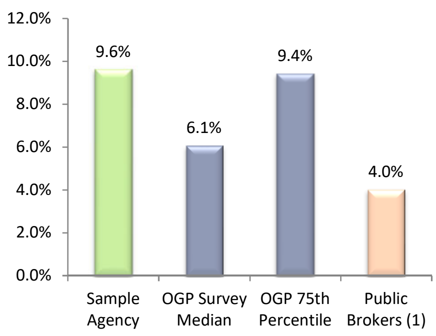
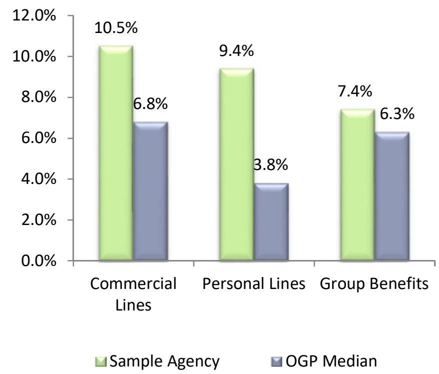
Organic Growth

Total Agency Organic Growth



Your organic growth rank:	**70th - 80th percentile**

Organic Growth by Product Line

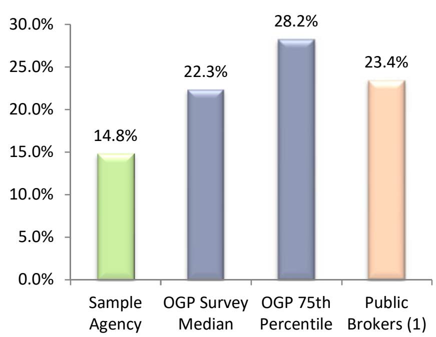


Reagan Consulting Observations

- Brokers posted their strongest 9-month performance since 2013 (6.8%) with organic growth of 6.1% (vs. 3.9% in Q3 2017 and 6.1% in Q2 2018)
- Commercial lines posted its highest Q3 growth since 2014 at 6.8% and personal lines posted its highest Q3 growth since Reagan began tracking results in 2008
- Group benefits continues to be a high performer for many firms at 6.3% growth in Q3 2018 (same as Q2 2018)
- **OGP Projected 2018 Growth: 6.0%**
  Brokers maintained their growth expectations for the year at 6.0% for 2018 (vs. 4.5% in 2017)

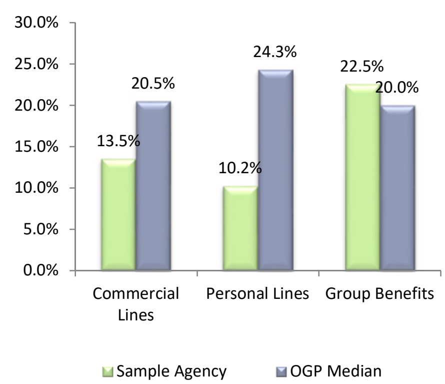
Profitability

Total Agency EBITDA Margin



Your profitability rank:	**10th - 20th percentile**

EBITDA Margin by Product Line

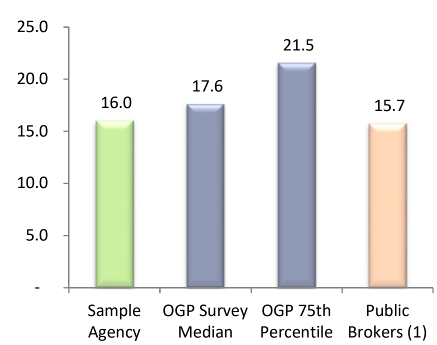


Reagan Consulting Observations

- Overall broker profitability of 22.3% decreased slightly from 22.7% in Q3 2017
- Similar to Q2, overall revenue is up over 6% through Q3, but contingent income is slightly lower year-over-year pushing margins down
- Like overall EBITDA margin, margins in all three lines of business declined slightly vs. prior year
- YTD profitability numbers are inflated by cash-basis contingent income recorded through Q3, so margins will come down slightly in Q4
- **OGP Projected 2018 Margin: 20.0%**
  Brokers are maintaining their outlook for a 20.0% margin in 2018, in line with the 2017 full-year margin of 20.4%

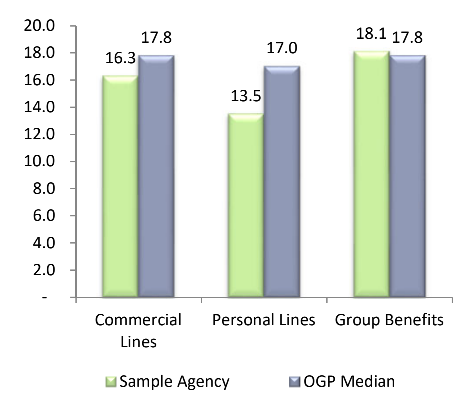
The Rule of 20 (see note below)

Total Agency Rule of 20



Your Rule of 20 rank:	**30th - 40th percentile**

Rule of 20 by Product Line



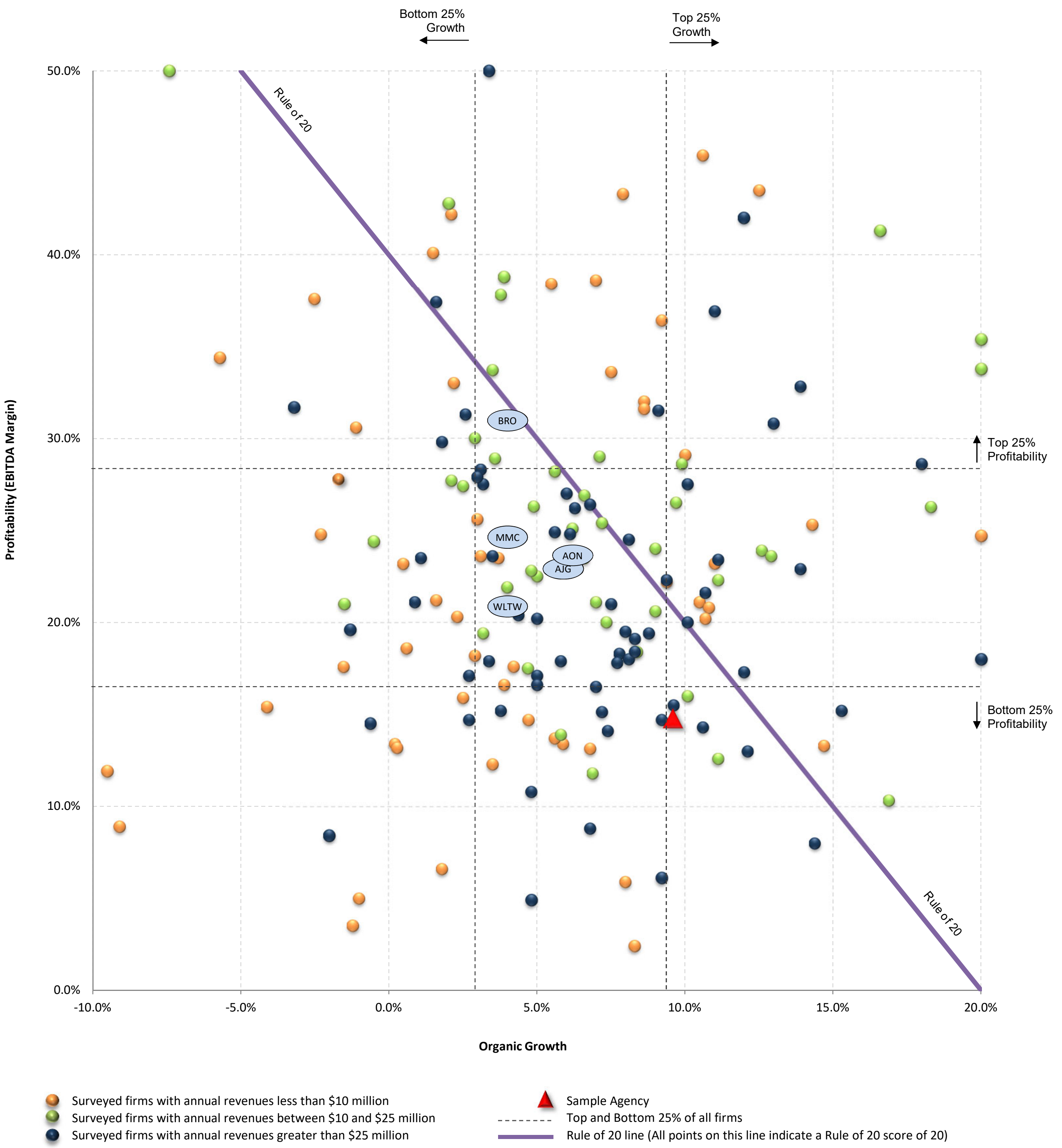
Reagan Consulting Observations

- Driven by high organic growth, the 17.6 median Rule of 20 score is up 2 points over last year's 15.6 score through Q3
- Rule of 20 scores for both commercial lines and group benefits were up over 2017, but personal lines dipped due to lower margins
- Rule of 20 scores, like EBITDA margins, are inflated by cash-basis contingent income and will likely decline in Q4
- **OGP Projected 2018 Score: 16.8**
  Brokers project a solid increase in rule of 20 scores for 2018 (vs. 14.3 in 2017) which reflects their positive outlook for organic growth

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) Represents Q3 2018 results for AJG, AON, BRO and MMC and Q2 2018 results for WLTW.

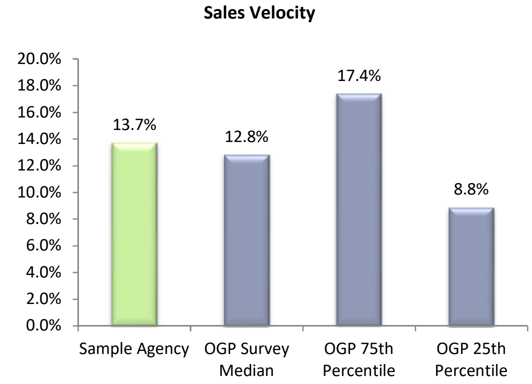


About the Scatter Plot

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.

Note: Scatter Plot represents Q3 2018 results for AJG, AON, BRO and MMC and Q2 2018 results for WLTW.

Sales Velocity (see note below)



Your Sales Velocity rank:	**50th - 60th percentile**

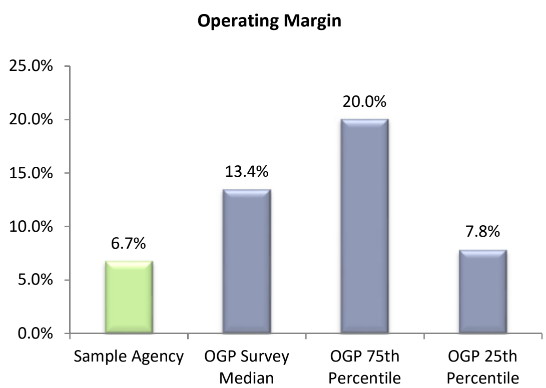
About Sales Velocity

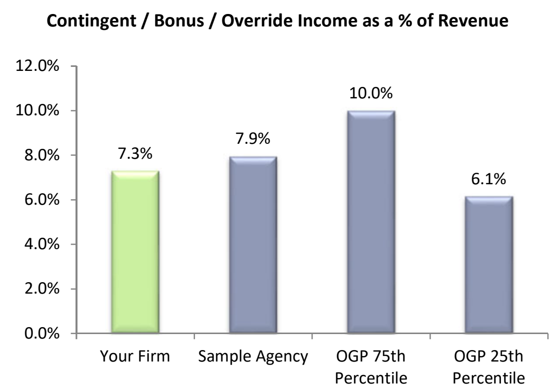
Reagan Consulting has developed a metric called "Sales Velocity" to benchmark an agency's new business results against other firms. Expressed as a percentage, Sales Velocity is calculated by dividing the new business written in the current year by the prior year's commissions and fees. Sales Velocity is among the most important drivers of organic growth.

Reagan Consulting Observations

- The industry has maintained Sales Velocity numbers in the low teens over the last several years, varying between 10.0% and 14.0%
- Median Sales Velocity was 12.8% for the industry through the first nine months of 2018, which is right in line with historical levels
- If a firm consistently posts Sales Velocity figures in the top 25% of the industry (17.4% or higher in Q3 2018), it is likely the firm will generate above average organic growth, assuming normal levels of client retention

Operating Margin & Contingent Income as % of Revenue





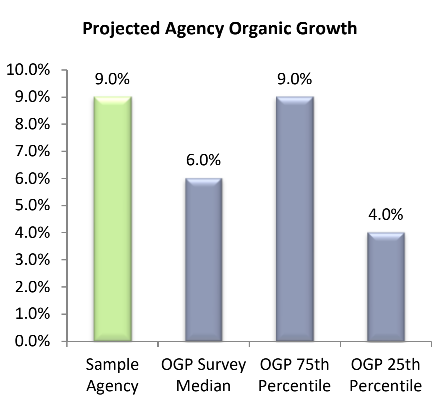
Your Operating Margin rank:	**20th - 30th percentile**

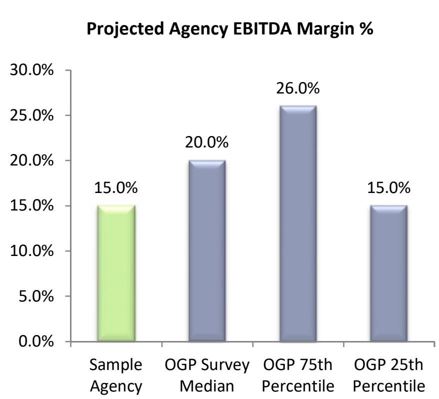
Your Bonus Inc. as % of Revenue rank:	**40th - 50th percentile**

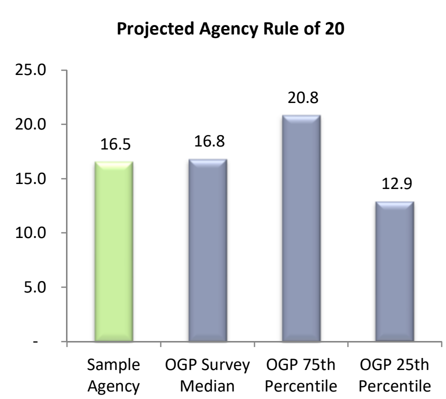
About Operating Margin

Operating Margin is calculated as EBITDA less contingent / bonus / override income, divided by pro-forma net revenues less contingent income.

2018 Projections





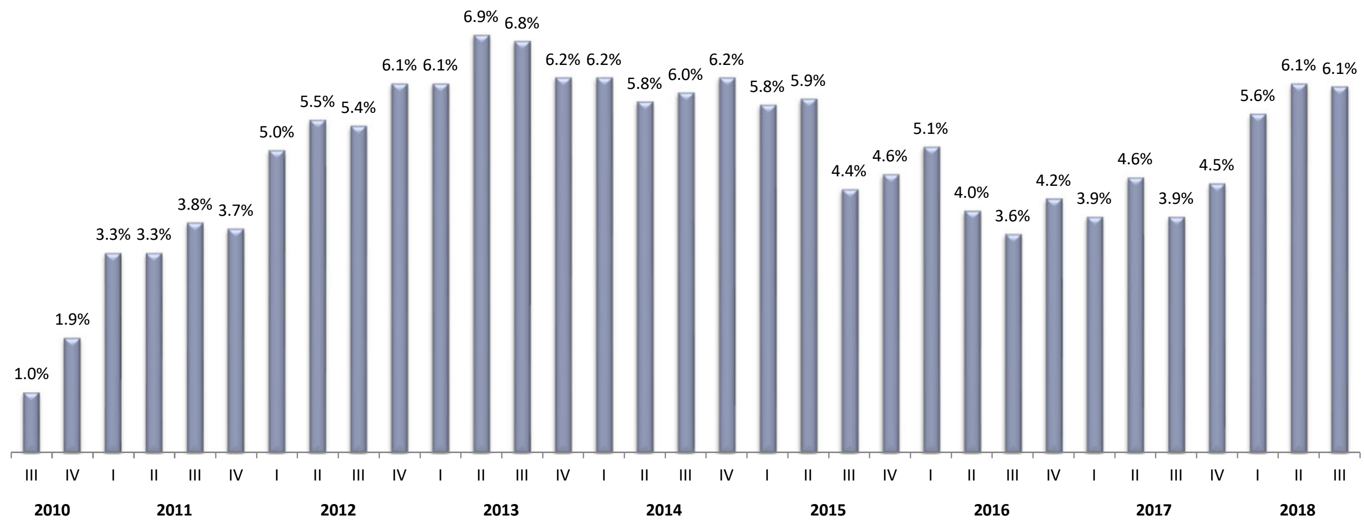


Your organic growth rank:	**70th - 80th percentile**

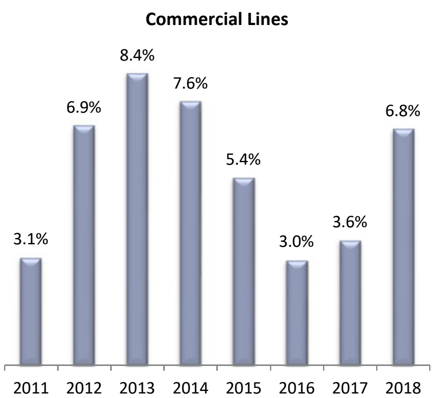
Your EBITDA margin rank:	**10th - 20th percentile**

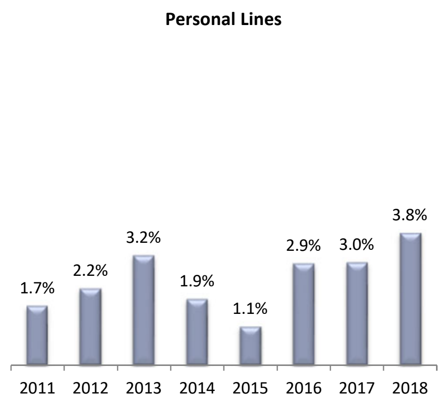
Your Rule of 20 rank:	**40th - 50th percentile**

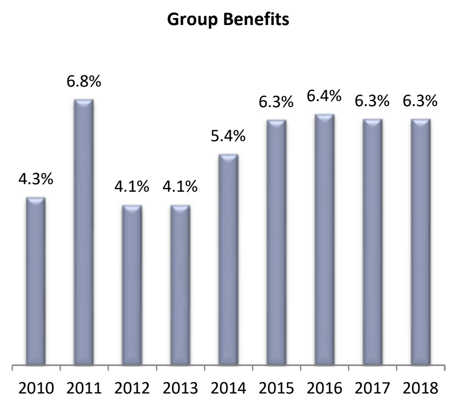
Quarterly Organic Growth - Total Agency Median (Q3 2010 - Present)



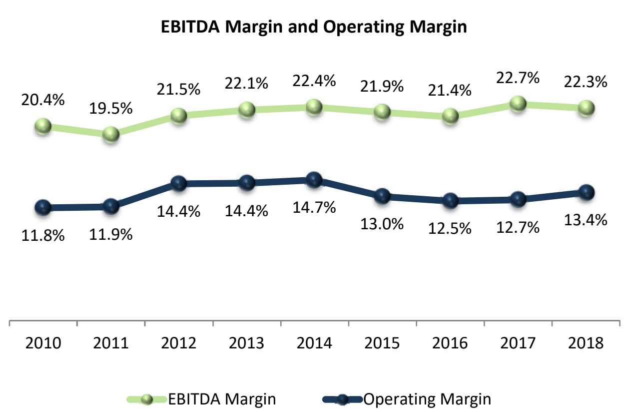
Comparative Median Organic Growth by Product Line (Third Quarter Numbers, 2010 - 2018)

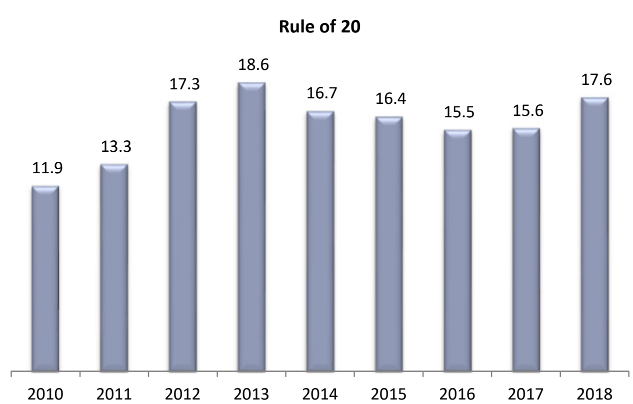






Comparative Median Profitability and Rule of 20 Analysis (Third Quarter Numbers, 2010 - 2018)





About EBITDA Margin and Operating Margin

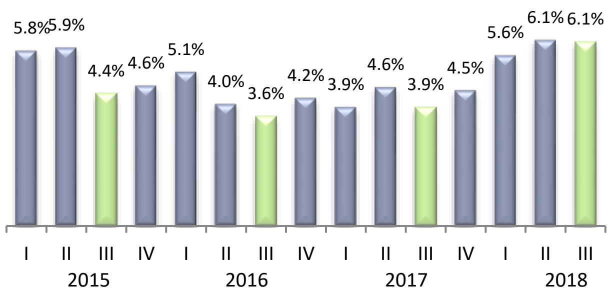
EBITDA Margin is calculated by dividing a firm's pro-forma EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) by the firm's pro-forma net revenues. Operating Margin is calculated as EBITDA less contingent / bonus / override income, divided by pro-forma net revenues less contingent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

Big Growth and Big Bets are Placed as Insuretech Battle Lines are Drawn

by Harrison Brooks

Big growth continued in Q3, matching last quarter's organic growth rate of 6.1% – the highest achieved in 15 quarters. The fact that Q3 growth matched Q2 should invoke broker confidence as Q3 growth has historically lagged Q2 growth, possibly driven by policy renewal cycles and the slower summer months. The chart below presents a bullish organic growth trend over the past four years and highlights this year's Q3 improvement (green bars).

Agency Organic Growth by Quarter (2015-2018)

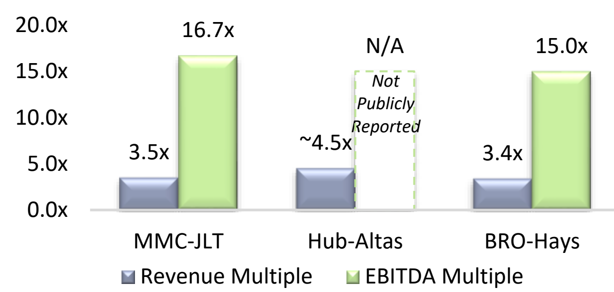


Source: Reagan Consulting OGP Survey

Sustained organic growth and healthy industry fundamentals have led to some big bets being placed on both the acquisition and insuretech front since our Q2 OGP update.

- **Acquisitions:** Marsh & McLennan announced its $6.3 billion acquisition of JLT, Brown and Brown announced its $700+ million acquisition of The Hays Group, and HUB announced a minority investment by Altas Partners, a long-term oriented investment firm based in Toronto, Ontario. An overview of these transactions, which occurred at record high valuation multiples, is displayed below.

Recent Large Deal Valuation Multiples

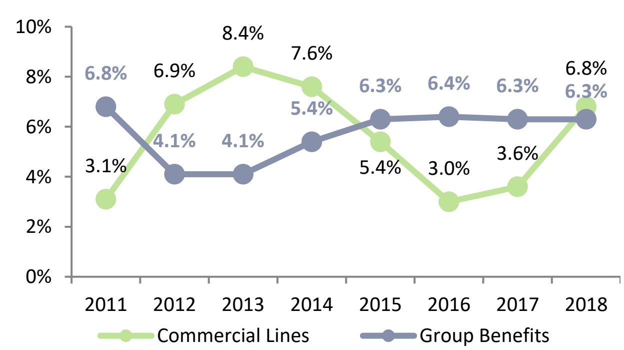


- **Insuretech:** Big bets have been placed on the insurance technology front. CapitalG, Google's investment arm, purchased a large minority stake in Applied Systems. Meanwhile, Salesforce, no longer satisfied to just be a customer relationship management tool, is aggressively pursuing new agency partnerships and is aspiring to become the industry's next major agency management system.

Commercial Lines Growth Soars

Commercial lines is king in a growing US economy, recording impressive growth of 6.8%. Commercial growth surpassed group benefits for the first time since 2014, as group benefits growth remained flat at 6.3%.

Q3 CL vs. Benefits Organic Growth, 2011-2018

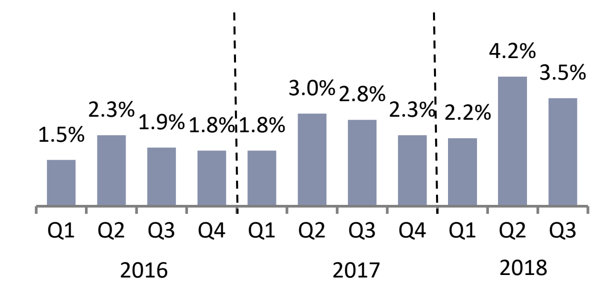


Sources: Reagan Consulting OGP Survey, 3rd Quarter Results

Additionally, we believe Q3 commercial lines growth benefited from rate increases and anticipate slight rate increases to continue.

If history is any indication of future performance, strong commercial lines growth will likely continue. During the last contraction/expansion cycle, there was a 6-to-9 month lag between U.S. GDP results and their eventual impact on insurance broker growth. The uptick in GDP growth since Q4 2017 is promising for agents and brokers and will likely carry into mid-2019.

Real GDP: % Change from Preceding Quarter



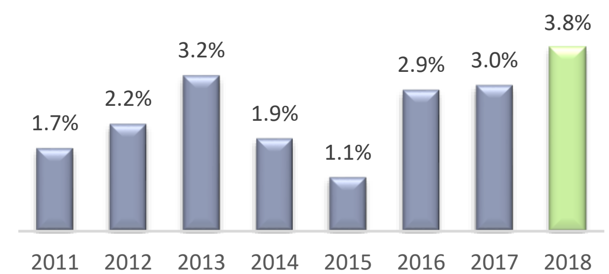
Source: U.S. Bureau of Economic Analysis

Insuretech is Embracing, Not Displacing the Broker

Commercial lines, specifically small commercial, was a hot topic at the InsureTech Connect conference last month, the world's largest insurance technology conference held annually in Las Vegas. There were over 7,500 attendees, consisting of carriers, regulators, brokers, and insuretech startups. A key takeaway from the conference: the insuretech landscape is shifting, from a theme of displacing the broker to embracing and collaborating with the broker. Insuretech startups like Bold Penguin, Indio, Broker Buddha and Modern Submissions are just a few firms trying to leverage technology and blend it with human touch to improve the client experience in commercial insurance. There are still several insuretech startups, like Next Insurance, whose goal is to displace the broker through online distribution and believe the insurance broker is going the way of the travel agent. But the big news is that action seems to be tilting toward collaboration and away from displacement.

Last quarter, Reagan had a hypothesis that the increase in personal lines organic growth may be partially driven by agents embracing insuretech. However, the InsureTech Connect conference raised doubts about this hypothesis. There seems to be no silver bullet or tool that agents are using to drive top quartile organic growth in personal lines. In our conversations with top quartile personal lines brokers, we are finding many are setting themselves apart using creative referral partnerships, aggressive marketing and efficient systems/processes to reinvigorate a historically slow growing line of business. Additionally, we believe this growth is driven in part by hardening in the personal auto market in certain states.

Personal Lines Organic Growth, Q3 2011-2018

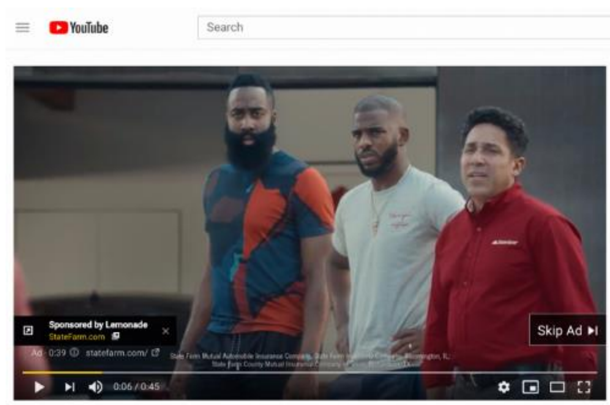


Source: Reagan Consulting OGP Survey, 3rd Quarter results

Insuretech Battle Lines Drawn

We also recently witnessed an advertising battle between insuretech startup Lemonade and personal lines incumbent State Farm. If you have not had a chance to watch the advertisement, check it out on YouTube. At a minimum, it's good for a laugh and frames an important conversation about the balance of technology (artificial intelligence, chatbots and behavioral economics) versus relationships for brokers. Large incumbents and agencies are weighing the question: "How can we best incorporate technology into our operations and new business generation while not losing touch of the personal relationship that likely won the account?"

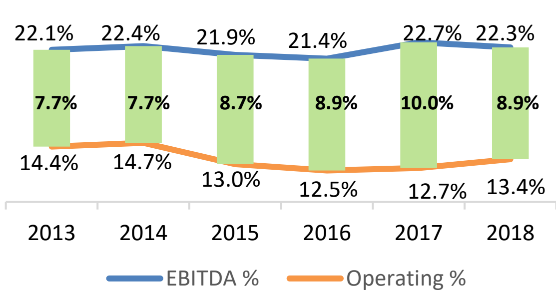
The New State Farm Ad Sponsored by Lemonade



Profitability

Over the past year, Reagan has noticed an alarming trend of declining EBITDA margins, especially in larger agencies. This declining EBITDA margin trend continued in Q3 and is not surprising, given the ever-increasing demands of investing in costly value-added resources and technology. However, the real culprit seems to be declining contingent income, which dropped from 8.6% of revenue in 2017 to 8.0% of revenue in 2018. A clear indicator of this is the spread between EBITDA margins and operating margins. Operating margins exclude contingent/bonus income from the calculation of EBITDA. Encouragingly, brokers experienced an uptick in Q3 operating margins, potentially highlighting a renewed focus on agency profitability.

Q3 EBITDA Margin and Operating Margin



Hopefully, the declining EBITDA margin trend can be tempered by agencies continuing to improve their operating margin, which is the best indicator of structural profitability. Contingent/bonus income can fluctuate based on factors outside of the broker's control, however operating margins can be improved with a focus on efficiencies and expense control.

Conclusion

Agencies are feeling good with strong commercial and personal lines organic growth, record breaking valuation multiples and a changing insuretech landscape increasingly focused on broker collaboration instead of broker disruption. Brokers would be wise to take advantage of favorable economic conditions and re-invest aggressively in their businesses. Most agencies seem to be doing little to embrace insuretech. Agencies that will benefit most from the Insuretech movement are those that focus on pain points in their business and seek Insuretech partners/solutions.

Mark Your Calendar: May 5-7, 2019

Reagan Consulting will once again be hosting our bi-annual **Agency Ownership Summit** in Atlanta on **May 5-7, 2019**. Approximately 175 industry leaders will attend the industry's premier event dedicated to agency valuation, leadership, perpetuation and M&A. Many have referred to it as the best industry event they've ever attended. Next quarter's Market Commentary will provide sign-up instructions. If you'd like more information about the Summit, please call 404.233.5545.