

Second Quarter 2013

Moratorium on Merger Activity Affecting the Value of Allstate Agency's

Moratorium (Noun – A temporary prohibition of an activity) Moratorium might not be the most appropriate word to describe the Merger activity occurring in 2013, but I would say it is close enough for darts. Following the period of 2009-2012 where approval was granted to essentially any Outside Buyer whose business plan called for the purchase and merger of two, three or four geographically appropriate agencies, we were bound to see a slow-down in the number of approved merger transactions.

Instead of a gradual modification in policy regarding merger opportunities, we received an all-out slamming of the brakes with both feet as nationally we are seeing essentially no approval of merger requests. I'm bringing up this conversation not from a perspective of sour grapes (acquisition loans are down, but PPCLOAN is providing capital for other purposes and in other niches'), but from a true analytical perspective of how the elimination of a buy / sell option effects values.

I'll cut to the chase – By essentially eliminating mergers, we have a narrower scope of transition options which is a negative for agency values. Less buying options = less interested buyers = less value. If you take a tool out of a carpenter's tool box, you diminish his capability to build a house. Regardless of how often the tool is used or how essential the tool is to the overall creation of the house, the absence of any tool dilutes the value of the final product.

Who is Most Affected?

Sellers of small agencies are those most feeling the pain of not having the option of selling their agency to an Outside Buyer or an Existing Agency Owner as part of a merger transaction. The reason is simple – there are a good number of approved buyers who will not purchase a \$1Million Earned Premium agency unless it is merged as part of a larger operation. Based on their personal lifestyle needs, or their career timeline, some buyers must instantly realize the cash flow benefits of an agency already at scale. Thus, the pool of potential buyers has shrunk for small agency sellers.

On the flipside, larger sized agencies are seeing greater demand for their agencies as the ability to reach scale through the purchase and merger of multiple low priced small sized agencies has been essentially eliminated as a competitor to those owners looking to sell their larger sized agency.

The New Opportunity for Small Agency Sellers

Recognizing small agencies need a boost to their cash flow to grow Allstate has expanded its Agency Development Bonus program to those purchasing an agency with \$1.5Million in Premium or less. The attractiveness of the expansion of the ADB program to agency buyers has yet to fully materialize, but certainly it represents a significant positive to those who see organic growth to scale as a viable venture.

CONTACT THE AUTHOR

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

Were the 2009 – 2012 Mergers Judged Fairly?

We have all heard that Merger activity wasn't as successful as some had hoped it would be. PPCLOAN financed hundreds upon hundreds of the merger transactions that occurred between 2009 and 2012 for Outside Buyers and Existing Agency Owners and in reviewing our customers post-acquisition CSRP reports, the performance could best be described as flat.

My initial thought was that mergers aren't necessarily a recipe for success. But then I thought I would do a little research. I'd go back and look at the Smart Reports to analyze the performance of the agencies that were purchased as part of a merger and compare them to the buying agent's performance after the purchase. Certainly, the quality of a seller's book of business (or lack thereof) has some bearing on the new agent's performance. Here is what my research uncovered about those who purchased and merged agencies:

- Some of the worst performing books of business I have ever seen were sold as part of a merger transaction between 2009 and 2012. The general theme was that buyers would not purchase a poor performing agency by itself, but if an underperforming Book of Business could be bought at a discount and merged into another agency - why not give it a shot.
- 72% of Outside Buyers who merged agencies wrote more new business in their first year than all their sellers combined wrote the year prior to selling.
 - Furthermore, 29% of these buying agents more than doubled the amount of new business written compared to their sellers.
- On average Retention dropped a nominal 0.31%
- In most instances the agencies being merged were less than \$1,500,000 in Premium. Absent the current Agency Development Bonus program these agencies represented a business few approved buyers were willing to purchase as a stand-alone agency at the time.

I recognize my analysis is limited to just the performance of PPCLOAN's customers and certainly analyzing new business and retention does not represent the full measurement of success. However, I do think the majority of those agents who utilized PPCLOAN for a merger loan were successful and I think they did a good job of "stopping the bleeding" of an agency that was shrinking – a not so easy task that cannot be overlooked. I further believe that a systematic and carefully executed approach to mergers could allow for more consistency in agency values over time and would avoid periods of ramped merger activity followed by periods of no merger activity.

New Feature

It is a regular occurrence that I hear of a seller digging in their heels and wanting to only sell their agency for the exact multiple listed on the Allstate Agency Value Index even though their book is less than desirable and should likely garner a

CONTACT THE AUTHOR

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

value below the average. I also hear stories of buyers looking to get a great deal on an outstanding book of business by refusing to pay more than the current Value Index Average. My statement to both these individuals is that the Value Index represents an average of a wide range of agency sales multiples. Some very high and some very low but none selling for exactly the average. I have added the new feature below to show the lowest price multiple paid in a quarter and the highest price multiple paid in a quarter – both to give perspective to what the comprises the average. Not all agencies are created equally and the wide range of prices below reflects this.

Agency Analysis by Size Group

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

PPCLOAN was not involved in the financing of any Agencies in this size group in the Second Quarter of 2013. Historically, 100% of the agencies analyzed in this size group were part of a merger transaction.

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

It was last reported that 44% of these sized agencies transitioned in the First Quarter of 2013 were part of a merger transaction. This was reported as a significant drop from 80% of these sized agencies being part of a merger acquisition during the Fourth Quarter of 2012. As the chart above shows the near absence of merger transaction has resulted in these agencies seeing a reduction in value from 2.15 times in the First Quarter to 1.99 times in the Second Quarter.

\$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 Second Quarter of 2013 Agencies of this size have dipped to a multiple of 2.30. After a closer examination, this lower multiple may be an anomaly as there appears to be more than the usual "good deal" transactions that occurred in this size group during the Second Quarter.

It may also be the case that some buyers view purchasing a \$2Million Premium Agency as less attractive due to the new opportunity to receive enhanced commission for purchasing a slightly smaller book at \$1.5Million in Premium.

\$300,000+ in New/Renewal Commission

Agencies in this size group realized an average multiple of 2.57 times in the Second Quarter of 2013, a decent increase from the 2.51 times realized in the First Quarter of 2013. Word on the street is that books in excess of \$3Million in Premium are very scarce due in part to the inability to reach this size via merger of multiple small agencies.

CONTACT THE AUTHOR

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

Allstate Agency Price to Renewal Commissions Ratio (National Average)

	2012 1st QTR	2012 2nd QTR	2012 3rd QTR	2012 4th QTR	2013 1st QTR	2013 2nd QTR
\$0 to \$100,000	1.87	1.84	1.96	2.14	2.1	N/A
\$100,001 to \$200,000	2.2	2.27	2.22	2.21	2.15	1.99
\$200,001 to \$300,000	2.41	2.4	2.33	2.43	2.38	2.3
\$300,001 and up	2.54	2.56	2.59	2.55	2.51	2.57
Simple Average	2.3	2.3	2.28	2.39	2.3	2.34
Low	1.47	1.46	1.27	1.53	1.28	1.88
High	3.07	3.29	3.24	3.36	2.95	3.07

Allstate Agency Value Ratios

	2012 1st QTR	2012 2nd QTR	2012 3rd QTR	2012 4th QTR	2013 1st QTR	2013 2nd QTR
Agency Price to Renewal Commissions	2.3	2.32	2.28	2.39	2.3	2.33
Agency Price to Total Revenues	2.02	2.05	2.05	2.11	2.06	2.11

CONTACT THE AUTHOR

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