First Quarter 2013

New Direction in 2013

2012 was a good year for Allstate Agency Values, as each size group showed signs of stabilization throughout the year, with a surprisingly strong finish in the Fourth Quarter. The driving factor of a strong 2012, was the continued rampant merger activity and whispers in the Allstate community that merger opportunities were winding down (giving some compulsion to execute a purchase before the window of opportunity closed).

In droves, Outside Buyers were able to achieve "Scale" through the purchase and subsequent merger of two to four smaller sized agencies into a single location. The attractiveness of the opportunity to purchase and merge multiple agencies for entrepreneurs who were joining the Allstate Agency Owner ranks for the first time, was the stability of the renewal commission income they were purchasing and its ability to provide ample cash flow to meet overhead, debt service and a fair owners wage to pay their personal living obligations. This attractiveness gave Outside Buyers the confidence to pay higher multiples for smaller sized agencies as the end product (a merged $3.5Million Agency), does not require large capital reserves required to fund a start-up or smaller sized agency during its "growth years."

So what is the "New Direction" I mentioned in my heading? It is the New "Outside Buyer Incentive Test Program." This program allows Outside Buyers purchasing an agency at $1,500,000 EP or less to receive the ADB (Agency Development Bonus) on a sliding scale for 4 years at 80% of traditional ADB rates (traditionally this program was reserved for agencies at $750,000 in EP or less). This program will give small agency purchasers additional capital to re-invest in their business for growth. What is yet to be determined is how this new program will be presented by Regional Management, accepted by the lending community and how it will be received by those choosing to make Allstate their new career.

The major lending players in the Allstate market have traditionally struggled to fund the purchase of smaller sized agencies, especially those at or under $1,500,000 in Earned Premium (this was Allstate Bank's flagship lending benchmark for years). The simple reason is cash flow. If you want to grow a $1,300,000 Earned Premium agency, you have to spend money. Prior to the new Outside Buyer test program, at 10% New/Renewal commission income a $1,300,000 Earned Premium agency struggled to pay the overhead of the business and debt service, much less fund growth. Absent a Development Bonus many owners of small sized agencies have to make tough decisions about how to fund the growth of their business while feeding their family gets relegated to a credit card.

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

I like that the new program includes agencies up to $1,500,000 in Earned Premium as agents can still receive ADB while having a larger renewal base to provide some stability in their cash flow as they work to grow their business. At the heart of this program, every Bonus Dollar received by Outside Buyers purchasing agencies at or just under $1,500,000 in Earned Premium must be re-invested back in the agency for the true economics of the program to be realized.

Under this new program, Growth is mandatory and essential if the Owners wants to have a business that makes good money once the ADB bonus is exhausted after 48 months. No high achieving entrepreneur goes into business and puts their personal capital at risk to make $40,000 a year. Successful Entrepreneurs are looking for a greater return on their investment and they want to be able to take large sums of money out of their business while still having the ability to meet business objectives and invest additional capital when prudent.

My greatest concern with the Outside Buyer Test Program is that outside forces will diminish the true value and growth potential of the program by making a grab for the cash (offsetting the true program goal which is to provide small agency purchasers with additional capital to re-invest and growth their business).

Concern #1 – Sellers – If Sellers view the Development Bonus as an opportunity to get a piece of the pie through a higher purchase price, this will diminish the value and growth opportunity of the program. Sellers grab for the cash will result in higher debt payments, reducing the amount of development bonus available to be re-invested to grow the business.

Concern #2 – Lending – If lenders require greater capital infusion, charge higher interest rates, or provide shorter loan amortizations associated with their perception of greater lending risk, this will diminish the program. Banks receive a fixed rate of return on their loans, and therefore; have a fixed appetite for risk. It would be understandable if the banking community did not participate or temper their participation in a program where consistently hitting growth goals is essential for long-term timely repayment of bank debt.

Agency Analysis by Size Group

$0 to $100,000 in New/Renewal Commission

Agency Values with New and Renewal Commissions between $0 and $100,000 saw a slight decrease during the First Quarter of 2013 to 2.10 times, which is to be expected after the sharp increase realized in the Fourth Quarter of 2012. Greater than 50% of these sized agencies were purchased by Existing Agency Owners as part of a strategy to increase the size of an already well-established book of business.

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

$100,000 to $200,000 in New/Renewal Commission

Mergers of these sized agencies dropped to 44% in the First Quarter of 2013, compared to 80% of Agencies with between $100,000 and $200,000 in New and Renewal Commissions being part of a merger acquisition during the Fourth Quarter of 2012. This drop in merger activity likely had some factor in the decrease in the average sales multiple for these sized agencies.

It will be interesting to watch how the Outside Buyer Test Program affects the value of these sized agencies. Also having an effect will be the allowance or discontinuation of mergers for these sized books of business.

$200,000 to $300,000 in New/Renewal Commission

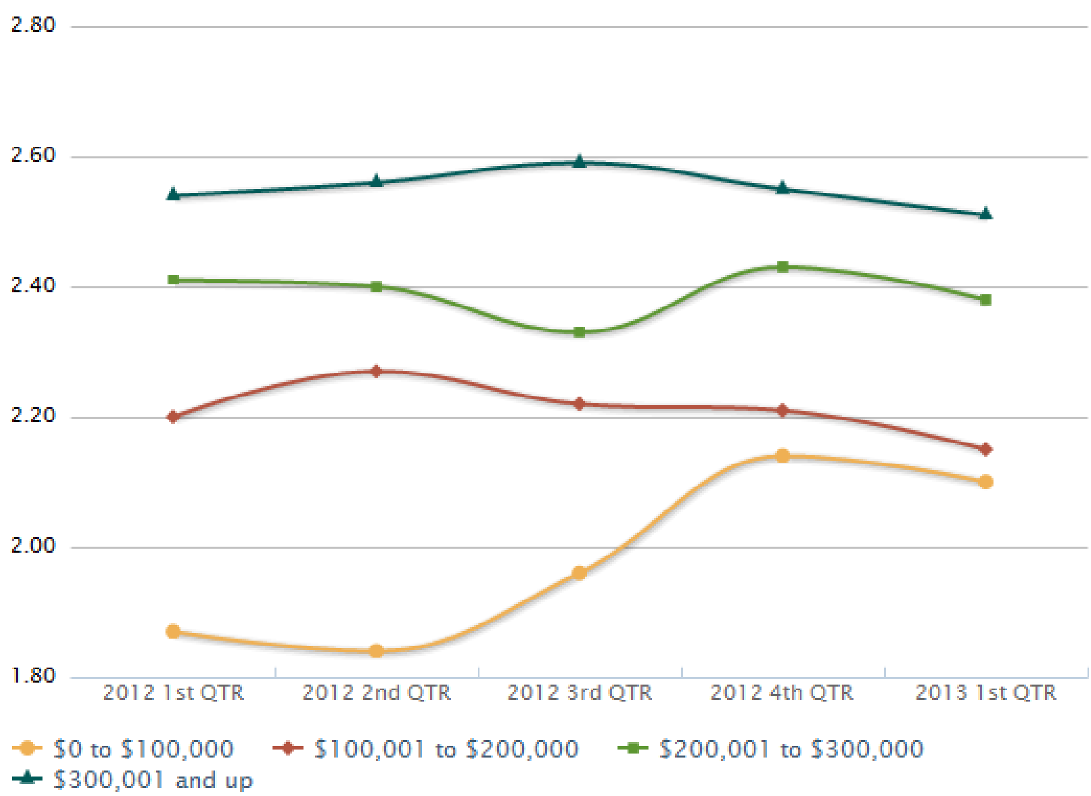
Agencies ranging from $200,000 to $300,000 in New and Renewal Commissions have historically been the most steady of all Size Groups, consistently maintaining a value multiple of 2.40 to 2.50 times over the past three years. During the First Quarter of 2013 Agencies of this size have dipped to a multiple of 2.38. It is expected this dip is temporary as these sized agencies continue to be very highly valued by the market of Outside Buyers.

$300,000+ in New/Renewal Commission

Agencies in this size group realized an average multiple of 2.51 times in the First Quarter of 2013, keeping pace with the previous four Quarters of 2012, all of which realized a value in excess of 2.50 times. This group appears to be the most consistent of all the size groups with regards to consistency in value.

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

Allstate Agency Price to Renewal Commissions Ratio (National Average)						
	2011 4th QTR	2012 1st QTR	2012 2nd QTR	2012 3rd QTR	2012 4th QTR	2013 1st QTR
$0 to $100,000	2.05	1.87	1.84	1.96	2.14	2.1
$100,001 to $200,000	2.23	2.2	2.27	2.22	2.21	2.15
$200,001 to $300,000	2.45	2.41	2.4	2.33	2.43	2.38
$300,001 and up	2.52	2.54	2.56	2.59	2.55	2.51
Simple Average	2.34	2.3	2.3	2.28	2.39	2.3
Weighted Average	2.31	2.25	2.25	2.28	2.33	2.29



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Allstate Agency Value Ratios						
	2011 4th QTR	2012 1st QTR	2012 2nd QTR	2012 3rd QTR	2012 4th QTR	2013 1st QTR
Agency Price to Renewal Commissions	2.3	2.3	2.32	2.28	2.39	2.3
Agency Price to Total Revenues	2.06	2.02	2.05	2.05	2.11	2.06

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