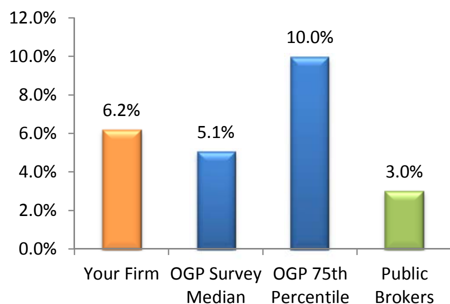
Q1 2016
OGP ID: 9999
Current Value Driver Comparison

Organic Growth & Profitability Survey

Reagan Consulting

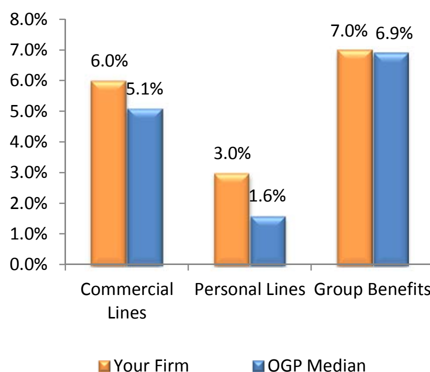
Organic Growth

Total Agency Organic Growth



Your organic growth rank: **50th - 60th percentile**

Organic Growth by Product Line



Reagan Consulting Observations

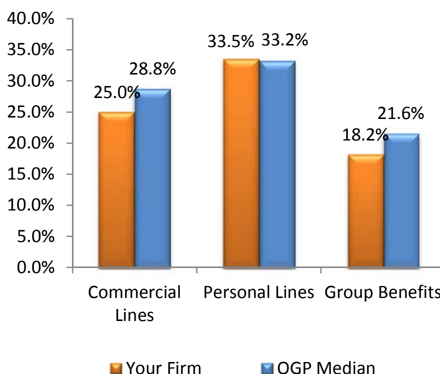
- Organic growth reached 5.1% in Q1 2016, the second consecutive quarterly increase
- Benefits led all lines of business with 6.9% organic growth, its largest increase in over four years
- The top quartile of agents and brokers recorded organic growth in excess of 10% in Q1 2016
- **OGP Projected 2016 Growth: 6.0%**
  Brokers maintain the 6.0% growth projection estimated at the begininng of the year

Profitability

Total Agency EBITDA Margin

Your profitability rank: **40th - 50th percentile**

EBITDA Margin by Product Line

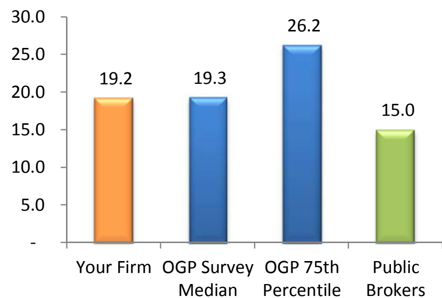


Reagan Consulting Observations

- Total EBITDA was 28.5% in Q1 2016, lower than Q1 2015, but still the third highest mark in OGP history
- Operating margin of 9.9% - which excludes contingent income - increased from Q1 2015 of 9.5%
- First quarter commercial lines and benefits margins both improved from Q1 2015 by nearly two percentage points
- **OGP Projected 2016 Margin: 20.0%**
  Overall, brokers are expecting EBITDA margin to stay constant from 2015 to 2016

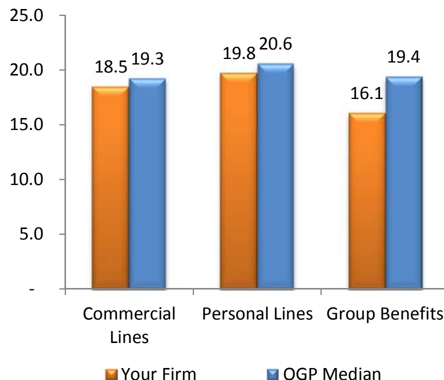
The Rule of 20 (see note below)

Total Agency Rule of 20



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

Rule of 20 by Product Line



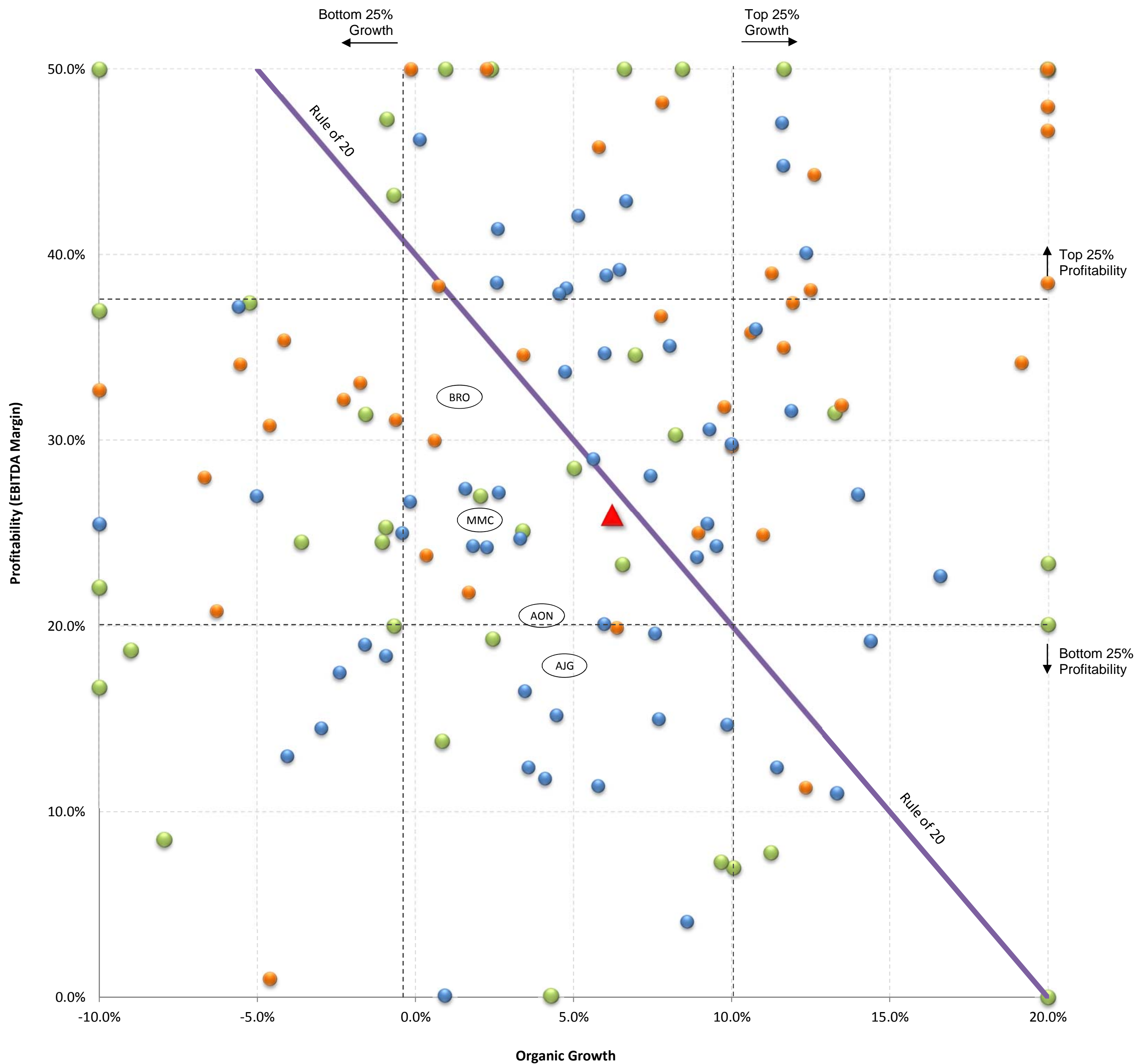
Reagan Consulting Observations

- Rule of 20 scores, like EBITDA margins, are inflated by cash-basis contingent income and will decline throughout the year
- The median Rule of 20 score was 19.3 in Q1. Commercial lines worsened versus Q1 2015 but benefits improved seven points in Q1 2016 over Q1 2015, primarily driven by increased organic benefits growth.
- **OGP Projected 2016 Score: 16.8**
  This projection is higher than what brokers estimated at the beginning of the year and, if achieved, would be among the best years of the past decade

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.

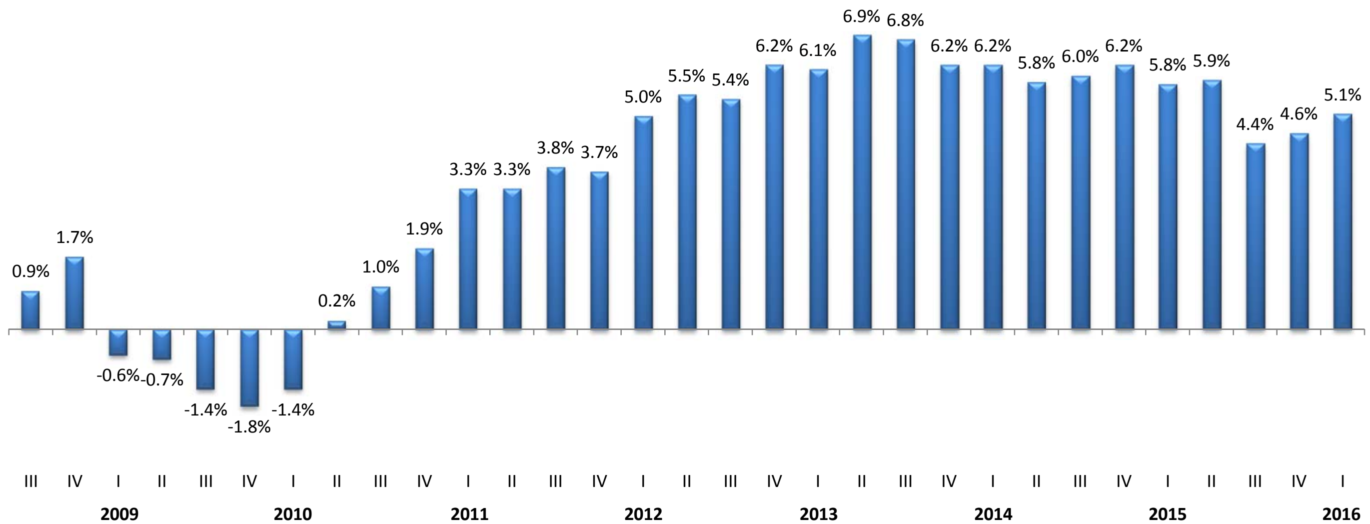


Surveyed firms with annual revenues less than $10 million
Surveyed firms with annual revenues between $10 and $25 million
Surveyed firms with annual revenues greater than $25 million
Your Firm
Top and Bottom 25% of all firms
Rule of 20 line (All points on this line indicate a Rule of 20 score of 20)

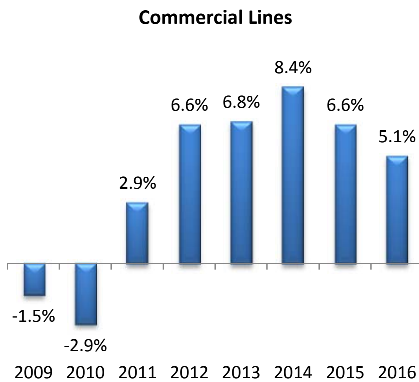
About the Scatter Plot

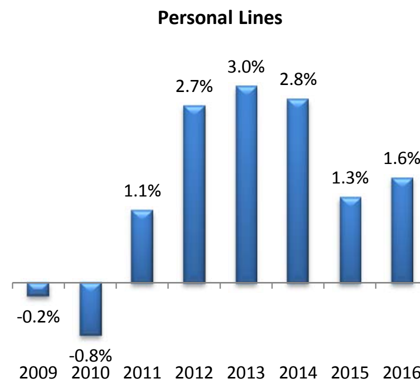
In the chart above, we've plotted every firm in the survey that completed both the total agency organic growth section and the total agency profitability section. Each firm's organic growth is plotted along the x-axis, and each firm's profitability is plotted along the y-axis. We've included a couple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

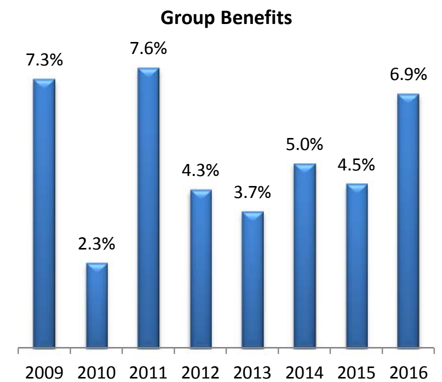
Quarterly Organic Growth - Total Agency Median (Q3 2008 - Present)



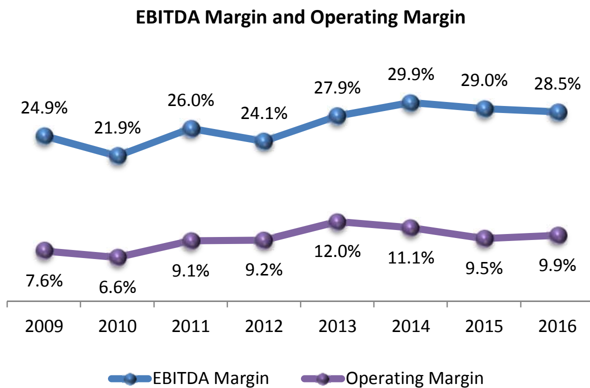
Comparative Median Organic Growth by Product Line (First Quarter Numbers, 2009 - 2016)

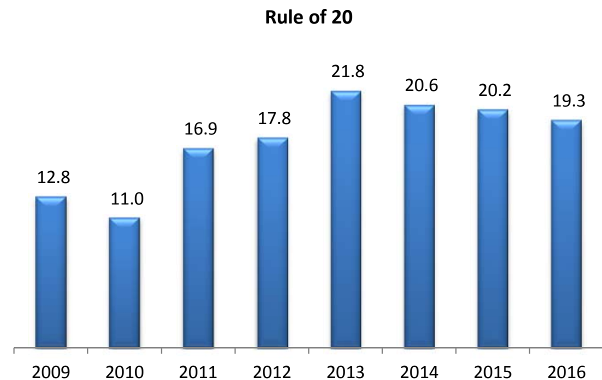






Comparative Median Profitability and Rule of 20 Analysis (First Quarter Numbers, 2009 - 2016)





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

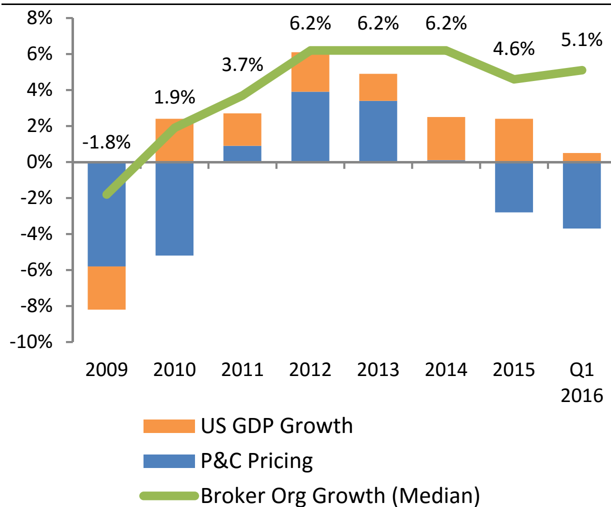
Market Commentary (Q1 2016)

Record M&A Valuations are Forcing Insurance Brokers to Achieve Higher Levels of Performance

by Kevin Stipe

Organic growth bounced to 5.1% during the first quarter, which was higher than the 4.6% posted for 2015. This improvement came in spite of some powerful headwinds: commercial P&C rate softening is accelerating and the U.S. economy is growing at a snail's pace. In fact, the Commerce Department reported in late April that U.S. gross domestic product grew at only 0.5% during the first quarter. If P&C pricing continues to deteriorate and the economy doesn't pick up, agency growth rates are likely to suffer later this year.

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



Sources: CIAB and Bureau of Economic Analysis

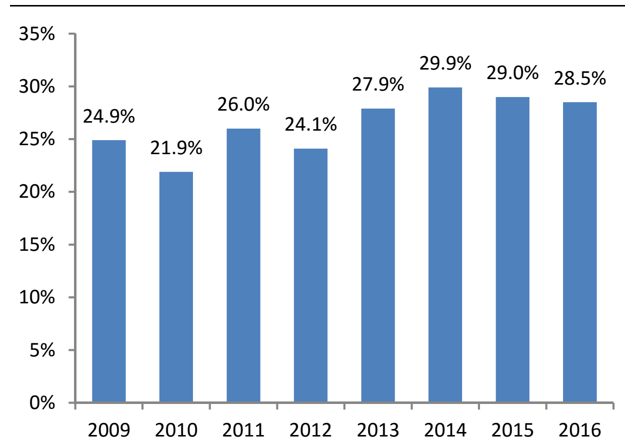
Agency organic growth was helped by the strong performance of employee benefits (EB), which grew at an impressive 6.9%. If EB maintains this growth pace, it will be the fastest growth year for EB in over four years, dating back to 2011.

The 6.9% growth rate made EB the top performing line of business during Q1. Commercial P&C grew by 5.1% while personal lines grew at 1.6%.

Agency profitability was slightly lower than last year, but still strong by historic standards as overall EBITDA margins were 28.5% versus 29.0% for Q1 of 2015. It is important to remember that EBITDA margins are always highest during the 1st quarter, since contingent income is reported on a cash basis. Margins then tend to slide throughout the year, as the early-year effect of the contingent income wanes.

Full-year EBITDA margins seem to be on track to hit a year-end level of approximately 20%.

Q1 EBITDA Margins, 2009 to present



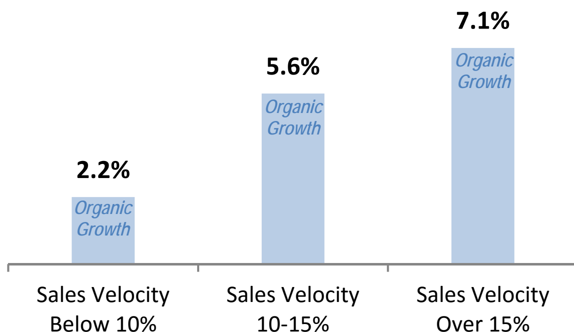
In response to the slow economy/soft P&C market headwinds, many OGP agencies are intensifying their efforts to produce new business – and it is having a powerful effect on their success.

Sales Velocity, which measures new business written as a percentage of overall commissions

Reagan Consulting

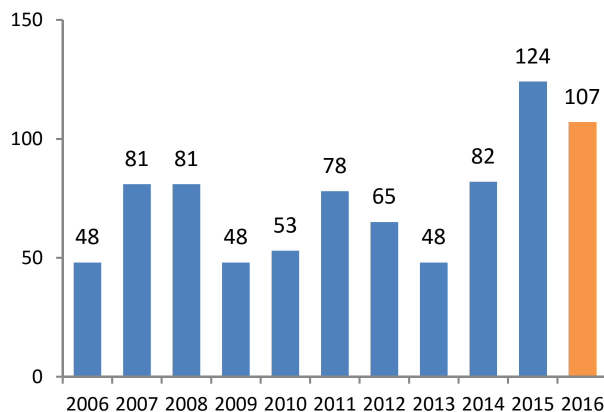
and fees, was 12.1% during Q1. Sales Velocity remains the single greatest differentiator of high growth versus low growth firms. Firms that achieved a 15% or higher Sales Velocity grew by 7.1%, while those that achieved less than 10% grew by only 2.2%.

Sales Velocity – the Key Driver of Organic Growth



Agency M&A continues to be the industry's biggest story. Deal activity continued at a blistering pace during the first quarter. Publicly announced deals totaled 107, which was just slightly below the all-time record pace of 2015.

Q1 Deal Activity: 2006-2016



Source: SNL Financial, Reagan Analysis

What is driving all of this deal activity? There are three key reasons why firms are selling today:

1) Agency valuations remain at all-time highs.

2) Agency leaders are looking for more resources in a highly competitive market. While the hunger for resources is most intense in employee benefits, it is also strong in P&C, as firms are trying to specialize and bring more competitive differentiation to their best clients.

3) Many firms have an aging employee base and have failed to effectively recruit the next generation of leaders and producers.

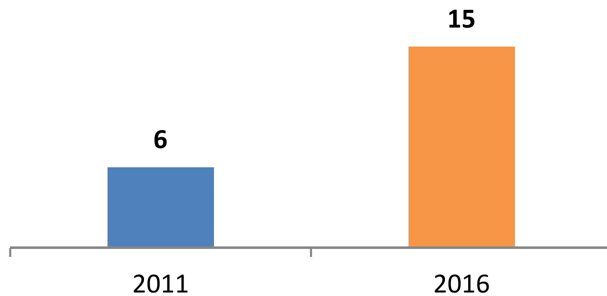
M&A transactions are grabbing the headlines and rightly so. When some of the industry's most successful privately-held firms – including Barney & Barney, MHBT and William Gallagher – sell to a third party, agency owners take notice.

But there is another story out there – perhaps even more impactful – that isn't getting much attention, since it is quietly happening behind the scenes. What is that story?

A new generation of independent firms has emerged with an intense resolve to remain independent. These firms believe that employee ownership is more than culturally important – they believe it is their greatest source of competitive advantage. Their ownership model is their defining characteristic. And as they watch peer firms sell to third parties, their resolve to remain independent strengthens even further.

This strengthened commitment to employee-ownership is perhaps most visible among a group of the industry's largest firms. With the record consolidation going on, one might think that the number of firms with majority employee ownership and revenue over $100 million (The $100M Club) is shrinking. But the opposite is true. This year, the $100M Club will grow to a record 15 firms, versus only 6 in 2011. This is a 150% jump in the $100M Club during the most intense consolidation period in our industry's history!

The $100M Club: Firms with $100 Million in Revenue and Majority Employee Ownership



Source: Reagan Analysis

This is doubly surprising since the temptation to sell is so strong for the $100M Club firms – they are being offered greater valuation premiums than any other size agency. So what exactly are they doing to lock in their long-term independence?

1) **Maximizing shareholder returns.** Recognizing they are forgoing a premium valuation that is likely available from outside buyers, firms are stepping up their game to try to match those returns while remaining independent. For most, this translates into a heightened focus on the twin pillars of value creation – organic growth and enhanced profit performance. Thus, in an ironic twist, the M&A capital pouring into the industry is actually having a positive impact on the performance of at least some firms that remain independent.

2) **Managing age demographics.** Like many other mature industries, insurance brokers have recently awakened to our industry's demographic time bomb. Most brokerages need to get younger fast. And for those that aspire to long-term private ownership, spreading talent across multiple generations is even more important, since age-driven ownership concentrations cause a perpetuation melt-down if too many shareholders of a single age group need to get cashed out at the same time.

3) **Monitoring the Perpetuation Plan.** Top firms are paying greater attention to perpetuation than ever before. With the shareholder return pressures being imposed on leadership teams, the margin for error is extremely thin. As a result, many firms today are building systems to regularly monitor their perpetuation program. This involves building a dashboard of key metrics. It also includes doing regular long-term forecasting of redemption obligations, new share purchases, company cash flow, retained earnings and value. Early warning systems are vital to avoiding problems later.

4) **Communicating constantly.** With private ownership the centerpiece of their employee value proposition, firms are more openly sharing financial results than in the past. And to ensure employee-shareholders are on the same page, they provide regular education to enable each shareholder to understand how he/she contributes to value creation. They believe that educated, high-performing shareholders are their best weapon in the battle for long-term independence.

These are exciting times for our industry. The outside world (represented by private equity) has fallen in love with the investment performance of insurance brokers. Their acquisition hunger has driven values to levels never before seen. While this is gratifying, it is also sobering, as agency owners feel the pressure to either capture those higher returns by selling out, or matching them by creating a rapid growth, high margin firm. For those that are able to do so, the future looks incredibly bright.

All securities transactions are conducted through Reagan Securities, Inc., an affiliate of Reagan Consulting, Inc. Reagan Securities, Inc. is a member of FINRA/SIPC.

Copyright © 2003-2016 **Reagan Consulting**. All rights reserved. No portion of this site may be reproduced without the prior written consent of Reagan Consulting.