his mother squiring him to gigs, and he thought that he could easily and contentedly continue along that path. After “barely” graduating from high school, having been too busy with his extracurricular projects, he thought that the future would continue along the same lines.

“I was entrepreneurial from the word go, perhaps because I come from a line of entrepreneurs,” says Tannas. “My great-grandfather was an entrepreneur who was quite successful, was wiped out in the Depression, and then started building it all back again. My grandfather and all his brothers were merchants and entrepreneurs.

“My father was the first university-educated member of the family. He became a teacher and later a school principal, but he also was an entrepreneur. He and my mother had businesses that they ran in addition to their careers — they have a travel business and my mother had a little dress shop in High River. She was a nurse. So they kind of had that gene in them as well.”

Tannas’ mother, however, pushed him out of the nest, urging him to broaden his experience before settling down in High River. So he was bundled off to college in Calgary, which he ended up attending fitfully as his entrepreneurial urges got the better of his academic leanings. “I went to the city and enrolled in college and then got a job, and then got two jobs, and pretty soon I wasn’t going to college — I was living at the college residence and not attending classes,” Tannas recalls. “So I eventually dropped out of college and went to work full-time.”

His first serious position was in the travel business, an industry where he would end up spending a decade. He started out working in a call centre taking reservations for a small but growing tour company. Five years later, as the firm took off, he was the operations manager at the age of 26, running the call centre with 100 people under his supervision. Sobered by that responsibility, given that he had no formal management training, Tannas decided it was

time to widen his experience.

“During my first five years in the travel business I learned a lot about fast-growing companies, about people under stress, about trying to work quickly, trying to solve problems all the time, making things up as you go, and how important customer service is because we were all front line staff,” says Tannas. “Through those five years I really got a

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heck of an education but I needed something more.”

That led him to take a part-time post as a consultant with Canadian Pacific Hotels, working for a senior executive, who ran the Banff Springs Hotel, the Jasper Park Lodge and Chateau Lake Louise. He was assigned various projects and allowed to pursue other opportunities on the side. His boss, Tannas remembers, believed in hiring lots of young people and giving them lots of responsibility, so he got his wish for a broader and wider business background.

“He was a great guy — a visionary hotelier in the old style. He was an immigrant and had started out as a bell-

hop and worked his way up through the organization to its highest levels,” Tannas recalls. “He was a very colourful character, a legend out here.

“During the five years I spent as a consultant, I got to do a lot of good stuff and be part of lots of different things. There were huge problems at the resorts, particularly around getting staff. So I was kind of the guy who was given jobs where I could go in up to my eyeballs for a short period of time, try to focus on the issues and see what the solutions were or what the strategy was.”

Tackling the staff problem was one of Tannas’ big successes. As the tourist season gradually became extended beyond August and into early October, the Alberta resorts had a six-week window where they had trouble finding employees once summer students returned to school. He came up with the idea of recruiting brand new immigrants and refugees, who typically didn’t speak English and had no job skills, bringing them in to bridge the gap. The immigrants were trained as chambermaids and dishwashers and they got some Canadian job experience to put on their resumes. CP also started a school to help teach them English, so they came away with improved language ability.

“At the end of that period of time, we had a graduation. They got a piece of paper that said they were the best darn dishwashers there ever were and they had English as a second language, so they had a start,” says Tannas. “These were people, many of them, who had been in the country for less than a few months and were from some pretty awful places. So for them it was a real great beginning. Now, if I go to the Banff Springs, I still see some of those people; there are many, many of them who stayed and became full-time employees. In fact, a number of them are supervisors.”

Another problem Tannas took on was the dilemma of finding affordable permanent housing in Banff for the people who worked there year-round. He organized a project with 20-odd businesses to build a housing project, undertaking the enterprise on a success fee basis. It worked out and Tannas received a “nice” fee. With a wife and two chil-



dren by then, the oldest one ready to enter grade one, he decided that it was time to finally return home and use his new nest egg to build some kind of business in High River.

After some consideration, Tannas picked general insurance, attracted by the complicated nature of the business, the relationship-building aspect, and the big role that trust plays. As well, after 10 years of hard work, he wanted a lifestyle change, he says, pointing out that “every insurance guy I ever knew was a great golfer.” He approached his family’s insurance brokerage, Hi-Alta, which had served not only him for 10 years but his father, grandfather and great-grandfather before him. The firm had been established in 1901 and had then been owned for 20 years by two partners who didn’t have children in the business and were pondering retirement.

Considering Hi-Alta the strongest and most respected firm in the town and in the region, Tannas made a pitch. He couldn’t afford to purchase the entire agency outright so he proposed becoming a third partner who would buy the other two out over time. The owners agreed to the arrangement and Tannas found his niche.

He then embarked on what he describes as “the Ray and Wally management training program.” He spent his first year with Hi-Alta as a customer service representative, an experience that stands him in good stead today when called upon to deal with front line issues. In his second year, he became a producer, selling to commercial accounts.

“They didn’t really give me much of a map on how to do it since they’d never had a salesman before, so it was new territory,” says Tannas. “I just took the phone book and highlighted all of the business names in the phone book and then looked them up in the computer to see whether or not we had them as customers. If we didn’t, then I wrote them a letter saying I was coming to see them. I had the simplest sales line in the world: Could I quote on your insurance when it comes due for renewal; I think I might be able to save you some money. What businessman is going to say absolutely not, I don’t want to do that?”

Following that year of prospecting, Tannas took over all of the brokerage’s

management duties and his two partners started to scale back their input. At that point, he began attending insurance brokers’ meetings and conventions to meet colleagues, getting involved with insurance companies, and dealing with the staff. “I really took the lead on everything and they started taking long lunches and coming in late and leaving early and going on longer vacations,” he says. “So that’s how I kind of got eased into the business.”

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#### WEIGHING THE FUTURE

In the driver’s seat by 1995, with a load of debt on his shoulders, Tannas began some long-term strategizing. He identified three trends that concerned him and would shape his business planning.

First of all, he felt that the insurance companies were changing, especially as consolidation increased, and with that shift relationships based on trust and longevity no longer meant as much as pure economics. “It became all about how big could this relationship get, how are you going to get me more volume, and less about how we trust you, we sure love the history we have with you, and how can we help develop the business.”

Tannas explains.

“There was a time when we could pick up the phone and say we believe in this customer, we’re advocating for him, and we want you to take our word that this is a good way to go,” he remembers. “Our word wasn’t worth as much as it was in the past. It was going to be worth less going forward. You could just see these guys were getting bigger and bigger. If we stayed the same size, then a dilution in relationships was going to take place without question. To me there was a size issue that was not present in the past that was going to be prevalent in the future.”

The second challenge-cum-threat Tannas pinpointed was technology. He says that Hi-Alta was an early adopter of computers but they didn’t always live up to their vaunted promise. He found the existing technology inefficient and he foresaw never-ending costs in what looked like it would be a constant need for improvement. “I had come from the travel business where they have had very efficient computer systems for 30 years. I couldn’t understand why everything was less efficient in this industry,” he says. “You’d be better off with recipe cards than computers. All I could see was continual investment in the system with no payback and no efficiency. Boy, was I right. Here we are 10 years later, still with no solution that’s really capturing any really meaningful efficiency for us.”

The third issue was the incursion of banks into the p&c arena — what Tannas deems as the “the real storm cloud on the horizon.” They had got their foot in the door with some changes to the Bank Act and he believes that they will not stop until they eventually force their way right in. “That made me convinced that certainly by the end of my career, I would be leaving an industry where the banks, credit unions and potentially these large insurance companies that I had as my suppliers would be my competitors in the future, not the guy down the street that I could out-hustle — it would be big institutions.

“I really saw some things that worried me, that led me to believe that the business was undergoing some pretty big changes, that the ground was starting to shift. What I heard from colleagues was that they didn’t always agree,” says



Tannas. "But I felt strongly enough about it and I really was nervous. I had been given such a great opportunity by Ray and Wally and I was going to owe them a lot of money for a long time, and there was going to come a point where I was going to still owe them money and they would not be capable of taking the business back if it ever failed."

Tannas met with other brokers who were talking about working together through clustering — wherein separate and individual brokers come together in a loose alliance to solve problems and acquire greater leverage in various areas. But he was not keen on that approach, having seen it in action in the travel industry. Clustering only works, he says, until there is trouble in the ranks.

"The minute that you most need everybody to pull together is exactly when everybody rides off in pursuit of their own interest, and the whole thing falls apart. So you wind up going down a road with a false sense of security, only to fall apart at the exact wrong moment. I saw it time and again in the travel business. I believe that you've got to be committed through ownership if you're going to get through the hard times."

#### BUY, BUY, BUY

With that analysis, Tannas concluded that his only option was to get bigger and thereby increase his buying power with insurers, enjoy economies of scale on the technology front, and be prepared to take on the banks. He decided to stick with small towns because they were familiar and he considers rural brokerages to be more stable with a loyal client base. And he decided to take the company public in order to raise money for acquisitions. Was he daunted about going from one office to dozens, from a private company to a public one? No, he says, thanks to his CP experience.

"Canadian Pacific was the premiere company in Canada with all kinds of resources, so you had the biggest canvas that you could possibly have and you could say anything out loud and you wouldn't be judged on the basis of oh, we couldn't possibly do that. It was judged on well, does that make sense? Can we actually accomplish that and what value would be created? It was never oh, we could never possibly do that. Those

words were never in their vocabulary. It was a matter of whether something was desirable, not if it was possible."

With his game plan in hand, one of the first potential investors that Tannas approached was entrepreneur Hughes, a former Member of Parliament who ended up signing on as a director as well. Hughes later left Hi-Alta in 2000 to try the brokerage business on his own.

"I was motivated to work with Scott because I knew him to be a very straightforward, honourable person who would work hard to make a success at whatever he turned his hand to," says Hughes. "None of us at the outset had the grand vision that has been implemented but I knew at the time that we had a good shot at building the business because nobody is more persistently creative in making things happen than Scott. And he did end up carving out a new economic force."

The company became Hi-Alta Capital Inc., a capital pool corporation listed on the Alberta Stock Exchange; a few months later, it was listed on the Toronto Stock Exchange. Tannas started adding offices, beginning with one in the next town. He went around wooing potential candidates and, as he recalls, there was "a lot of romancing done" in the first 10 deals before the company gained momentum. By the time that the roster hit 15, a template for acquisition and integration had been hammered out. In 2002, the company changed its name to Western Financial Group Inc. and a year later Tannas was recognized as the 2003 Ernst & Young Entrepreneur of the Year in the professional/financial services category for the Prairie region.

"At around 15 locations we had had the battles, determined who was boss, who was really going to emerge as the leader. That was a difficult process but I think, for the most part, we made the right decisions about what to do. And then that was over," Tannas explains. "So now when you come to us we say here's what's going to happen when you join."

"Our pitch to potential sellers has changed a lot. It used to be: Come join us and lay your sword on the table with the rest of us, and we will figure it all out together, which was attractive. Now, we say that all those decisions have been made and we know what's going to hap-

pen. But for a lot of people it gives them some certainty. They know what their status is going to be and they know what they're getting into."

Now, WFG will snap up brokers as the opportunity arises, Tannas says, planning to push the expansion of the network along. Acquired operations typically keep their own name along with incorporating the Western Financial Group master brand, and the existing staff is maintained. However, common standards and service requirements are introduced. Overall business is 55-percent commercial and 45-percent personal lines.

Could WFG be an acquisition target itself? Not so easily anymore. Earlier this year, the company adopted a shareholder rights plan to "discourage discriminatory, coercive or unfair takeovers."

#### ONE-STOP SHOPPING

With the brokerage network chugging along, WFG made a strategic investment in Jennings Capital in 2002 that gave it a 29.7-percent interest in the firm. A couple of thousand of its customers now have Jennings Capital accounts. Ultimately, the goal is to offer investment products under WFG's own banner but Tannas says that the company will not rush in this direction until it finds the right product, something that truly adds value and would make Western Financial stand out in what is already a crowded field.

"I think it will probably be something in the area of retirement savings where there is a clear formula that if you do this, then when you retire this will happen. I think that's what people are looking for," he suggests. "The whole romance of saying I'm in and I'm out of the market, I'm trading this and I'm buying that, is too fleeting."

"Whatever you put forward, the taste will change. But there is a reality that every person has and it's that some day they're going to retire and they're going to have to live off the money that they've saved up. So, to me, finding something that addresses that fundamental need is what we're most interested in."

To further the idea of providing one-stop shopping, WFG attracted considerable notice when in January 2003, following



changes to the Bank Act, it created Bank West, a chartered bank offering GICs, loans, mortgages, premium financing and other products. That means that if the p&c industry must deal with greater bank powers than Western Financial “can at least figure out a way to bundle products and services and provide extra value,” says Tannas. “We want to be able to say oh, they’re going to give you that — well, here, we can find a way to save you money or help you to get both of those things as well. That’s what drove us.”

It has not been an easy road, Tannas concedes, but he thinks the bank has finally found its legs. Indeed, in the first quarter of this year it turned its first profit; by the end of March it also passed the \$100-million mark in total outstanding loan balances.

There hadn’t been a bank started from scratch in Canada for decades, he points out, so a lot of mistakes were made as the institution evolved. “It’s been in the last year to 14 months where we knew that we were onto something, that, oh, this was going to work and we’ve got the momentum that we need to carry on. But for the first couple of years we struggled and we questioned ourselves, and fought against ourselves in trying to do it. We just did lots of things wrong.”

Bank West sells all its products not through branches but through WFG brokerage offices, which accept deposits on behalf of the bank and refer mortgages and loans to the central High River location. The bank also works with some WFG customers who refer business — such as car, RV and boat dealers, mortgage brokers, and realtors. In fact, some 86 per cent of the loan transactions are in Western Financial Group communities but they come from all kinds of sources. More than 80-per-cent of the business is consumer-driven.

The next step is to be able to expand and tailor Bank West’s products — such as providing credit cards and lines of credit — but Tannas estimates that will take some time yet because of the technology demands and his desire to introduce something innovative that will differentiate the bank from the crowd. He says the company will continue to watch and learn for a while longer because “we do not want to fall on our face in front of

all of our customers and make them mad.” Perhaps in a couple of years, he estimates, Bank West will have the resources — and the courage — to take things further.

“Right now, the bank is \$130 million and we’ll finish up the year at maybe \$150 million. I can see maybe five years from now that it may be a half-billion-dollar organization,” he projects. “That’s the kind of size I think where it will be

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able to start doing interesting things.”

Tannas is also excited about the cross-selling possibilities opened up by the February 2005 acquisition of Federated Life Insurance Co., which WFG renamed Western Life Assurance Co. Its products are distributed through WFG brokerages as well as the alternate channels that existed before the change in ownership. In the previous 10 years before WFG came into the picture, Tannas says that Western Life was pretty much a mature company but it has now turned into a growth business, with year-over-year sales up 12 per cent.

“We get a lot of credit for having been clever in starting up the bank but, five years from now, I think that the cleverest

thing that we will have done will prove to be the life insurance company because the sales are so easily integrated,” he says. “Everything that we do with the life insurance company from a financial point of view today, every sale we make, has a positive influence on the life company’s bottom line. It’s instantly valuable.

“The bank is a long-term build. We’re competing in the banking business with companies that have been there for a 100 years or more. They’ve had a 100 years to get their systems running right, to get their balance sheets right, to develop their reputations. It’s going to be a long time before the bank, from a financial point of view, is a real shining star.”

#### BOTTOM LINE

Tannas believes that Western Financial is somewhat insulated from the general p&c market cycle, enjoying less pronounced peaks and valleys because a quarter of its volume comes from agribusiness that tends to be less sought after in soft markets and less affected in hard markets. Then, he points out, personal lines are becoming highly regulated, almost like a utility — that means that altogether some 70 per cent of WFG’s business is not really affected by cycle turns. “One of the nice advantages of being out in the sticks is that things are a little more stable,” he says.

In the first quarter of 2006, WFG saw its profit rise 8 per cent to \$1.1 million or four cents a share from \$1 million or four cents a share a year earlier. Revenue increased more than 37 per cent to \$16.7 million from \$12.12 million previously. In 2005, profit jumped 43 per cent to \$4.8 million from \$3.4 million. Earnings per share declined to 15 cents from 16 cents. Revenue was up 51 per cent at \$63.6 million, compared with \$42.2 million in 2004.

In his latest research report, analyst Pow sees revenue climbing to \$83.8 million in 2006 and \$97.7 million in 2007. He estimates earnings per share at 17 cents and 21 cents in those two years respectively. His 12-month share target price for Western Financial is \$3.30.

“We’ve got a huge amount on our plate,” says Tannas. “But we believe that we will always be first and foremost, insurance brokers, insurance retailers, and that everything else will be in support of that central role.”