

Second Quarter 2014

New Trends Drive Allstate Agency Values Up

Allstate Agency Price to New/Renewal Commissions Ratio (National Average)						
	2013 1st QTR	2013 2nd QTR	2013 3rd QTR	2013 4th QTR	2014 1st QTR	2014 2nd QTR
\$0 to \$100,000	2.1	N/A	2.19	N/A	1.74	N/A
\$100,001 to \$200,000	2.15	1.99	2.18	2.2	2.32	2.43
\$200,001 to \$300,000	2.38	2.3	2.39	2.48	2.35	2.47
\$300,001 and up	2.51	2.57	2.68	2.74	2.7	2.76
Simple Average	2.3	2.34	2.5	2.5	2.38	2.62
Low	1.28	1.88	1.59	1.07	1.07	1.73
High	2.95	3.07	3.07	3.49	3.16	3.52

Two new trends have emerged with prominence during the Second Quarter of 2014, both of which have contributed favorably to the significant spike in Allstate Agency Values.

1. Increased level of existing agency owners purchasing a satellite

During the entire calendar year of 2013, the phenomenon of an existing Allstate agency owner purchasing a satellite agency represented just 9.8% of agency sales. During the second quarter of 2014, existing agency owners purchasing a satellite represented 26% of the total Allstate Agency sales.

The question is, "Why does an increase in existing Allstate agency owner purchasing activity have an effect on Agency Values?"

The answer is simple supply and demand economics:

More potential buyers = More demand.

More demand for agency purchases = Higher multiples.

CONTACT THE AUTHOR

Paul Clarke, President and CEO | (800) 456-2779 | paul@ppcloan.com



Although this simplistic Supply and Demand example makes sense, I think there is more to the story when it comes to Existing Agency Owners contributing to the increase in Allstate Agency Values (discussed in greater detail below).

Hungry for Additional Premium Ownership

From my perspective, there is a sizeable group of Existing Allstate Agency Owners around the country who have experienced an unquenched hunger for ownership of additional Allstate premium dollars. This significant desire to own additional Premium dollars is now an opportunity many top performing agents can execute on, and they are viewing the opportunity as "too good to pass up." As a result, existing Allstate agents are making aggressive purchase offers when a quality buying opportunity presents itself, significantly contributing to this Quarter's upward trend of agency values.

Increased Ability to Pay

Beyond just their desire to purchase additional premium dollars, existing Allstate Agency Owners are in a unique buying position as they simply are able to pay more for a purchase than your typical outside buyer. Utilizing the equity in their existing agency contributes to an agent's purchasing power, something an Outside Buyer does not have at his or her disposal.

In most instances, an existing Allstate agency owner is providing for their personal living needs from the cash flow of their existing agency, and any profits from a satellite purchase simply represents "gravy." This is not the case with Outside Buyers, as they typically need every dollar of cash flow to support their personal living obligations and pay business overhead, along with business purchase loan payments.

Certainly, the increased ability to pay for a satellite purchase by existing Allstate agency owners is a contributing factor to the upward movement in Allstate agency values realized in the Second Quarter of 2014. It will be interesting to watch as we finish 2014 and move into 2015, the mix of existing agency owners and outside buyers bidding and competing for agency purchases. At the end of the day, more approved buyers pursuing agency purchases results in the Market Value of agencies rising to or potentially exceeding the maximum Economic Value of an Allstate Agency.

Market Value = The agreement of price achieved by a willing buyer and willing seller with neither party having compulsion to buy or sell.

Economic Value = The value of an asset deriving from its ability to generate income. The value the cash flow of the business can support.

CONTACT THE AUTHOR

Paul Clarke, President and CEO | (800) 456-2779 | paul@ppcloan.com



It is not often that Market Value exceeds Economic Value. A recent example is Steve Ballmer purchasing the Los Angeles Clippers for \$2 Billion. Based on the operating income of the business, Forbes placed a value on the Clippers of \$575 Million (its Economic Value). Due to an overwhelming desire to join the exclusive club of NBA ownership and an overabundance of cash Mr. Ballmer made this seemingly bad business purchase without damaging his personal worth or livelihood.

Relating the Clippers story back to Allstate: existing Allstate agency owners are purchasing satellites with some level compulsion. However, I feel the multiples for which agencies are currently trading are not in excess of Economic Value, as is the case with Mr. Ballmer's purchase. Instead, I believe that the new existence of Existing Agency Owners as competing purchasers alongside Outside Buyers is a healthy increase in approved buyers that has helped move the Market Value needle in line with maximum Economic Value that is supported by an Allstate agency's cash flow.

2. Greater access to Agency Development Bonus (ADB)

With more than 14% of the transactions PPCLOAN was asked to finance in the Second Quarter of 2014 qualifying for Agency Development Bonus (ADB), we were involved in many transactions where a single agency was "Split" and sold to two parties to allow the Outside Buyer candidate to qualify for ADB.

A common example was a \$1.8 Million Earned Premium agency being split and sold to two separate buyers. The larger slice, typically as close to \$1.5 Million in Earned Premium as possible, would be purchased by an outside buyer and the remaining \$300,000 in Earned Premium would be purchased and merged by an existing agency owner in the local market.

Split Book Purchases good for Sellers

In most instances, a prospective Outside Buyer would be disinterested in purchasing a \$1.8 Million Earned Premium agency knowing they were just barely missing out on all the perks and enhanced compensation that comes with purchasing an Agency that meets the guidelines to qualify for ADB (i.e. \$1.5 Million in Earned Premium or less). Therefore, split agency transactions will often allow the seller to garner a stronger purchase multiple than if their \$1.8 Million Earned Premium agency was sold with a going forward commission rate of 10%.

Split Book Purchases also good for Buyers

Buyers would likely make a low-ball offer or simply not purchase a \$1.8 Million Earned Premium agency due to the absence of ADB participation; however, now that a split book can accomplish their

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Paul Clarke, President and CEO | (800) 456-2779 | paul@ppcloan.com

goals Outside Buyers are willing to consummate a purchase at a higher multiple with access to the ADB opportunity. Due to the strength and abundance of cash flow from the ADB program, buyers come out ahead even after paying a slightly higher multiple to the Seller. Stated another way, the benefit achieved by ADB was received in spades, relative to the additional dollars paid to the seller in the form of a slightly higher purchase multiple.

Split Book Purchases good for company growth

It is safe to say that those Outside Buyers and Start-up candidates participating in the ADB program offered by Allstate realize greater policy and premium growth than those who do not participate. Certainly, there is a cost to Allstate Insurance by offering this program, as there is no such thing as free money. However, one cannot argue with the item count and premium growth the program provides, especially when growth and profitability seem to be the two major goals pursued by Allstate.

Percentage of Agency Sales by Size Group						
New/Renewal Commissions	2013 1st QTR	2013 2nd QTR	2013 3rd QTR	2013 4th QTR	2014 1st QTR	2014 2nd QTR
\$0 to \$100,000	17%	0%	7%	0%	6%	0%
\$100,001 to \$200,000	28%	21%	15%	25%	15%	17%
\$200,001 to \$300,000	27%	38%	26%	42%	58%	29%
\$300,001 and up	28%	41%	52%	33%	21%	54%

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 Quarter. During the Second Quarter of 2014, these largest sized agencies represented a much larger slice of the total at 54%.

With larger-sized agencies selling for the largest multiples, the simple average has increased during the Second Quarter of 2014, as agencies with more than \$300,000 in New and Renewal Commission income represented a larger percentage of total sales. This trend reminds us of the importance of focusing on the sales multiple for each size group, with the remainder of this report focusing on analyzing those Allstate agency sales that took place for each size group.

CONTACT THE AUTHOR
 Paul Clarke, President and CEO | (800) 456-2779 | paul@ppcloan.com

Allstate Agency Value Ratios						
	2013 1st QTR	2013 2nd QTR	2013 3rd QTR	2013 4th QTR	2014 1st QTR	2014 2nd QTR
Agency Price to New/Renewal Commissions	2.3	2.33	2.5	2.5	2.38	2.62
Agency Price to Total Revenues	2.06	2.11	2.21	2.19	2.17	2.28

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