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The Driving Factors of Allstate Agency Value – What Story Is Your Agency Telling?

BY PAUL CLARKE

Capitalism

I think it is safe to state that the goal of any business owner is to maximize the amount of money they make. Certainly, we all want to have a good reputation within the market we serve, provide a valuable service to our clients and enjoy our work, but we also want to make money.

The ultimate prize for an Allstate agency owner with regard to return on investment is the end sales price received for their agency—the eventual cashing out following 5, 10 or 25 years of sweat and hard work. At some point in time, we all ask ourselves, "What price would my agency fetch today if I retire or decide to sell?"

Granted, in the transfer of any asset there are factors that affect the value of a single agency that are out of the owner's control. It may take some time to find a buyer who's a good fit in terms of experience, credit quality and the capacity to repay the debt associated with purchasing the business.

So, for the purpose of this article, let's concentrate on the things we can control—that primarily being the quality of your book of business nearing the time of sale.

Market Value vs. Economic Value

Before we address the factors that drive the value of Allstate agencies, I think it is appropriate to address how we get from a handshake agreement on price to a close and funded Allstate agency acquisition transaction.

Once a willing buyer and a willing seller have agreed on a price for an Allstate agency, Market Value has been set. However, money must be brought to the table for a true transfer of Market Value to take place. In most cases, a third party lender is introduced to assist in facilitating the transfer of Market Value from seller to buyer.

The lender will bring to the table a unique perspective as to the degree of fit between the buying agent and agency in question. The net result of this process is the determination of the loan amount and other structural elements of the transition the lender views as necessary in ensuring the ultimate successful repayment of the loan. The upper limit of this process is the value for which an agency's historical cash flow will support, also known as Economic Value.

To the extent that the Market Value (the price agreed upon by buyer and seller) for an Allstate agency exceeds its Economic Value (the value the cash flow will support), the difference represents the value a buyer has decided to pay for the Potential Future Earnings (i.e., earnings not evidenced in the agency's historical performance) of the agency.

For buyers, the payment of a premium for Agency Potential is reasonable because their potential future return on their Agency Acquisition investment is unlimited, and thus offsets the risk they take in paying the premium.

For lenders, financing this premium portion of the total purchase price is equally unreasonable since their potential future return on the Agency Acquisition financing transaction is fixed at their annual rate of interest charged on the loan, and thus offers no upside to offset the risk taken in financing the premium portion.

The net result is that the portion of the purchase price for an Allstate agency that exceeds its Economic Value will have to be paid by either a cash down payment by the buyer or a seller note, or a combination of the two.

Unique Industry

Allstate agents are in a unique position, having a vibrant market of available financiers willing to assist in the transfer of value from seller to buyer. This vibrant lending market is a testament to a variety of factors including:

1) Allstate Insurance's representing the buyer of last resort, essentially setting a floor value of agency purchases at 1.5X with the Termination Payment Provision.
2) Allstate Insurance, being a single payor system allows banks to easily control their collateral—the cash. This is in direct contrast to independent agents who have various contracts with various payors making it virtually impossible for lenders to control the flow of cash in and out of the business.
3) The general quality of the individual who pursues this line of business, and with the pre-screening by Allstate Insurance, produces a high-quality buyer pool for those lenders that choose to participate in the Allstate niche.

Other industries, such as financial planning, in a best-case scenario get 30% of their business value at closing due to a lack of an organized or mature lending environment. Without the current competitive lending environment Allstate agent's currently enjoy, a Seller would be forced to take all or part of the risk associated with the transition in the form of a seller note, or, simply take a reduced price due to a lack of available bank financing.

<u>Driving Forces of Value</u>

Having started the Allstate Agency Value Index in 2008 in direct response to the age-old question "What are books selling for these days?" I have taken a lot of care to ascertain some of the driving factors in agency value.

- <u>Agency Size</u>—The first and most important factor in driving the market value of Allstate agencies is size. The following chart was detailed in the Second Quarter 2009 Allstate Agency Value Index:

Comparative Model

	AGENCY "A"	AGENCY "B"
AGENCY SALES PRICE	$ 330,000	$ 925,000
PRICE MULTIPLE	2.00	2.50
AGENCY REVENUES	$ 165,000	$ 370,000
AGENCY OVERHEAD (35%)	$57,750	$ 129,500
PRINCIPAL AND INTEREST PAYMENT*	$49,629.36	$ 139,112.64
CASH FLOW TO BUYER	$57,620.64	$ 101,387.36

*ACQUISITION LOAN FOR 100% OF THE PURCHASE PRICE REPAID OVER 10 YEARS AT A RATE OF 8.75%

As seen in the comparative model shown above, the same buyer will realize greater net personal earnings by buying agency "B" even at a considerably higher multiple.

- <u>Retention</u>—This is an easy one. Imagine you have a $2 million Earned Premium Allstate Agency. If your retention is 85% (essentially 15% attrition), you need to sell $300,000 in new business just to break even. Likewise, if your retention was 95%, you would end the year at $2.2 million in Earned Premium—10% growth!

Allstate agency buyers have historically, and continue to, place a very high premium on agency retention.

- <u>Profitability</u>—No, I'm not talking about profitability to Allstate Insurance in the form of loss ratio (loss ratio is certainly recognized as a driving factor in agency quality, but does not rank in the top driving factors of agency value), I'm talking about the amount of money an agency owner will make. Certainly, each individual buyer makes his or her own decision about how much to spend on marketing and staffing costs; however, all agencies are not created equally in the profitability department.

Again, if you have two agencies, all things being equal, would you rather pay $1,000 a month for rent or $5,000 per month for rent? Would you rather purchase an agency where the seller overpays his staff and does not monitor their performance or would you rather purchase an agency with a quality staff in place making a fair wage in exchange for quality performance?

<u>Conclusion</u>

I hope this article has shed some light on some of the key driving factors that affect agency value. It is always important for agency owners, especially those nearing the eventual sale of their agencies, to take care in keeping the performance of their agency at top level.

Think to yourself, "What story is my agency telling?" If you have let performance slip 24 months prior to selling, there is a high likelihood that this will be interpreted as an indication of a poor agency. At the very least, you will lose agency value, and it may even render your agency unfinanceable.

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