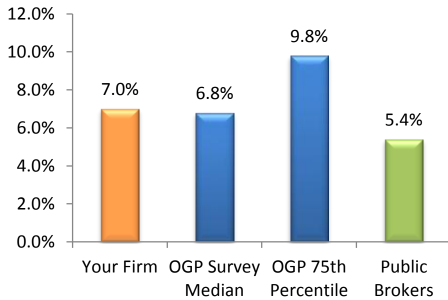
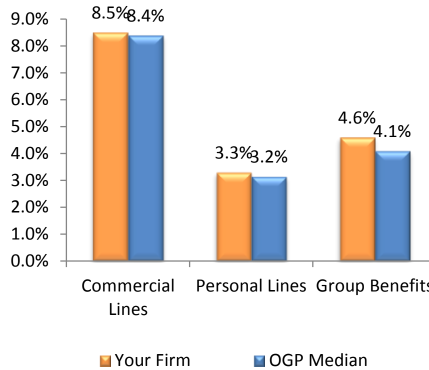
Organic Growth

Total Agency Organic Growth



Your organic growth rank:	50th - 60th percentile

Organic Growth by Product Line

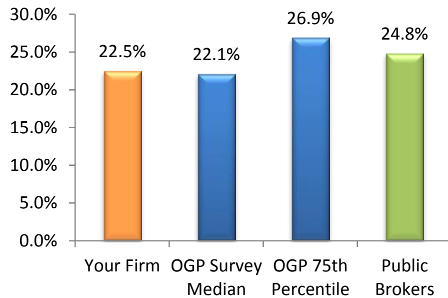


Reagan Consulting Observations

- Median organic growth was 6.8%, roughly equivalent to the 6.9% in the Q2 survey
- Organic growth is up almost a point-and-a-half from 2012 (Q3 2012 growth was 5.4%)
- Commercial lines continues to drive overall growth performance - while group benefits growth is unchanged from Q3 2012, commercial lines growth has increased from 6.9% in Q3 2012 to 8.4% in Q3 2013
- **OGP Projected 2013 Growth: 7.0%**
  Agents and brokers have maintained their full-year organic growth forecast of 7.0%

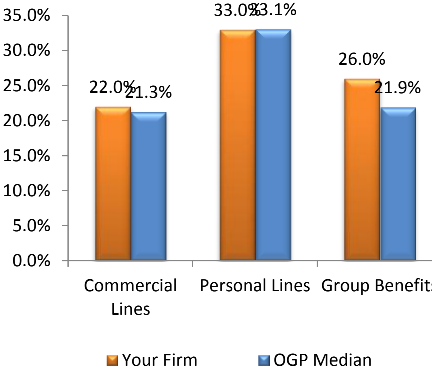
Profitability

Total Agency EBITDA Margin



Your profitability rank:	50th - 60th percentile

EBITDA Margin by Product Line

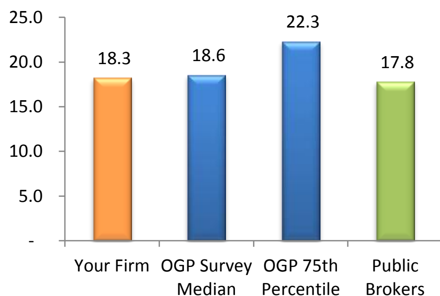


Reagan Consulting Observations

- Median EBITDA margin in Q3 2013 is up 0.6 percentage points from last year's Q3 figure of 21.5%
- Median EBITDA figures will continue to decline throughout the course of 2013, as front-loaded contingent income results are spread across the entire year
- Personal lines margins are over 10 points higher than both commercial and group benefits margins
- **OGP Projected 2013 Margin: 20.0%**
  Brokers are maintaining their strong margin forecasts for the year

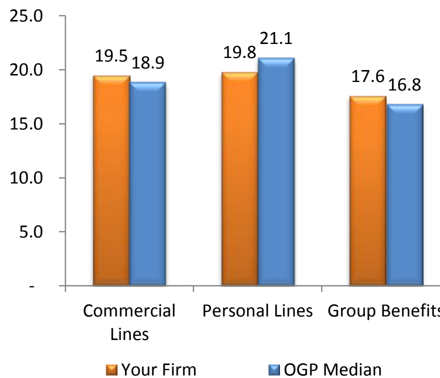
The Rule of 20 (see note below)

Total Agency Rule of 20



Your Rule of 20 rank:	40th - 50th percentile

Rule of 20 by Product Line



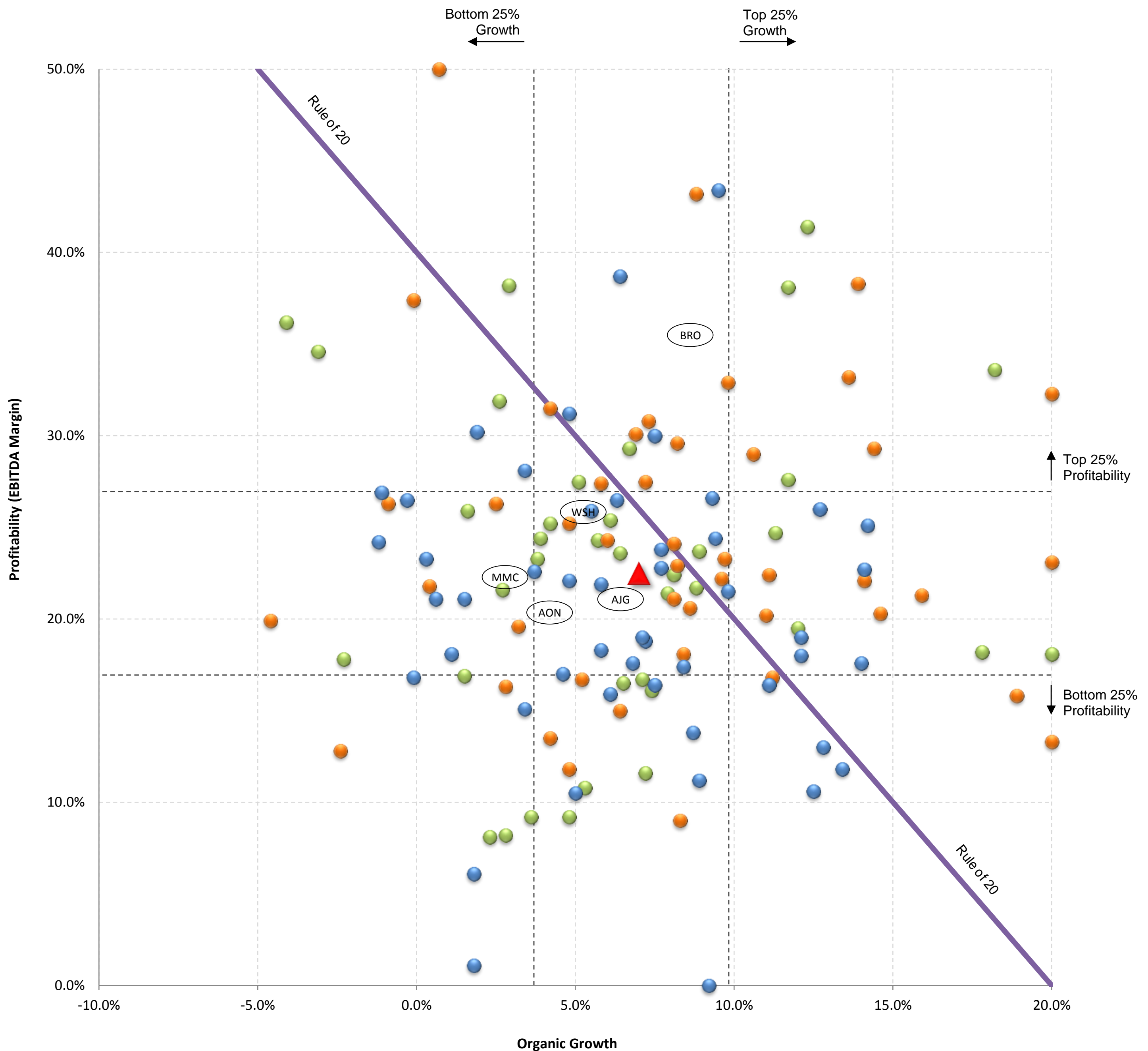
Reagan Consulting Observations

- The 18.6 median Rule of 20 score is just below the Q2 2013 score of 18.7
- Over 36% of OGP participants had a Rule of 20 score of 20 or higher through the first three quarters of 2013 - and 18% scored 25 or higher
- Rule of 20 scores, like EBITDA margins, are inflated by cash-basis contingent income and will decline throughout the year
- **OGP Projected 2013 Score: 18.0**
  The projected Rule of 20 score is basically unchanged from Q2's projection, but will be nearly 200 bp above Q4 2012 level

About the Rule of 20

Reagan Consulting has developed a metric called the "Rule of 20" to provide a quick means of benchmarking an agency's shareholder returns. The Rule of 20 is calculated by adding half of an agency's EBITDA margin to its organic revenue growth rate. An outcome of 20 or higher means an agency is likely generating, through profit distributions and / or share price appreciation, a shareholder return of approximately 15% - 17%, which is a typical agency / brokerage return under normal market conditions.

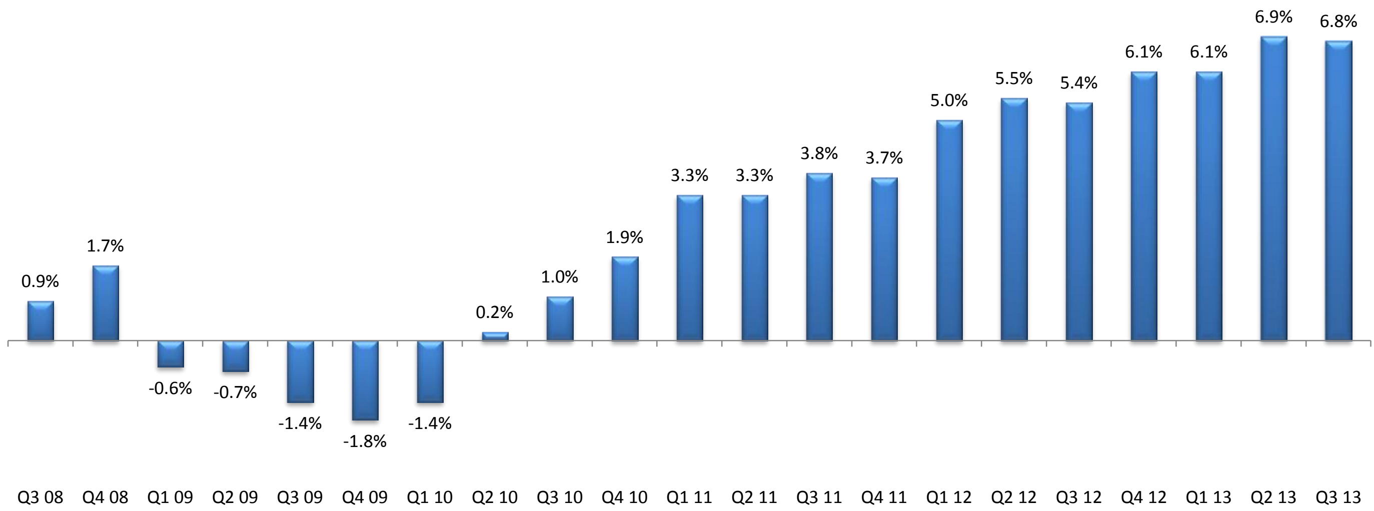
Note: If data for your firm reads "0.0%" or "0.0" it may mean that no data was submitted for that metric.



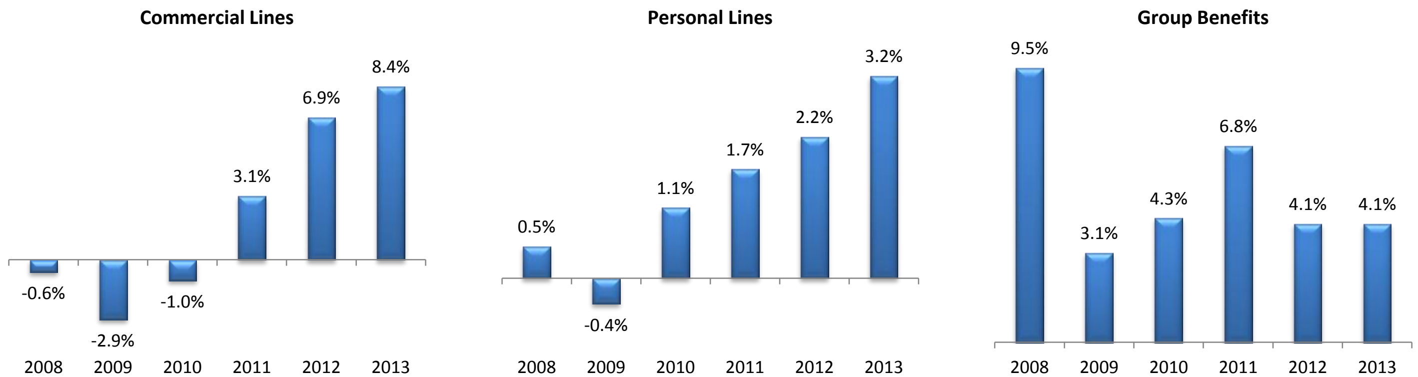
About the Scatter Plot

In the chart above, we've plotted every firm in the survey that completed both the total agency organic growth section and the total agency profitability section. Each firm's organic growth is plotted along the x-axis, and each firm's profitability is plotted along the y-axis. We've included a couple of guidelines on the graph to help in interpreting the data. The grey dotted lines show the top and bottom 25% of firms in organic growth and profitability. The solid blue line represents all combinations of organic growth and EBITDA margin that result in a Rule of 20 score of 20. Finally, we've broken the firms into groups based on revenue size, as distinguished by the different colored dots. The goal of this scatter plot is to show the wide range of organic growth and profitability results in the industry and to benchmark where your firm falls.

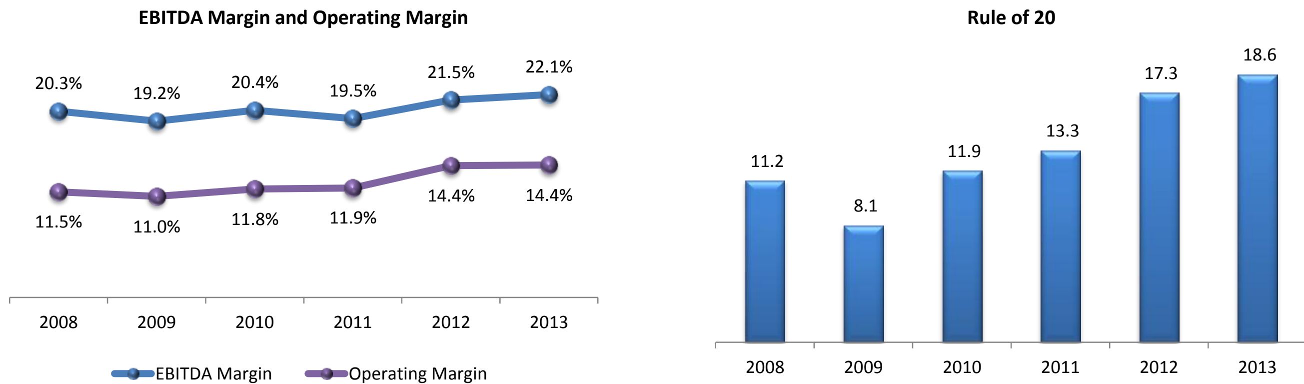
Quarterly Organic Growth - Total Agency Median (Q3 2008 - Present)



Comparative Median Organic Growth by Product Line (Third Quarter Numbers, 2008 - 2013)



Comparative Median Profitability and Rule of 20 Analysis (Third Quarter Numbers, 2008 - 2013)



About EBITDA Margin and Operating Margin

EBITDA Margin is calculated by dividing a firm's pro-forma EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) by the firm's pro-forma net revenues. Operating Margin is calculated as EBITDA less contingent income, divided by pro-forma net revenues less contingent income.

Organic Growth & Profitability Survey
Market Commentary (Q3 2013)

The Factors Driving Today's Record Broker Valuations

by Kevin Stipe and Brian Deitz

Broker results continue to improve each quarter and agency principals are enjoying the best returns they've achieved since 2007. This is great and important news, yet it is being dwarfed by other headline-grabbing news that began last year and continues today. What is this news? Large agencies have been selling at eye-popping valuations.

Since the beginning of last year, several large, notable acquisitions have occurred, including:

- **Bollinger** by **Arthur J. Gallagher**, 8/2013
- **Hub** by **Hellman & Friedman**, 8/2013
- **Beecher Carlson** by **Brown & Brown**, 6/2013
- **NFP** by **Madison Dearborn Partners**, 6/2013
- **USI** by **Onex**, 11/2012
- **Alliant** by **KKR**, 11/2012
- **AmWins** by **New Mountain Capital**, 4/2012
- **Arrowhead** by **Brown & Brown**, 1/2012

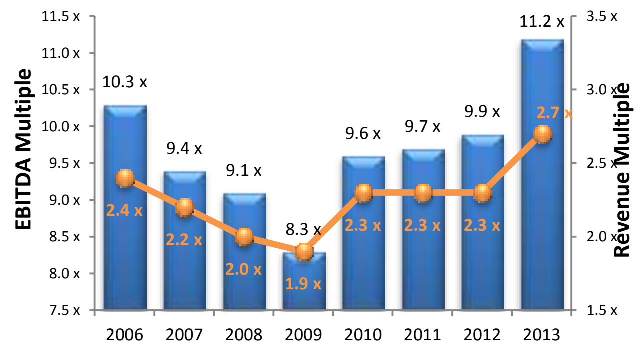
The revenue of the acquired firms ranged from $106 million (Beecher Carlson) to $1.2 billion (Hub.) The valuations for these deals were startlingly high: The average EBITDA multiple was 10.2, while the average revenue multiple was a whopping 3.07.

Why is this happening?

A perfect storm of factors has converged. They include:

1) **Public broker stock prices are very high.** Broker stocks are trading at high levels, reflecting strong investor interest in the insurance brokerage sector. Every broker stock is trading at or near its all-time high (or in the case of Marsh, its post-Spitzer high) with multiples of EBITDA currently averaging above 11. With profit margins also climbing, the values of the public brokers are currently trading at an average of 2.7 times trailing revenue, which by historic standards is very high. Since other potential investors (such as private-equity firms) watch publicly traded multiples very closely, this is probably the single greatest issue driving the high current valuations.

Revenue & EBITDA Multiples: 2006-2013



2) **P&C pricing continues to rise.** The industry is still experiencing the rare benefit of firming prices, a welcome development that began in early 2011 and, according to the CIAB Market Survey, continued through the 3rd quarter. While not a "hard" market by historical standards, gentle firming (with prices rising by roughly 3%-5%) has been a welcome development for brokers. Opinions vary widely over how much longer it will last. Nevertheless, when asked at Reagan Consulting's M&A Workshop in May as to how much longer it will last, six of the industry's leading CEOs unanimously agreed that it would be another 24 months or longer. If they are correct, and

assuming the economy still continues to grow modestly, brokers should continue to experience the benefits of solid growth in both revenue and profit margins.

3) **Private equity money continues to flood the industry.** Aside from the high valuations, the most notable feature of our list of large deals is that five of the eight were done by private equity (PE) buyers (and in four of those cases, it was a new private equity investor buying out an existing private equity investor.) Today's PE investors are taking advantage of credit markets that are surprisingly aggressive – offering credit terms comparable to those offered in the days leading up to the economic crisis of 2008. As a result, PE firms are able to borrow enormous amounts of debt financing, (approaching or even exceeding 7 times EBITDA) at ultra-low rates, with modest covenants.

   These borrowings are then used for a variety of purposes, including agency acquisitions. Since the credit terms are generous, they are able to pay very high multiples and still get a solid return on investment. Public brokers and other competing buyers are then forced to follow suit if they want to remain competitive, which drives agency prices higher.

4) **The $100 Million Club remains very small.** Although there are tens of thousands of agencies out there, very few ever grow to reach $100 million in revenue. According to Business Insurance, at the end of 2012, there were only 19 firms with over $100 million, and only a fraction of those are independent firms that could potentially be acquired.

   Firms of this size typically possess attributes not found in smaller firms, such as management sophistication and depth, geographic influence, multi-discipline specialization, technology savvy, etc. In addition, these firms are also attractive to buyers because they often have M&A experience of their own, having acquired smaller competitors. These attributes and experience, when combined with the scarcity of the firms that possess them, results in a supply/demand dynamic that is driving today's valuations to nose-bleed levels.

5) **Large employee benefits accounts are in the midst of a land-grab.** Despite the weeping and gnashing of teeth triggered by healthcare reform, many of the industry's largest players are viewing today's marketplace like the Oklahoma land grab of 1889. Optimistic about the possibilities of consulting to large employees regardless of how the law shakes out, they see open territory to be occupied as quickly as possible. When the industry-leading CEOs at our M&A Workshop were asked about their interest in pursuing groups with over 100 lives, 5 of the 6 said they are "more enthusiastic than ever." (Notably, they felt the opposite about small groups.)

   For large group benefits, the "price of poker" is increasing. Clients are demanding more help in navigating the complexity of an incredibly dynamic marketplace, and they need more sophisticated resources to help them respond. Brokers that dabble in the large group marketplace are going to be displaced by larger firms committed to building out resources. And since those resources are costly, those that do make the investments, must have sufficient scale to pay for them. Thus we are witnessing a massive (and appropriate) wave of consolidation among brokers vying for their share of the large group market.

What does the future hold?

While the scarcity of firms qualifying for the $100 Million Club won't change much going forward, the other factors will change; it is simply a question of when. Public broker valuations will likely remain strong until it becomes clear that the market is

heading into another soft market phase, or if the overall stock market takes a tumble. When interest rates rise and/or credit markets begin to tighten, valuations may also begin to soften. The industry's take on how clients will ultimately respond to healthcare reform and thus how brokers will be affected is likely to remain highly volatile.

The bottom line is that history has shown that valuations constantly ebb and flow, but when they are at a historically high level, it won't last forever. The good news is that regardless of the valuation market cycle, brokerages are valuable enterprises that provide strong and stable cash flow, combined with relatively low risk. This makes them attractive to investors, whether those investors are outsiders seeking purely financial returns, or insiders that want to build long-term wealth by owning a piece of their employer.

Stock Price Performance: Public Insurance Brokers vs. S&P 500, 9/30/2006 – 9/30/2013