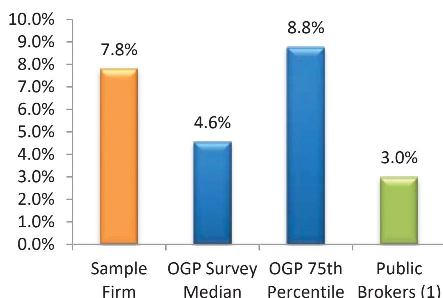
Q2 2017
OGP ID: 9999
Current Value Driver Comparison

Organic Growth & Profitability Survey

Reagan Consulting

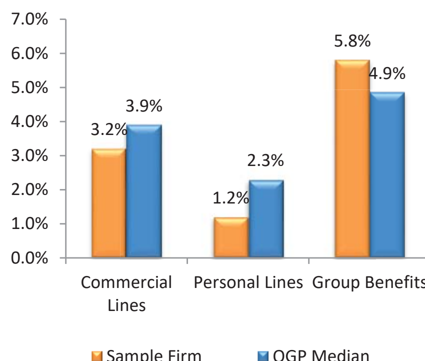
Organic Growth

Total Agency Organic Growth



Your organic growth rank:	60th - 70th percentile

Organic Growth by Product Line

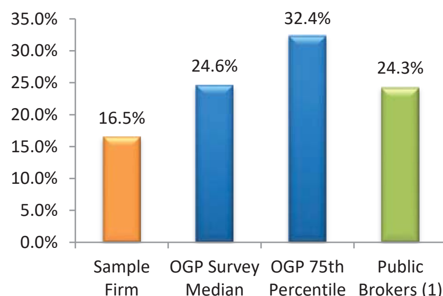


Reagan Consulting Observations

- After a soft Q1 at 3.9%, organic growth bounced back in Q2 to 4.6%
- Group Benefits continues to lag behind 2016 results, growing only 4.9% in Q2 2017 compared to 6.2% in Q2 2016. However, commercial and personal lines both posted growth increases over prior year.
- Like in Q1, a surprisingly high 25% of OGP firms reported negative organic growth in Q2
- **OGP Projected 2017 Growth: 5.0%**
  After showing slight improvement in Q2, brokers maintained their full year forecast at 5.0%

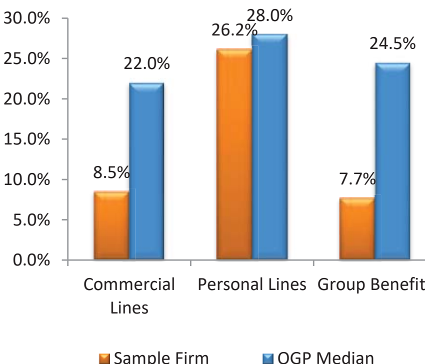
Profitability

Total Agency EBITDA Margin



Your profitability rank:	20th - 30th percentile

EBITDA Margin by Product Line

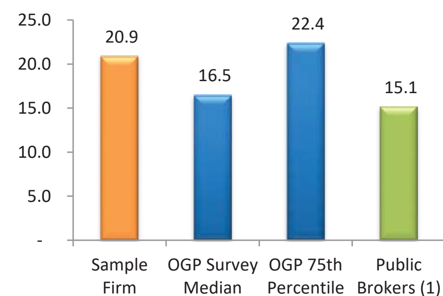


Reagan Consulting Observations

- EBITDA Margin increased to 24.6% in Q2 2017, back in line with 2014-2015 margins
- The main contributor to the increase in total margin was group benefits, which posted a strong margin of 24.5% in Q2 2017 versus 20.9% in Q2 2016
- Median EBITDA figures are inflated by the cash-basis recognition of contingent income, which is largely received in the first half. Thus, as in past years, EBITDA margins will decline throughout the course of 2017.
- **OGP Projected 2017 Margin: 20.0%**
  Overall, brokers are expecting EBITDA margin to stay flat from 2016 to 2017

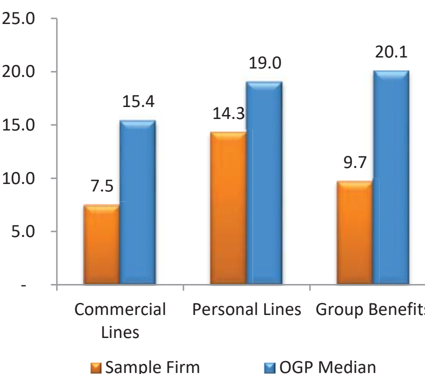
The Rule of 20 (see note below)

Total Agency Rule of 20



Your Rule of 20 rank:	50th - 60th percentile

Rule of 20 by Product Line



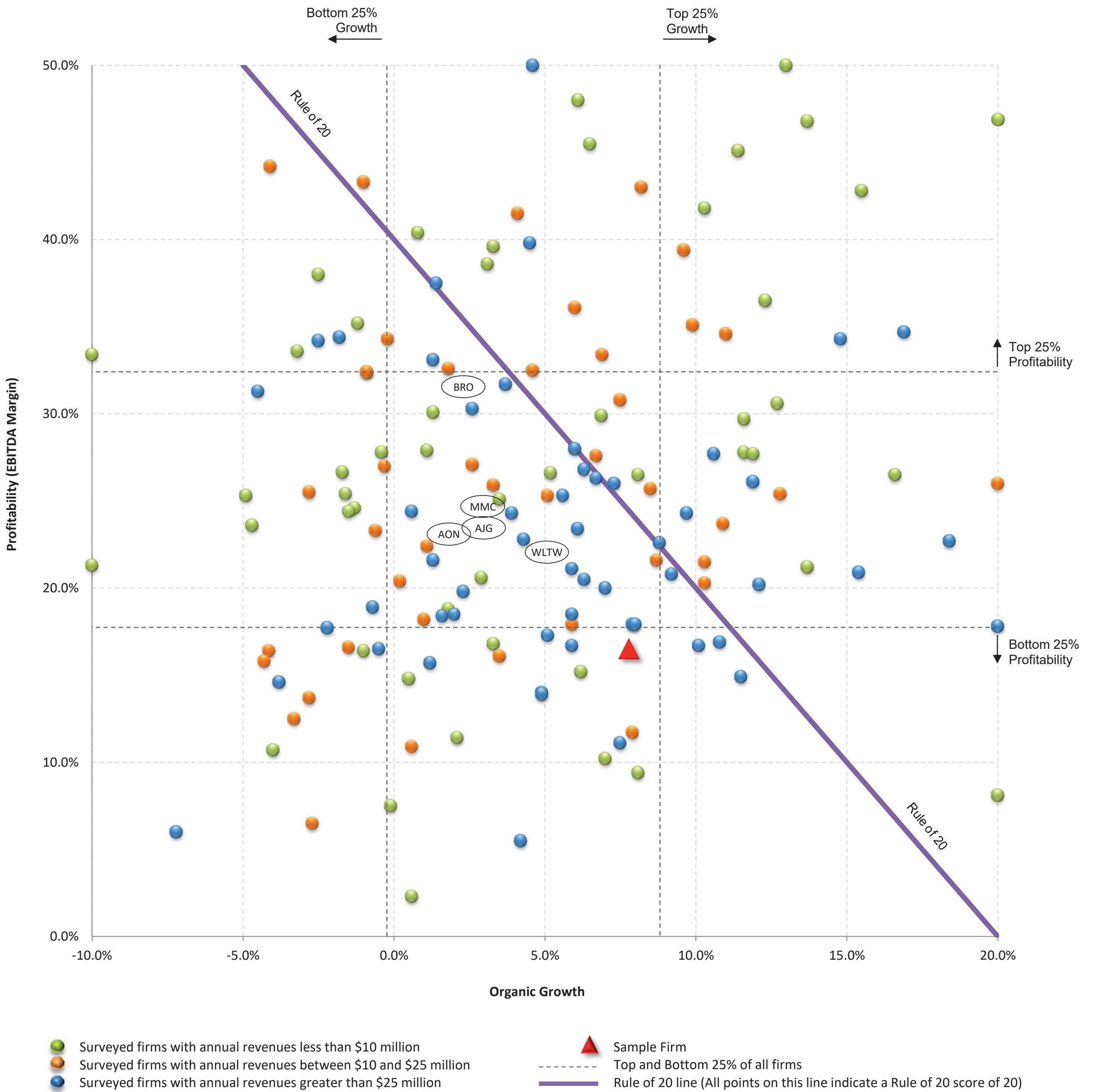
Reagan Consulting Observations

- The 16.5 median Rule of 20 score is in line with last year's performance
- Rule of 20 scores, like EBITDA margins, are inflated by cash-basis contingent income and will decline throughout the year
- **OGP Projected 2017 Score: 15.5**
  If accurate, this will be the best Rule of 20 score since 2014

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.
(1) Only includes results for three public brokers (AJG, BRO and MMC) who have released Q2 2017 results.

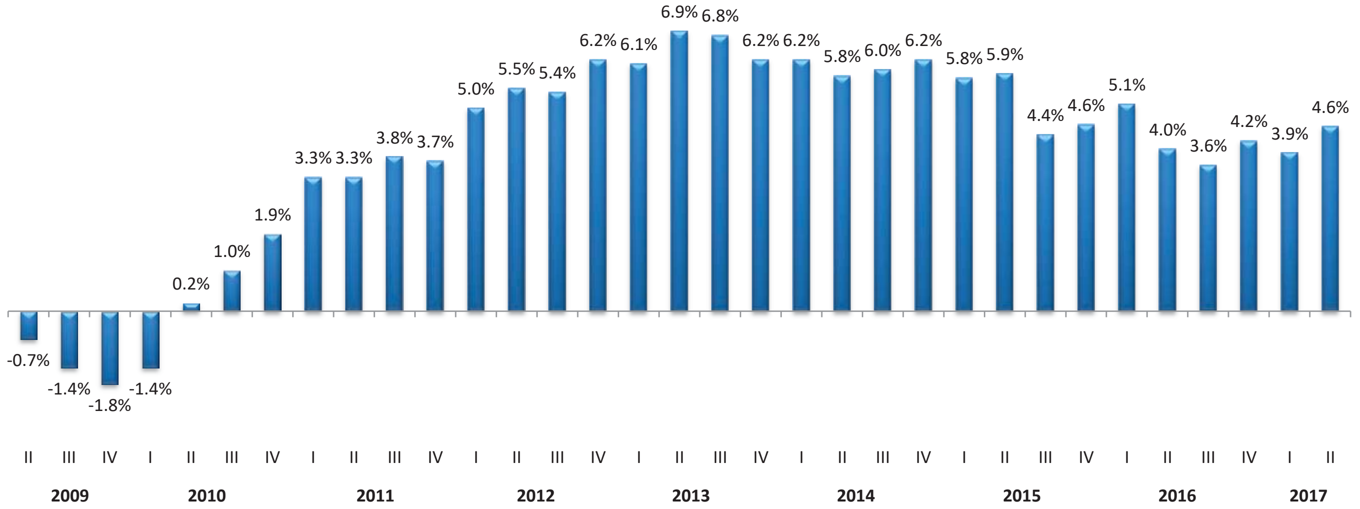


About the Scatter Plot

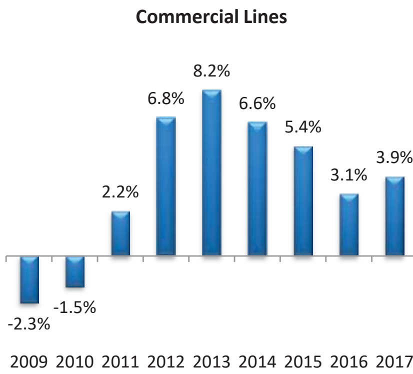
In the chart above, we've plotted every firm in the survey that completed both the total agency organic growth section and th e total agency profitability section. Each firm's organic growth is plotted along the x-axis, and each firm's profitability is plotted along the y-axis. We've included a couple 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 purple line r epresents 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 wher e your firm falls.

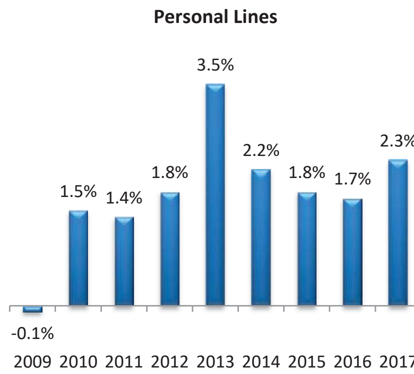
Note: Scatter Plot represents Q2 2017 results for AJG, BRO and MMC and Q1 2017 results for AON and WLTW.

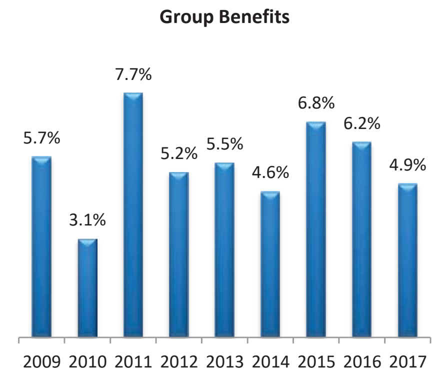
Quarterly Organic Growth - Total Agency Median (Q2 2009 - Present)



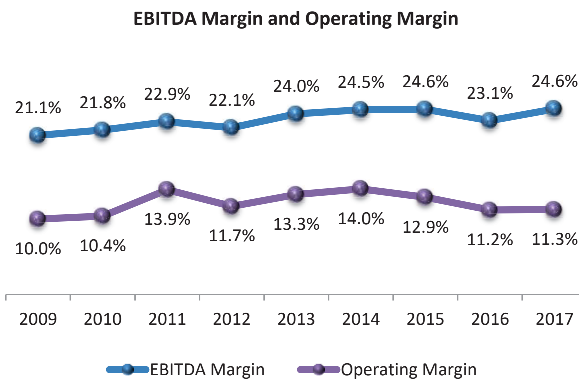
Comparative Median Organic Growth by Product Line (Second Quarter Numbers, 2009 - Present)

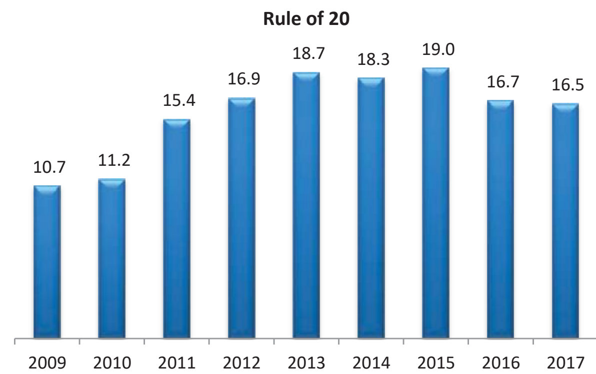






Comparative Median Profitability and Rule of 20 Analysis (Second Quarter Numbers, 2009 - Present)





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 (OGP) Survey

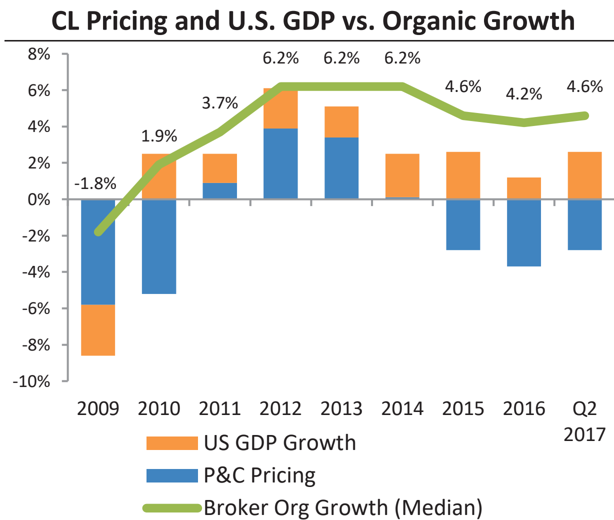
Market Commentary (Q2 2017)

Rumors of the Industry's Demise are Greatly Exaggerated

by Kevin Stipe

Organic growth was a surprisingly strong 4.6% in the second quarter, bouncing upward from the disappointing 3.9% figure in Q1. It appears the increase came from a variety of factors, including a stronger U.S. economy and more favorable P&C pricing.

CL Pricing and U.S. GDP vs. Organic Growth

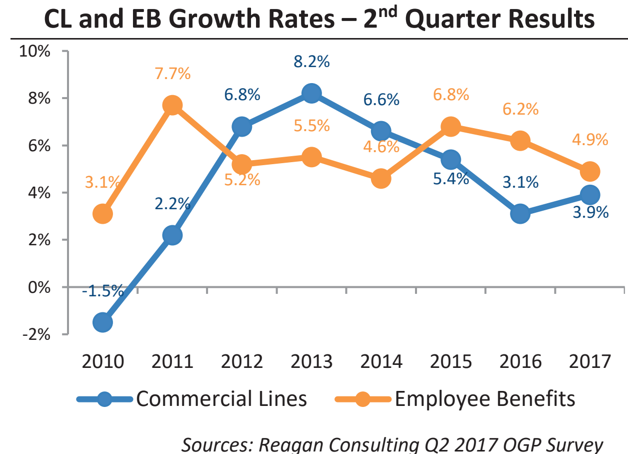


Sources: CIAB and Bureau of Economic Analysis

OGP Survey brokers are also confident that things will continue to improve throughout the balance of the year. They are forecasting 5% organic growth for the full-year 2017 results. This would mark the best full-year organic growth rate since 2014.

In the ongoing battle between commercial P&C and employee benefits growth rates, EB still has the upper hand, but not by much. Commercial P&C growth increased to 3.9% after three straight years of deceleration. Employee benefits, on the other hand, decelerated for the second straight year, to 4.9%. The following chart shows Q2 growth rates for the two lines over the past eight years.

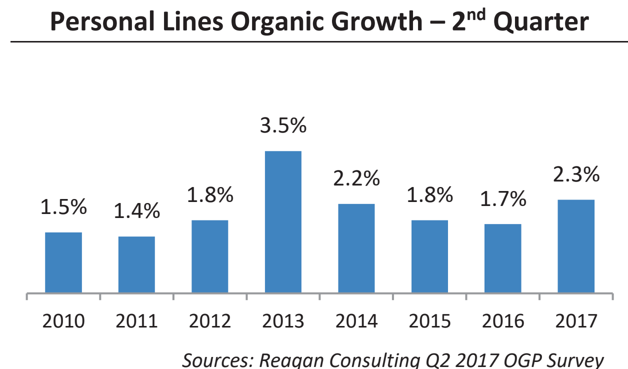
CL and EB Growth Rates – 2nd Quarter Results



Sources: Reagan Consulting Q2 2017 OGP Survey

Another pleasant surprise on the organic growth front: personal lines grew by 2.3% during the first half of 2017 – which may not sound like much but is in fact the fastest growth rate since 2013, and the second highest rate since the OGP Survey began in late 2008.

Personal Lines Organic Growth – 2nd Quarter



Sources: Reagan Consulting Q2 2017 OGP Survey

Given that personal lines is frequently noted to be the line of business most vulnerable to technology-driven disruption, it is heartening to see agency owners investing in and growing this line of business. Whether or not this trend will continue is anybody's guess. But the unprecedented level of insurtech investment continues, and many

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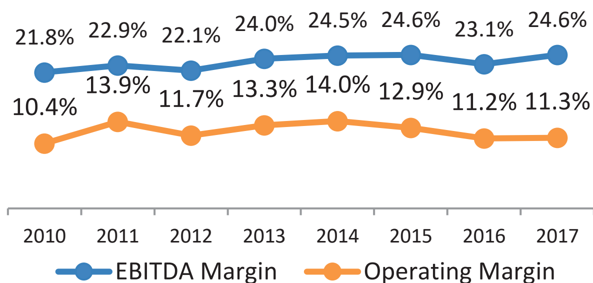
investors are eyeing passenger auto and homeowners as juicy targets for disintermediation.

More good news: profit margins also increased during the first half of 2017. The median OGP EBITDA margin of 24.6% tied the Q2 record set in 2015. If the 24.6% figure sounds too high to be real, keep in mind that mid-year margins in the OGP are always inflated due to the timing of contingent income receipts. Margins tend to peak during the first quarter and then drop throughout the year. Thus the actual full-year margin isn't as useful as the comparison between prior year Q2 numbers.

Q2 EBITDA Margin and Operating Margin



Sources: Reagan Consulting Q2 2017 OGP Survey

If you are desperate for some bad news, you might note that the Operating Margin line in the graph above barely moved up at all. Since operating margins exclude contingent income, it is clear that the increasing EBITDA margins are largely the product of strong contingent income, and are therefore vulnerable to a quick downturn. This is certainly possible and is worth watching over the next couple of years, especially if the industry suffers from bad loss ratios.

Industry Consolidation Update

OGP participants are well aware that our industry is consolidating at an unprecedented level. The past two years have been the most active merger & acquisition years in history, with nearly 500 deals in both years. The pace continues in 2017, with 255 deals reported during the first six months compared to 221 through the same period last year.

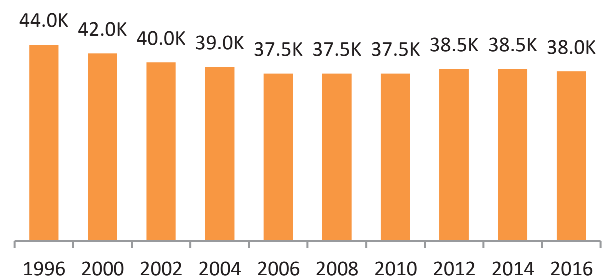
Many wonder…how long can this pace continue? Is the independent agent being hunted to extinction? Are we witnessing the demise of the independent agency in favor of some new and different ownership model?

Reagan Consulting set out to address this question recently. What we found was stunning, and also encouraging.

Although the number of independent agencies is in a long-term state of decline, the rate of decline is much lower than most realize. According to the *2016 Agency Universe Study* (by FutureOne - a collaboration between the IIABA and various insurance carriers), the number of independent agencies in the U.S. has decreased over the past 20 years from 44,000 in 1996 to 38,000 in 2016.

However, according to the same research, over the last 10 years the number of agencies has *increased* slightly from 37,500 to 38,000. How could this possibly happen in the most active consolidation era our industry has ever witnessed?

Number of Independent Agencies, 1996-2016



Source: FutureOne 2016 Agency Universe Study

The answer is *regeneration*. The *Agency Universe Study* data indicates that nearly 4,000 new agencies have been formed during the past five years. This figure is roughly twice the 1,918 announced acquisitions[1] during that same period.

[1] Source: SNL Research

Since every does not acquisition get announced, the number of actual deals is likely higher than 1,918. But it probably isn't more than double that number. Thus even in the midst of this unprecedented era of consolidation, we have a stable agency universe that might even be growing slightly!

Where is this growth coming from? Two primary sources:

1) Formerly captive agents and direct writers moving to the independent agent model. Examples include agents from Liberty Mutual and Allstate, among others.

2) Producers forming new agencies in response to their employer being acquired. As expected, an agency gets acquired and one or more producers, unhappy about the new owner, decide to strike out on their own and form a new agency. The recent consolidation boom has triggered an unprecedented level of new agency formation.

One visible piece of evidence regarding today's incredible rate of regeneration: there are more aggregators, clusters and franchise organizations than at any point in memory. Entities such as SIAA, Keystone, ISU and numerous others are larger and more sophisticated than ever before. They provide a newly formed independent agency market clout, back-office capabilities and access to resources that are historically unheard-of for smaller agencies and startups. The rise of these "partnerships" has been significantly impacted by the regeneration phenomenon we are witnessing. The movement has grown to the point where the partnership entities are now documented in an annual listing by *Insurance Journal* magazine.

Conclusion

One doesn't have to look far to see serious challenges facing our industry. Regulatory changes, especially on the healthcare side, could have a dramatic impact on the role of today's insurance brokers. The potential disruptive impact of the technology industry's entry into insurance underwriting and distribution will also inevitably have a profound impact on the way insurance is manufactured and sold. Finally, our industry is struggling to get younger and more diverse. Challenges abound.

Yet, to coin a Mark Twain phrase, rumors of the industry's demise are greatly exaggerated. The industry has repeatedly shown incredible resiliency, and with record amounts of capital flowing into our industry, it appears that the "smart money" is betting this trend will continue.

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