RIDGEWAY INSURANCE AGENCY- BUY OR PASS?

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Robert Morris, a successful insurance agency owner needed to decide whether to purchase the agency of another agent that was leaving the business. This was a major purchase. Robert estimated that the agency would cost between $500,000 and $565,000. Typically, agencies in this market sold for about 2.2 to 2.5 times the revenue (commission payment to the agency). Robert was intrigued by the opportunity to grow his business and expand into another market. Based on his review of the key financial metrics of the agency, Robert had concerns that needed to be weighed before a final decision could be made.

INTRODUCTION

Robert Morris had owned a successful insurance agency for the last fifteen years. Robert's agency wrote about $3 million in premiums ($300,000 agency commission revenue) last year including renewals and new business. His insurance policies covered everything from home to life to auto. Robert had consistently been recognized as one of the top agents in his region by his company. His customer retention rate had regularly been over 91% and his loss ratio had always been at below the company target. He had consistently met his objectives for writing new business. Robert recently paid off the note on his agency and felt that the time was right to expand into a different geographical location.

There was an agency about one hour from Robert's location that had become available. This agency was owned by Janice Ridgeway and sold similar policies in a non-competing geographical location. She had owned the Ridgeway Agency for only four years but needed to sell the business due to an illness in the family. This was a major commitment and risk for Robert which could double his size or even more if positive synergies occurred or it could have a detrimental impact on his current business. He estimated that Ridgeway would cost between $500,000 and $565,000. Typically, agencies in this area sold for about 2.2 to 2.5 times the annual revenue, defined as the commission payment to the agency. Robert contacted Janice and expressed his interest in purchasing her agency to expand his footprint into a new area. So that Robert could make an informed decision, Janice supplied him with financial reports and corporate key measures covering the last four years.

FINANCIAL REVIEW

Financial data for Year 1 through Year 4 was supplied for Robert's review. The Ridgeway Agency had a positive balance for the years Year 1 through Year 3. In Year 4, the agency sustained a loss of $13,700. Revenue grew each of the four years that Janice owned the agency. Reports from the last four years show that a large portion of revenue had been spent on employee salaries, including the corporate officer (agent owner). After reviewing these figures with Janice, Robert learned that her first year in business she had three employees. She had to let one employee go after the first year for not meeting her sales goals, so the second year in business Janice only had two employees. As business started to pick up in Year 3 Janice added another sales associate. As of Year 4 Janice had three full time employees, including two sales associates and a customer service associate.

Janice's loan was another major expenditure. Robert needed to take out a loan to purchase Janice's book of business. He was not sure what his monthly payment would be but estimated it would be somewhere close to what Janice was paying, if not more. One major concern that Robert had was the maintenance and repair costs for Year 4. The most that Janice had paid over the first three years in business was $1,231, but in Year 4 she paid $30,984. This played a major role in the agency showing a deficit in Year 4. After discussing this with Janice, Robert discovered that in her lease she agreed to assume responsibility for the HVAC system and plumbing for her office space in the shopping center where she was located. The landlord had upgraded the plumbing and replaced the HVAC system a couple of years prior to Janice purchasing the agency. Janice did not realize that these items were no longer under warranty, so she was stuck with a rather large bill when these items needed to be replaced.

In addition to reviewing key financial data, Robert also reviewed other important information to help assess the health of Janice's agency. He discovered that although the agency did increase the number of policyholders over the first three years in business, there was a decline in policyholders from year three to year four. Agency revenue continued to climb, but Robert discovered this was primarily due to a couple of rate increases during this time period. Even though the number of policyholders declined, the amount of premium coming into the agency increased.

DECISION

Robert knew that adding another agency to his existing book of business could help him grow and expand into a new market. Robert had met all the criteria mandated by the corporate office to be able to purchase an existing agency. However, there were concerns. Janice's agency had suffered a loss in Year 4. Furthermore, her retention rate had decreased, and she actually had fewer customers on the books in Year 4 than she did in Year 3. Robert had been extremely successful up to this point in his career and did not want to jeopardize that success by purchasing an agency that was headed in the wrong direction. A key question was, were the negative numbers of Year 4 a one-time thing or were they the start of a trend?

Year	Year 1	Year 2	Year 3	Year 4
Revenue	$200,146	$213,617	$220,395	$226,913
Expenses				
Compensation of Officers	$30,000	$40,000	$50,000	$55,000
Salaries	$60,000	$50,000	$60,000	$60,000
Rents	$13,000	$14,000	$14,500	$15,000
Taxes and Licenses	$5,000	$6,834	$7,486	$8,263
Depreciation	$2,859	$554	$1,234	$893
Insurance	$2,383	$2,497	$2,532	$2,684
Maintenance & Repairs	$401	$1,231	$1,157	$30,984
Utilities	$4,092	$4,344	$4,512	$4,639
Legal Fees	$5,000	$250	$250	$250
Postage	$500	$750	$1,000	$1,200
Loan Payments	$55,200	$55,200	$55,200	$55,200
Advertising	$5,100	$5,500	$5,785	$6,500
Total Expenses	$183,535	$181,160	$203,656	$240,613