

First Quarter 2015 Allstate Agency Value Index

Agency Development Bonus (ADB) makes small agency purchases more attractive

Throughout the history of Allstate agency sales, those agencies with over \$3 million in Earned Premium have been the most desired by approved agency purchasers. This is evidenced by the higher than average multiple for which these agencies have historically sold. There have been few occurrences over the last 15 years that have tempted Allstate agency purchasers to pursue an acquisition target other than a larger-sized agency as their first choice. However, one prime example of this was the opportunity to merge multiple agencies from 2009 to 2013.

Mergers were rampant at Allstate Insurance for a five-year period, and approved buyers could purchase two to three small-sized agencies and merge them together into a single location. The purchase multiple for a merger transaction was often 2.0 – 2.25 times, representing for many a great opportunity to reach scale at a discounted purchase price, when compared to purchasing a single location \$3 million+ Earned Premium agency for 2.75 times.

There is now a new opportunity that is catching the eye of approved buyers, and that is to purchase a smaller-sized agency that qualifies for Agency Development Bonus (ADB) and pursue growth towards scale.

ADB offers a lucrative bonus payment system which pays a commission rate to new agents of nearly 40% for new business written (renewals remain at 10%). Any agent doing a scratch start-up all the way up to purchasing a \$750,000 Earned Premium agency qualifies for the full Agency Development Bonus. Purchasing \$750,001 to \$1.5 million in Earned Premium qualifies for 80% of ADB and provides significant additional cash flow that can be used to reinvest in agency growth.

Over the past six months, PPCLOAN has been flooded with requests for financing to purchase an agency that qualifies for ADB. The market of agency purchasers is giving the purchase of a smaller-sized agency a hard look due to the ADB they would receive. Hence, larger-sized agencies, although remaining the most attractive of all Allstate agency purchase opportunities, have seen a dip in value. This trend certainly shows some level of correlation to the highly touted opportunity of purchasing a small-sized ADB qualifying agency.

Supply of small agencies plentiful due to "split book" opportunity

In the majority of the ADB qualifying agencies PPCLOAN was asked to finance in the First Quarter of 2015, the agency purchaser was able to achieve ADB qualifying status due to a larger agency (one not qualifying for ADB status) being split into various pieces that do qualify for ADB. Split book purchases are a common occurrence resulting from the splitting of a larger-sized agency into two to three new and separate agency locations. Typically, the goal has been to split agencies that result in exactly \$1.5 million in Premium "Slices" to allow for optimal ADB participation.

Clearly, the goal at Allstate is growth, and there is no better way to grow than to pay agents handsomely for successful growth. With a limited number of optimal sized small book purchase opportunities (optimal being those at exactly \$750,000 or \$1.5 million in Earned Premium), splitting agencies is the obvious choice to entice Outside Buyers to sign up for ADB.

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Example of split book transaction financed by PPCLOAN:

- Single location \$1,957,000 Earned Premium agency
- \$1,500,000 EP sold to an Outside Buyer who financed the purchase through PPCLOAN
- The remaining \$457,837 was sold to another agent

With the large cost incurred by Allstate Insurance to onboard new agents, matched with the high cost of the ADB program, it is imperative that these split book transactions result in significant agency premium growth. If significant growth in premium is not realized on an agency that was split Allstate's capital investment will have been wasted, as Allstate Insurance will have significantly overpaid agents for services rendered (i.e., upwards of 40% commission for writing new business) without receiving the level of growth that is necessary to justify such a large capital expenditure.

In looking at the example above from the agent's perspective, should the agency being purchased remain at or just above \$1.5 million in Premium, the agency will likely struggle to repay business overhead and acquisition debt. As Agency Development Bonus dollars diminish over time, the availability of free cash flow will shrink, limiting organic growth investment. The big risk of splitting books is that agents will not grow to "Scale", and their limited cash flow (once ADB diminishes) will prevent them from investing in staff and advertising.

Allstate Agency Price to New/Renewal Commissions Ratio (National Average)						
	2013 4th QTR	2014 1st QTR	2014 2nd QTR	2014 3rd QTR	2014 4th QTR	2015 1st QTR
\$0 to \$100,000	N/A	1.74	N/A	N/A	N/A	N/A
\$100,001 to \$200,000	2.20	2.32	2.43	2.52	2.43	1.99
\$200,001 to \$300,000	2.48	2.35	2.47	2.54	2.54	2.45
\$300,001 and up	2.74	2.70	2.76	2.77	2.79	2.66
Simple Average	2.50	2.38	2.62	2.66	2.69	2.50
Low	1.07	1.07	1.73	1.97	1.94	1.69
High	3.49	3.16	3.52	3.45	3.52	3.35

During the First Quarter of 2014, larger-sized agencies with new and renewal commission income of \$300,000 or greater represented only 21% of agencies sold. During the current Quarter, these largest sized agencies represent 47% of total agencies sold. With larger-sized agencies selling for the largest multiples, we are reminded to focus on the sales multiple for each size group.


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Percentage of Agency Sales by Size Group						
New/Renewal Commissions	2013 4th QTR	2014 1st QTR	2014 2nd QTR	2014 3rd QTR	2014 4th QTR	2015 1st QTR
\$0 to \$100,000	0%	6%	0%	0%	0%	0%
\$100,001 to \$200,000	25%	15%	17%	5%	3%	12%
\$200,001 to \$300,000	42%	58%	29%	43%	36%	41%
\$300,001 and up	33%	21%	54%	52%	61%	47%

For those residing in a state where a good portion of the homeowners insurance is written through a third party brokerage company (Florida in particular), looking at the multiple of revenues may be your best measuring stick for agency value. Certainly, the brokerage book is a reliable source of renewal income and has a level of value that is not presented in the traditional multiple applicable to Allstate commissions.

Allstate Agency Value Ratios						
	2013 4th QTR	2014 1st QTR	2014 2nd QTR	2014 3rd QTR	2014 4th QTR	2015 1st QTR
Agency Price to New/Renewal Commissions	2.50	2.38	2.62	2.66	2.69	2.50
Agency Price to Total Revenues	2.19	2.17	2.28	2.31	2.32	2.19



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