Just When You Thought the Industry's Performance Couldn't Get Any Wilder

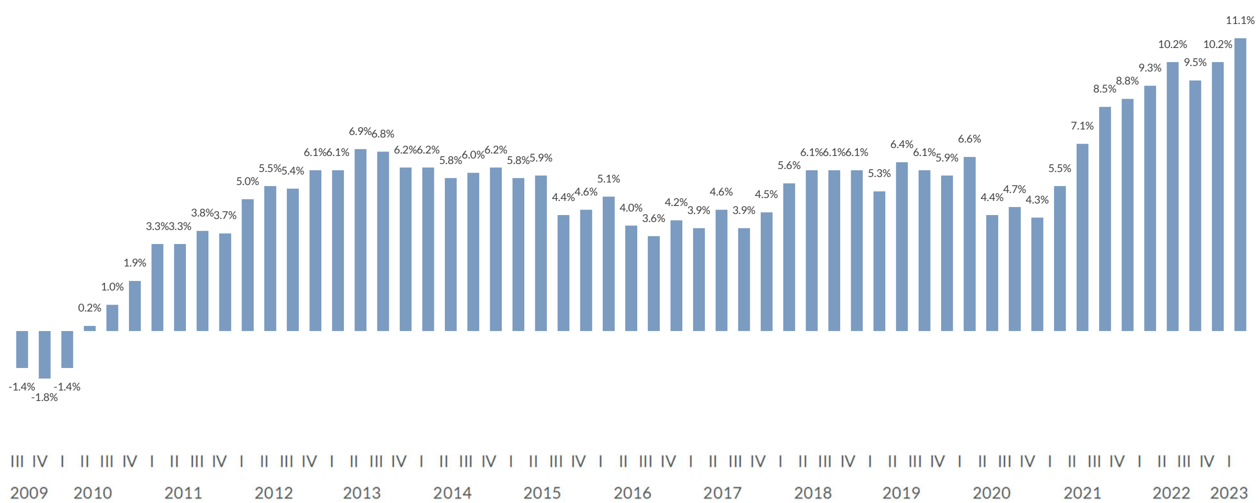
by Tom Doran

Growth by the Numbers

A recurring theme in Reagan Consulting's Growth and Profitability Survey ("GPS") since the world was introduced to Covid-19 in 2020 has been the remarkable performance of the insurance industry. At the end of 2022, we tallied the highest organic growth (10.2%) and second-highest profitability levels (22.5%) ever achieved since the GPS began in 2008.

Well, here we go again. Organic Growth totaled 11.1% in the first quarter of 2023, the highest quarterly growth result in the survey's history by almost a full percentage point.

QUARTERLY ORGANIC GROWTH TOTAL AGENCY MEDIAN (Q4 2008 - PRESENT)

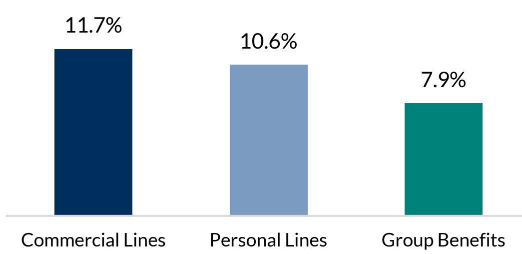


The Personal Lines Growth Explosion

One of the surprising growth drivers supporting the year-end 2022 growth results was Personal P&C (PL), which ended the year up a remarkable 7.5%. This was a monumental outcome for a line of business generally viewed as a high-profit, low-growth contributor to overall agency performance.

If 7.5% at the end of 2022 was monumental, we're at a loss to describe the organic PL growth results for Q1 2023: a

GROWTH BY PRODUCT LINE



Source: Reagan Consulting Growth and Profitability Survey, Q1 results whopping 10.6%. This is higher than Employee Benefits (EB) growth (7.9%) and slightly lower than Commercial P&C (CL) growth (11.7%).

Historically, many PL departments have been viewed as cash cows – very profitable, with modest growth potential. Well-run PL departments might achieve a high-20's to low-30's profit margin and 2.5%–3.5% organic growth. These high marginal profitability results stem from producer compensation practices, in which producer commissions on renewal PL business can be modest relative to Commercial P&C and Employee Benefits. With fewer dollars paid to PL producers after the first year, PL business becomes much more profitable than CL and EB.

Given the small dollar amounts PL accounts generate relative to CL and EB, PL growth can be tougher to achieve. It takes a lot of new PL business to move the meter. Even in agencies that excel in PL sales, rate and exposure base is usually the more significant contributor (or detractor) to growth. So, what's the story behind these incredible Q1 PL growth results?

According to Robbie Smith, CEO of Oakbridge Insurance, the PL growth story is complex and multifaceted:

- All carriers can get rate right now –no moderation-minded carriers are creating downward rate pressure.
- Inflation is pushing replacement costs up materially – for homeowners, the cost to rebuild is now as much as 20-40% higher than just 2-3 years ago.
- Carriers are pushing new replacement cost factors at renewal that might have been overlooked in past years to stay competitive.
- Physical damage claims on autos are materially higher due to new technologies – what used to be a simple fender-bender may now require the replacement of expensive sensors and components.
- Plaintiffs' attorneys often attempt to make any accident a "policy limits" claim.
- Anything with cat exposures (wind, storm surge, etc.) is tricky – and it's not just coastal exposures anymore – think tornadoes and hail in the heartland, too.

Smith sees no material relief in sight, so we may continue to see high PL growth for the foreseeable future. Until a handful of carriers blink on rate, PL renewals will remain challenging.

CL Growth Remains Hot & EB Growth Breaks Out

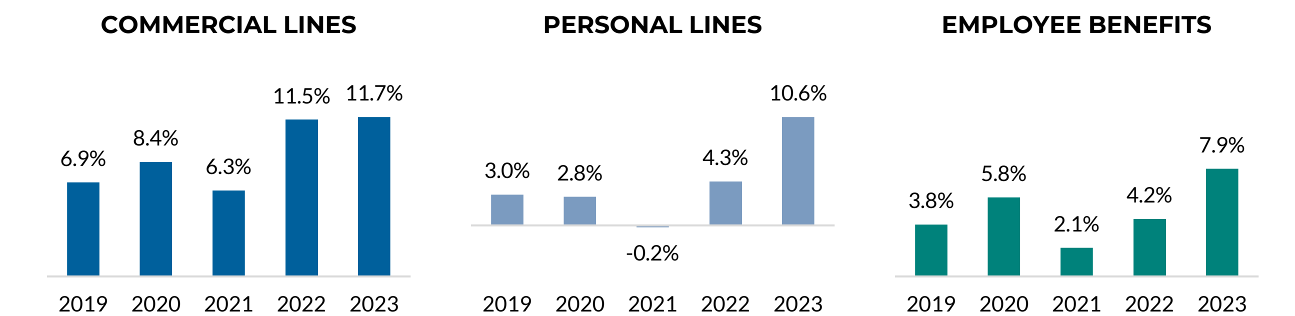
Although PL growth is the big story, growth in commercial insurance products remains strong, too.

Commercial P&C growth through Q1 totaled 11.7%, the highest Q1 result in GPS history. Many of the same factors driving PL growth also affect CL growth. The economy (for now) remains healthy and new growth opportunities abound.

In what would be the big story were it not for this PL growth news, Group Benefits / EB growth in Q1 totaled 7.9%, also the highest Q1 growth result ever seen in the GPS. This 7.9% result is 88% higher than last year's Q1 result (4.2%). Let that sink in … EB growth in Q1 was almost double what it was last year. EB growth, which has lagged CL materially in recent years, is now accelerating rapidly due to inflation pressures, the continuing economic recovery from Covid-19, and an expanding employee population nationally.

With all lines of business in hyper-growth mode, insurance broker growth is hitting on all cylinders.

ORGANIC GROWTH BY PRODUCT LINE (Q1 RESULTS)



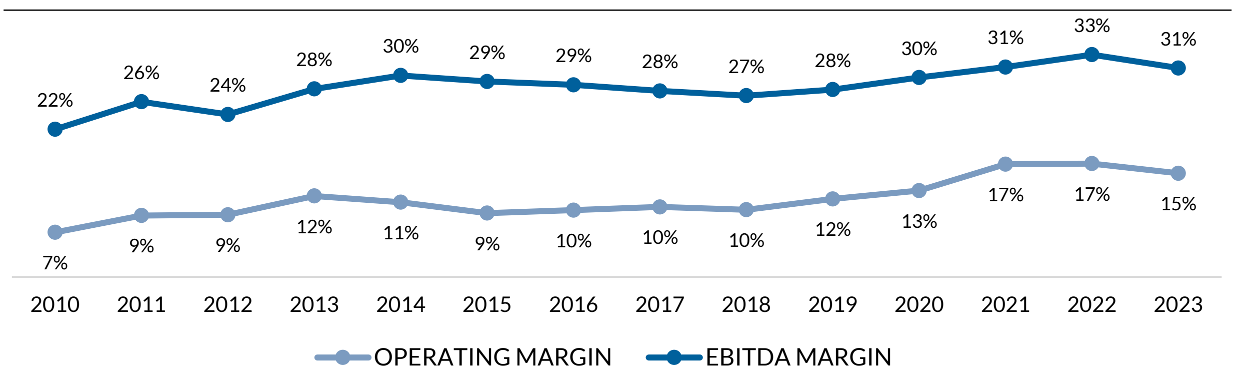
Source: Reagan Consulting Growth and Profitability Survey, Q1 results

What About Profitability?

The profitability party continues to rage right alongside the organic growth shindig. Although slightly lower than last year's 33% Q1 result, the industry's 31% EBITDA margin is still high versus historical norms. Operating margins, although still high, are cooling a bit.

As a reminder, margins are inflated in the first quarter due to the timing of contingent receipts – they will decline over the course of the full year. Nonetheless, based on these early results, 2023 is on pace to deliver another year of near-record profitability.

EBITDA MARGIN & OPERATING MARGIN

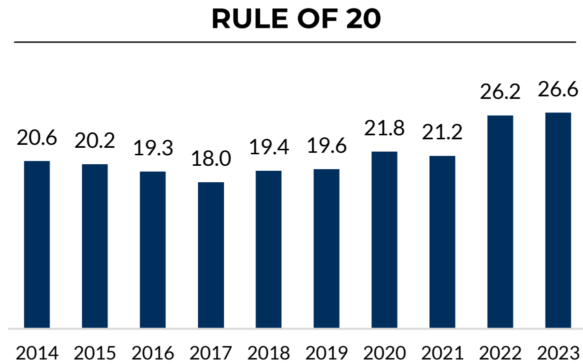


Source: Reagan Consulting Growth and Profitability Survey, Q1 results

The Mother of all Metrics – The Rule of 20

Reagan Consulting's Rule of 20 Metric is perhaps the most important measure of the industry's (or any brokerage's) overall health. Calculated by adding 50% of EBITDA profitability to organic growth, a 20 result is considered excellent.

The average Q1 Rule of 20 score totaled 26.6, yet another all-time Q1 record for the GPS. As with EBITDA profitability, the Rule of 20 score will come down as the year progresses and margins moderate. Nonetheless, by this measure, the industry has never been healthier.



Source: Reagan Consulting Growth and Profitability Survey, Q1 results

Where do we go from here?

From a purely numerical standpoint, it doesn't get any better than this. Growth and profitability are the primary drivers of any agency's valuation, and they continue to deliver the goods. With growing economic headwinds, the ongoing Ukraine conflict, sky-high inflation, and rising interest rates, all of which might serve to damper agency valuations, these GPS growth and profitability results are welcome news.

But there is more to the story than just the numbers. The people and processing sides of our brokerage world are under severe stress. Renewal conversations with clients are as challenging as they've ever been. Brokers struggle to find the talent they need to support the growth they're achieving - CSRs, Account Executives, Claims, Loss Control, accounting, and IT. Producers are particularly vulnerable to producer lift-out strategies from competing brokers. Running a brokerage right now is tough. Many of the leaders we encounter in our consulting practice confirm palpable fatigue.

Leaders would be well-advised to tend closely to their brokerage infrastructures, operations and people. This vertical growth is amazing. But horizontal growth is critical, too. As it turns out, trees don't grow year-round – they grow for a season when the elements (water, temperature, sunlight) support it. Then they turn their attention inward to horizontal growth to support recent growth and prepare for the next growth season. What do we do if this growth cycle doesn't slow down soon? How much uninterrupted growth is healthy? Can our organizations and people thrive in a season of unrelenting growth?

Agents and brokers in this raging growth cycle should carefully consider how best to navigate this remarkable season of growth to ensure that their organizations and people are well-served.

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GPS
GROWTH & PROFITABILITY SURVEY

The GPS Industry Snapshot | Q1 2023

11.1%	Median industry organic growth
9.0%	Projected year-end 2023 organic growth
31.0%	Median industry EBITDA margin
22.0%	Projected year-end 2023 EBITDA margin
11.7%	Median commercial lines organic growth
10.6%	Median personal lines organic growth
7.9%	Median group benefits organic growth

Stat of the Quarter

10.6%

Personal Lines Organic Growth

Brokers posted the highest quarterly Personal Lines Organic Growth rate on record, surpassing the previous all-time quarter high of 7.5% in Q4 2022 and the hightest Q1 result of 3.9% set in 2018. The double digit growth rate was fueled primarily by rising rates, infationary pressures and increasing property values, especially in natural disaster

Reagan's Growth & Profitability Survey is a real-time, quarterly look at the key drivers of value creation in the brokerage industry: organic growth and EBITDA margin. In Q1 2023, approximately 150 agencies participated in the GPS, with median annual revenues of approximately $16.7 million.

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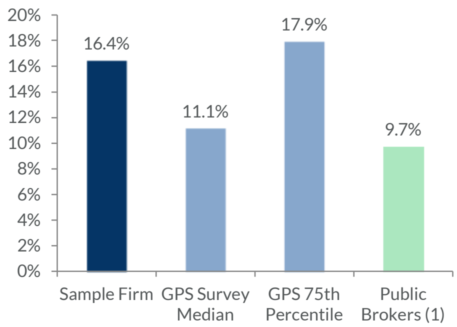
GROWTH & PROFITABILITY SURVEY

CURRENT VALUE DRIVER COMPARISON

Q1 2023
GPS ID: 9999

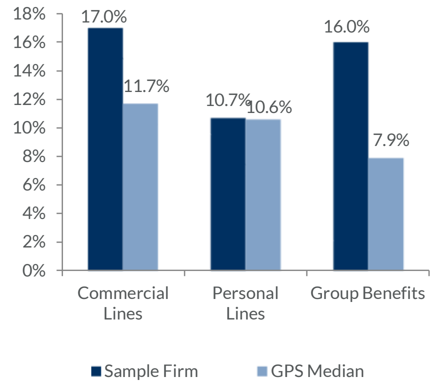
ORGANIC GROWTH

TOTAL AGENCY ORGANIC GROWTH

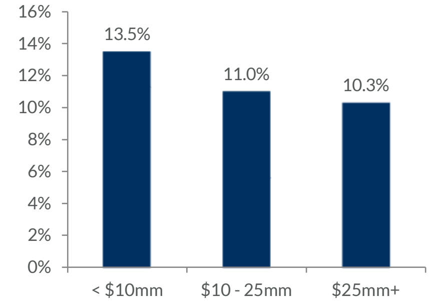


Your organic growth rank:	70th - 80th percentile

ORGANIC GROWTH BY PRODUCT LINE

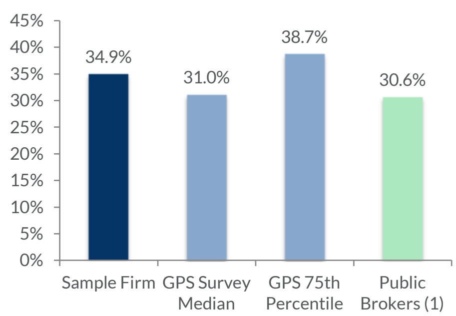


ORGANIC GROWTH BY SIZE CATEGORY



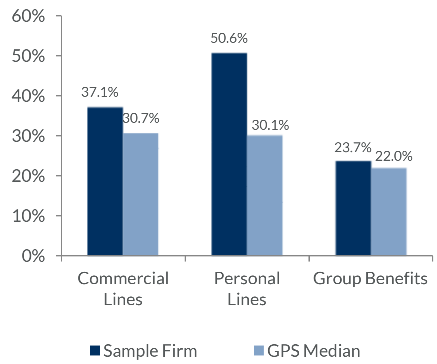
PROFITABILITY

TOTAL AGENCY EBITDA MARGIN

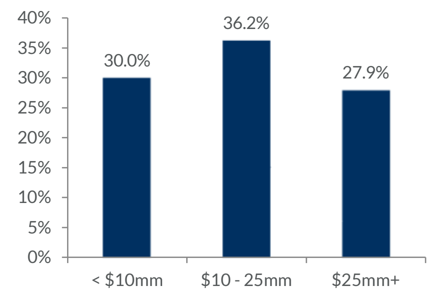


Your profitability rank:	60th - 70th percentile

EBITDA MARGIN BY PRODUCT LINE

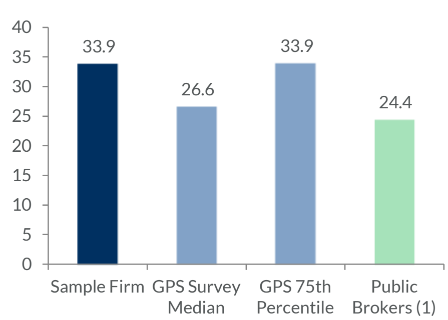


EBITDA MARGIN BY SIZE CATEGORY



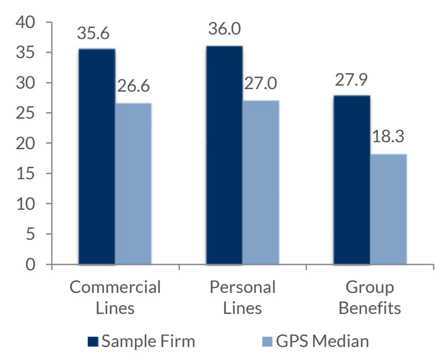
THE RULE OF 20

TOTAL AGENCY RULE OF 20

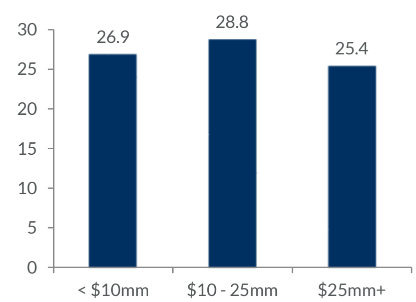


Your Rule of 20 rank:	70th - 80th percentile

RULE OF 20 BY PRODUCT LINE



RULE OF 20 BY SIZE CATEGORY



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 Sample Firm reads "0.0%" or "0.0" it may mean that no data was submitted for that metric.
(1) Represents Q1 2023 results for AJG, AON, BRO, MMC and WLTW.

GPS
GROWTH & PROFITABILITY SURVEY

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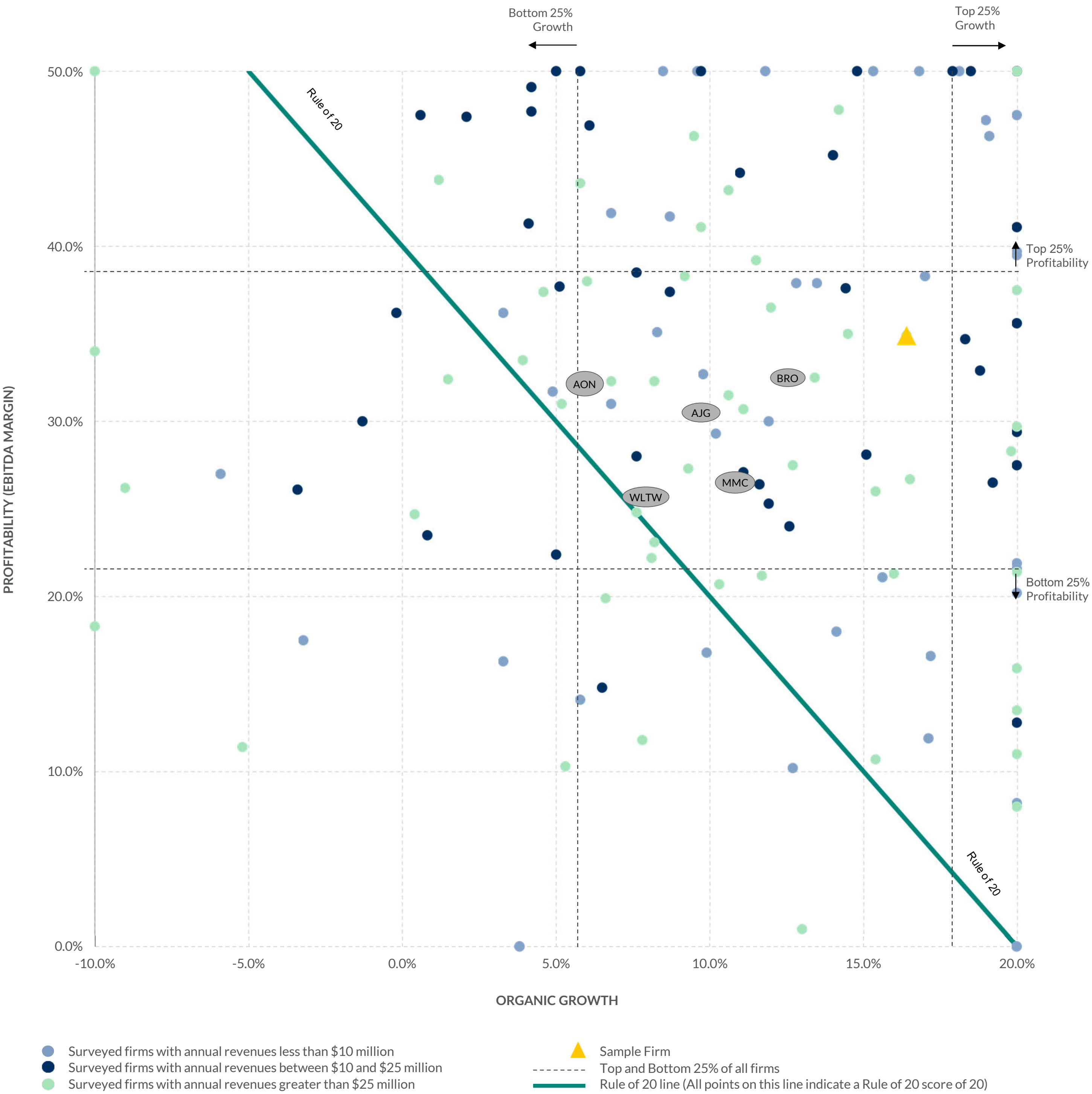
ORGANIC GROWTH & PROFITABILITY SCATTER PLOT

Q1 2023
GPS ID: 9999

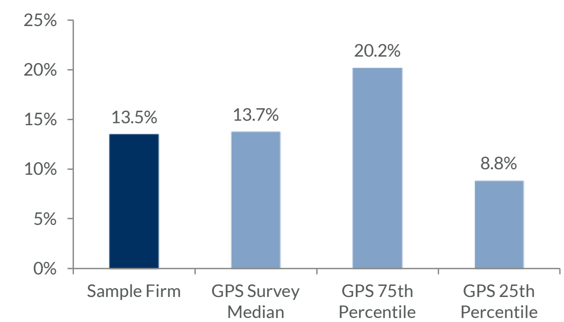


Scatter Plot
The goal of this scatter plot is to show the wide range of organic growth and profitability results in the industry and to benchmark where your firm falls. It shows every firm that completed the survey's total agency organic growth section and total agency profitability section. Each firm's organic growth is plotted along the x-axis, and each firm's profitability is plotted along the y-axis. The grey dotted lines show the top and bottom 25% of firms in organic growth and profitability. The solid green line represents all combinations of organic growth and EBITDA margin that result in a Rule of 20 score of 20. The firms are broken into groups based on revenue size, as distinguished by the different colored dots.

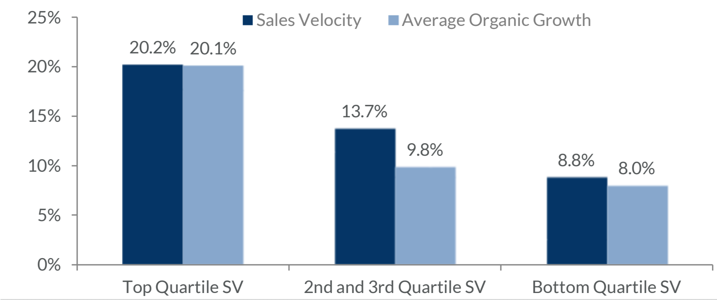
Note: Scatter plot represents Q1 2023 results for AJG, AON, BRO, MMC and WLTW.

SALES VELOCITY

SALES VELOCITY



AVERAGE ORGANIC GROWTH BY SALES VELOCITY QUARTILE

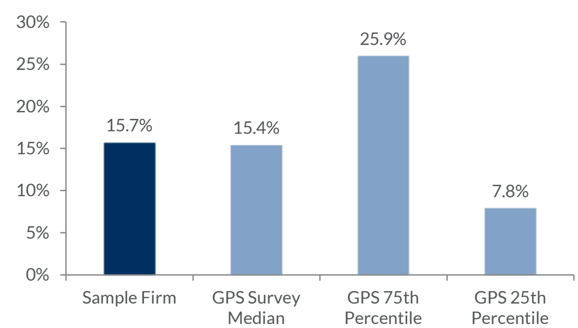


Sample Firm Velocity rank:	40th - 50th percentile

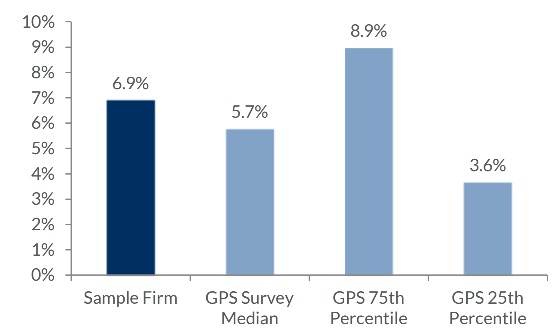
Sales Velocity
Reagan Consulting has developed a metric called "Sales Velocity" to benchmark an agency's new business results. Sales Velocity is calculated by dividing the new business written in the current year by the prior year's commissions and fees. The above graph shows average organic growth by sales velocity quartile - firms with the highest Sales Velocity post outsized organic growth.

OPERATING MARGIN & CONTINGENT INCOME AS % OF REVENUE

OPERATING MARGIN



CONTINGENT/BONUS/OVERRIDE INCOME AS A % OF REVENUE



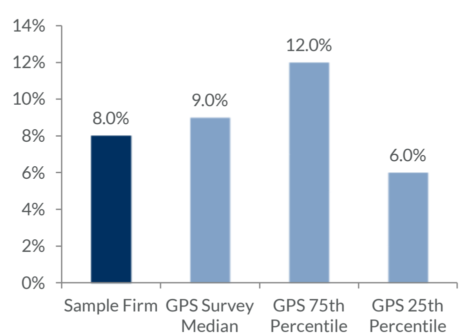
Sample Operating Margin rank:	50th - 60th percentile

Sample Bonus Inc. as % of Revenue rank:	60th - 70th percentile

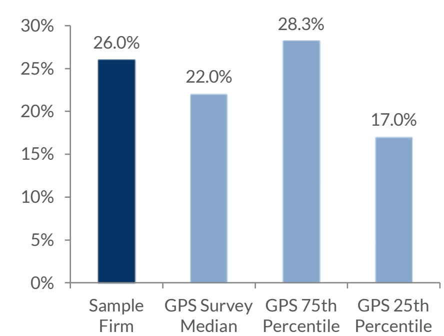
Operating Margin
Operating Margin is calculated as EBITDA less contingent / bonus / override income, divided by pro-forma net revenues less contingent income.

2023 PROJECTIONS

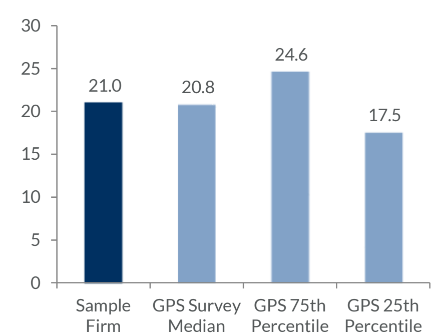
PROJECTED AGENCY ORGANIC GROWTH



PROJECTED AGENCY EBITDA MARGIN %



PROJECTED AGENCY RULE OF 20



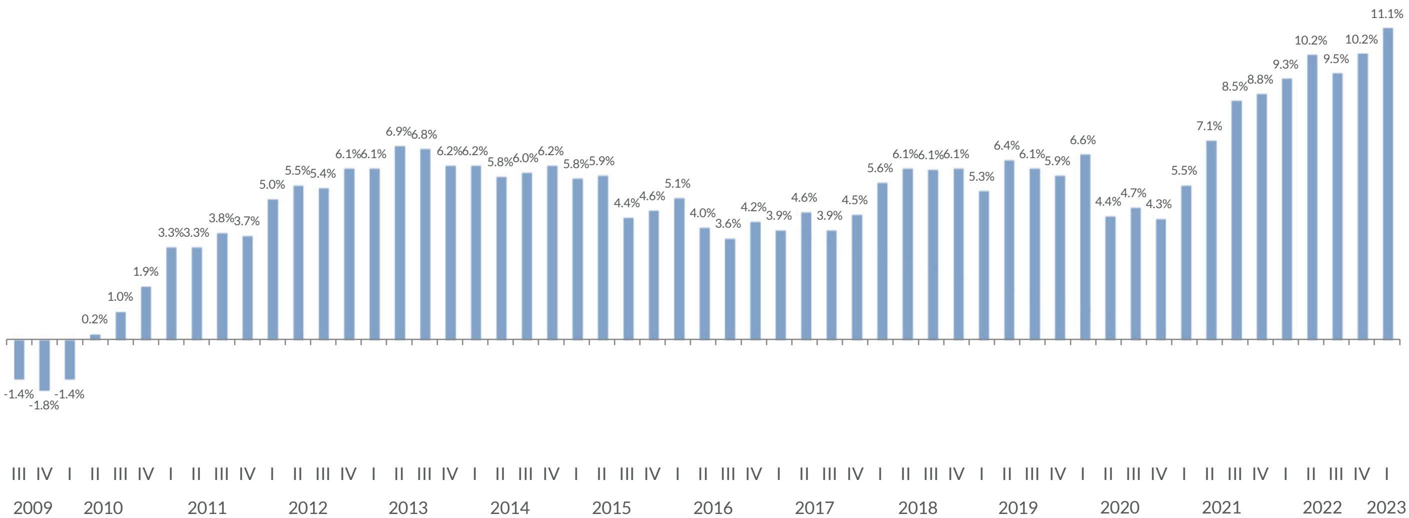
Sample organic growth rank:	40th - 50th percentile

Sample EBITDA margin rank:	60th - 70th percentile

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

QUARTERLY ORGANIC GROWTH - TOTAL AGENCY MEDIAN

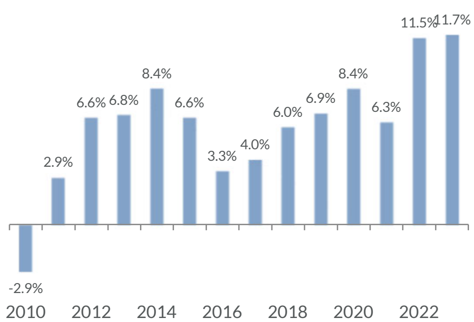
(Q3 2009 - PRESENT)



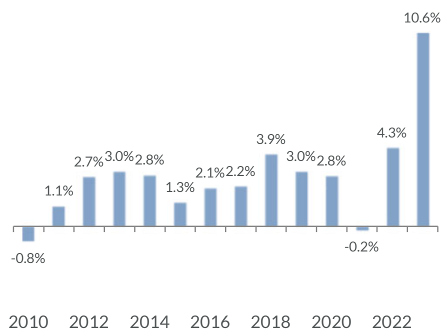
COMPARATIVE MEDIAN ORGANIC GROWTH BY PRODUCT LINE

(FIRST QUARTER NUMBERS, 2009 - 2023)

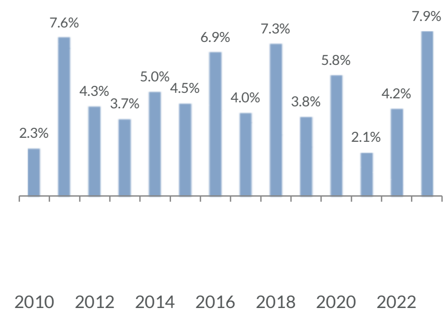
COMMERCIAL LINES



PERSONAL LINES



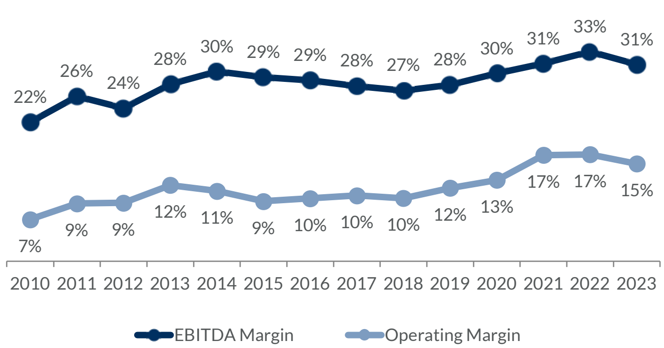
GROUP BENEFITS



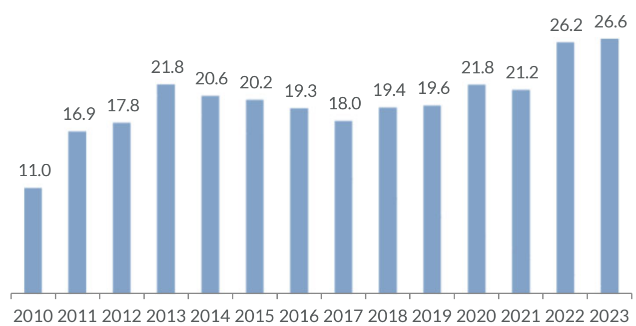
COMPARATIVE MEDIAN PROFITABILITY AND RULE OF 20 ANALYSIS

(FIRST QUARTER NUMBERS, 2010 - 2023)

EBITDA MARGIN AND OPERATING MARGIN



RULE OF 20



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.