GPS

GROWTH & PROFITABILITY SURVEY

The GPS Industry Snapshot | Q4 2022

10.2%	Median industry organic growth
8.1%	Projected year-end 2023 organic growth
22.5%	Median industry EBITDA margin
22.0%	Projected year-end 2023 EBITDA margin
12.6%	Median commercial lines organic growth
7.5%	Median personal lines organic growth
6.0%	Median group benefits organic growth

Stat of the Quarter

22.2

Median Rule of 20 Score

Brokers posted the highest full-year Rule of 20 score in GPS history, surpassing the previous record of 20.6 set in 2021. This was fueled by the combination of (a) record organic growth and (b) sustained post-COVID EBITDA margins.

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 Q4 2022, approximately 160 agencies participated in the GPS, with median annual revenues of approximately $15.4 million.

REAGAN

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GPS
GROWTH & PROFITABILITY SURVEY

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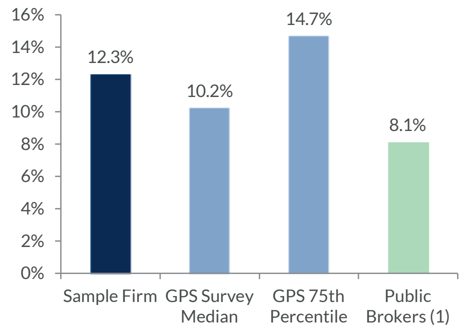
CURRENT VALUE DRIVER COMPARISON

Q4 2022
GPS ID: 9999

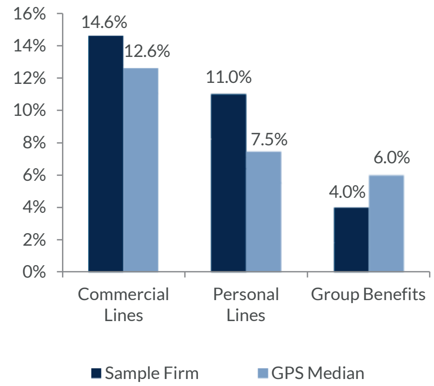
ORGANIC GROWTH

TOTAL AGENCY ORGANIC GROWTH

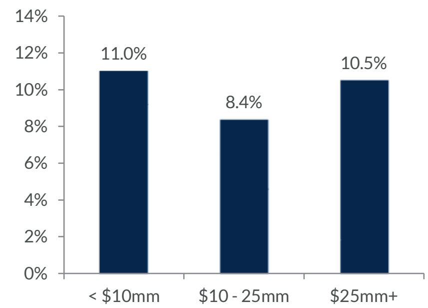


Sample organic growth rank:	60th - 70th percentile

ORGANIC GROWTH BY PRODUCT LINE

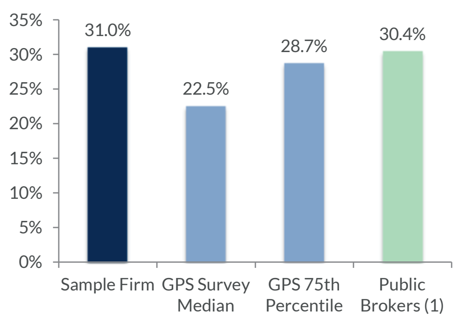


ORGANIC GROWTH BY SIZE CATEGORY



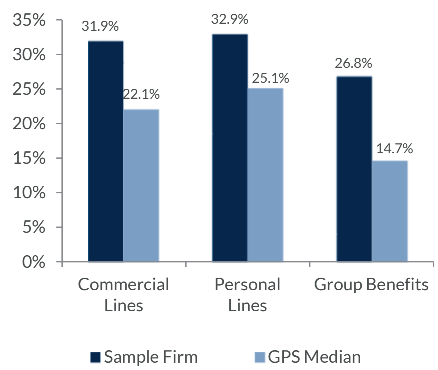
PROFITABILITY

TOTAL AGENCY EBITDA MARGIN

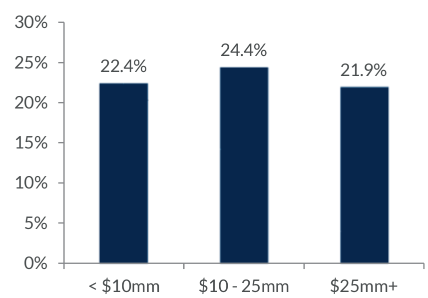


Sample profitability rank:	80th - 90th percentile

EBITDA MARGIN BY PRODUCT LINE

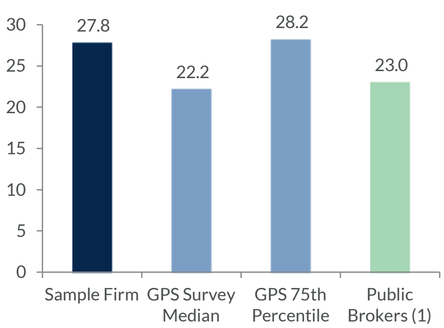


EBITDA MARGIN BY SIZE CATEGORY



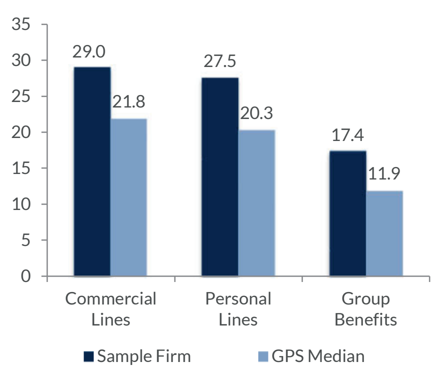
THE RULE OF 20

TOTAL AGENCY RULE OF 20

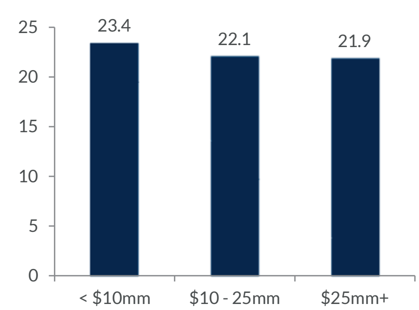


Sample Rule of 20 rank:	70th - 80th percentile

RULE OF 20 BY PRODUCT LINE



RULE OF 20 BY SIZE CATEGORY

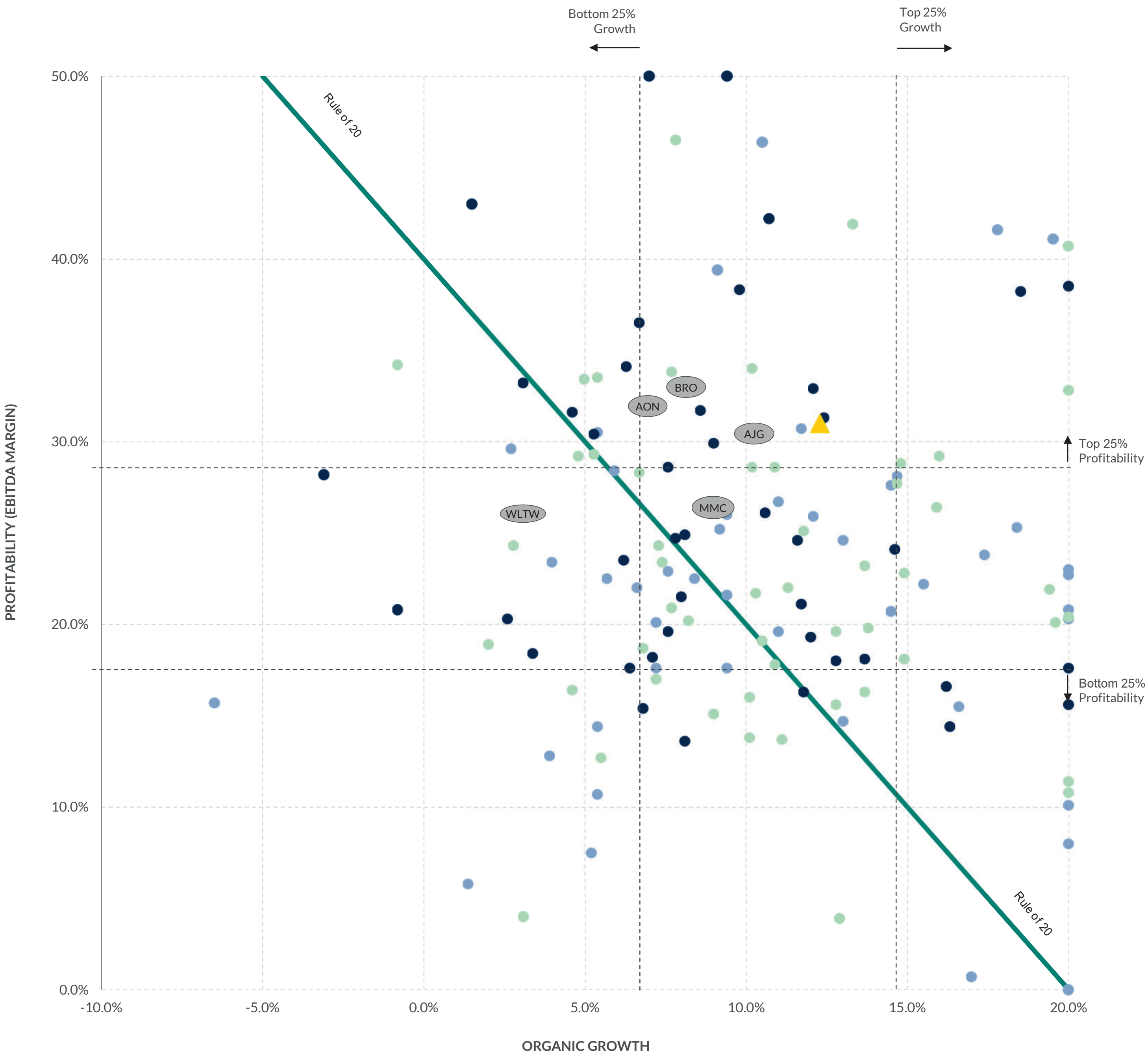


The Rule of 20
Reagan Consulting has developed a metric called the "Rule of 20" to provide a quick means of benchmarking an agency's shareholder returns. The Rule of 20 is calculated by adding half of an agency's EBITDA margin to its organic revenue growth rate. An outcome of 20 or higher means an agency 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 Q4 2022 results for AJG, BRO and MMC and Q3 2022 results for AON and WLTW.

ORGANIC GROWTH & PROFITABILITY SCATTER PLOT

Q4 2022
GPS ID: 9999



- 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
- Sample 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)

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 Q4 2022 results for AJG, BRO and MMC and Q3 2022 results for AON and WLTW.

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GROWTH & PROFITABILITY SURVEY

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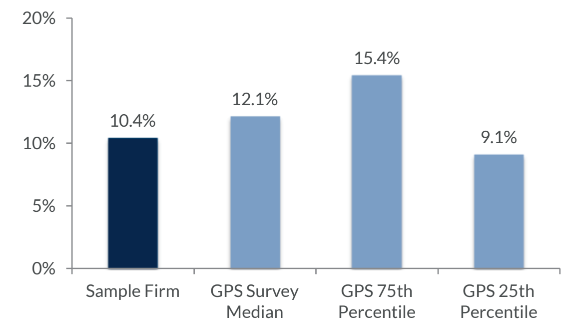
GROWTH & PROFITABILITY DRIVERS/PROJECTIONS

Q4 2022
GPS ID: 9999

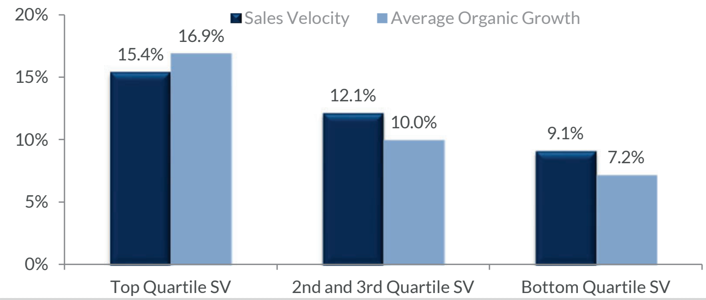
SALES VELOCITY

SALES VELOCITY



Sample Sales Velocity rank:	30th - 40th percentile

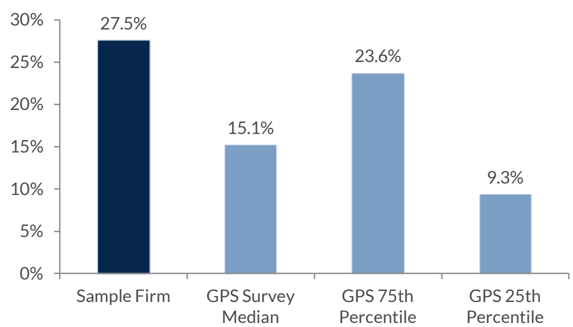
AVERAGE ORGANIC GROWTH BY SALES VELOCITY QUARTILE



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.

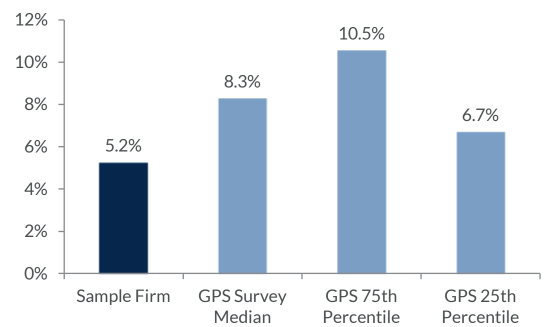
OPERATING MARGIN & CONTINGENT INCOME AS % OF REVENUE

OPERATING MARGIN



Sample Operating Margin rank:	80th - 90th percentile

CONTINGENT/BONUS/OVERRIDE INCOME AS A % OF REVENUE

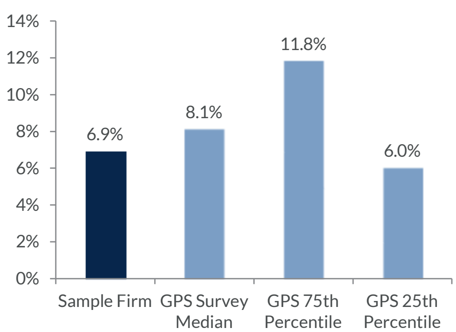


Sample Bonus Inc. as % of Revenue rank:	10th - 20th percentile

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

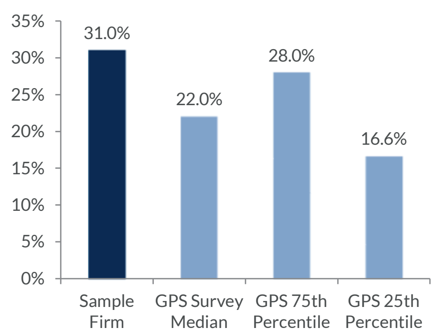
2023 PROJECTIONS

PROJECTED AGENCY ORGANIC GROWTH



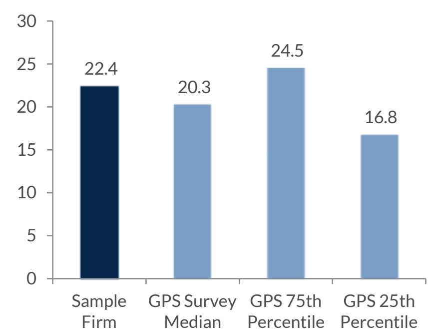
Sample organic growth rank:	20th - 30th percentile

PROJECTED AGENCY EBITDA MARGIN %



Sample EBITDA margin rank:	80th - 90th percentile

PROJECTED AGENCY RULE OF 20



Sample Rule of 20 rank:	60th - 70th percentile

GPS
GROWTH & PROFITABILITY SURVEY

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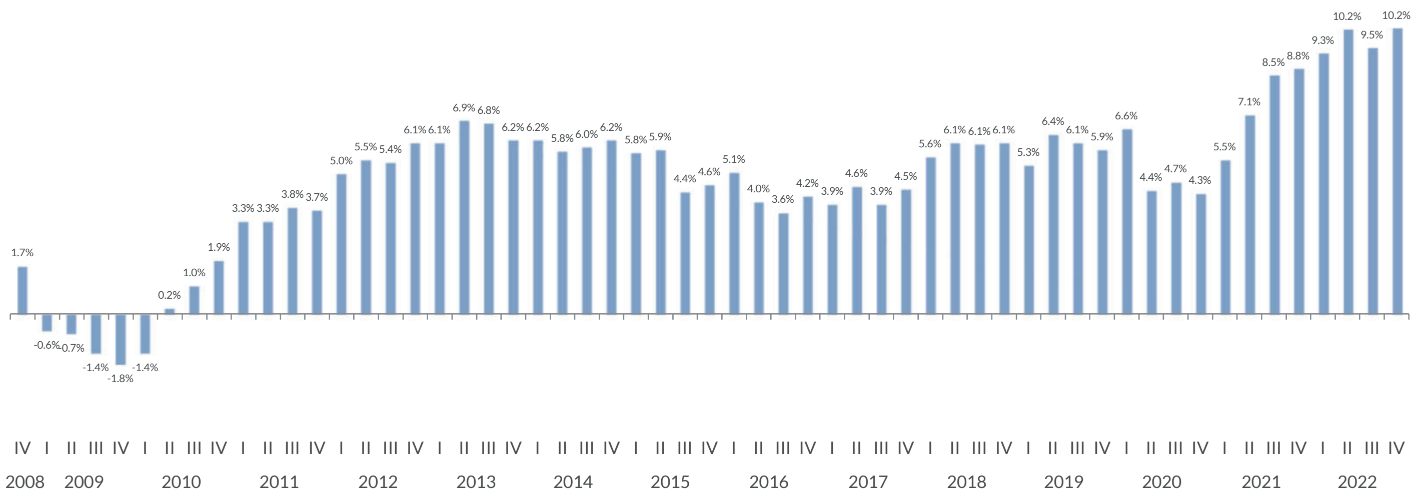
HISTORICAL TRENDING

Q4 2022
GPS ID: 9999

QUARTERLY ORGANIC GROWTH - TOTAL AGENCY MEDIAN

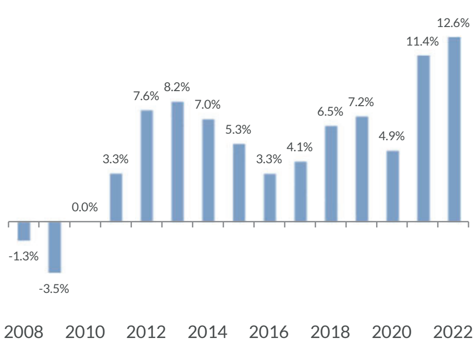
(Q4 2008 - PRESENT)



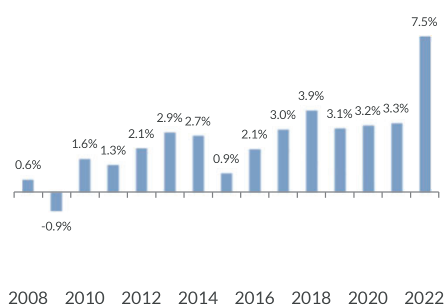
COMPARATIVE MEDIAN ORGANIC GROWTH BY PRODUCT LINE

(FOURTH QUARTER NUMBERS, 2008 - 2022)

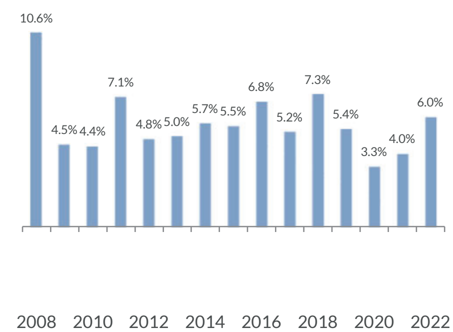
COMMERCIAL LINES



PERSONAL LINES



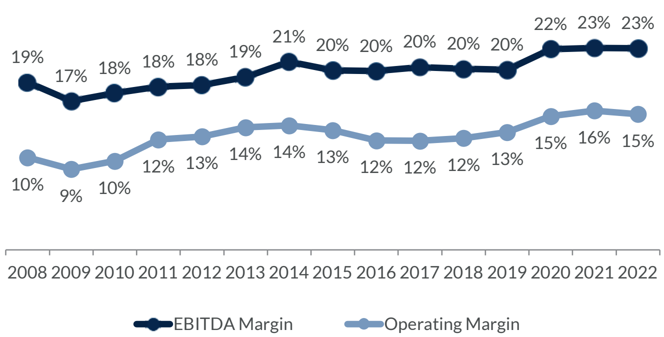
GROUP BENEFITS



COMPARATIVE MEDIAN PROFITABILITY AND RULE OF 20 ANALYSIS

(FOURTH QUARTER NUMBERS, 2008 - 2022)

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.

A Record Year, on Top of a Record Year: What is Driving These Results?

by Bobby Reagan

When we wrote the commentary on these pages a year ago regarding the record breaking 8.8% median organic growth for 2021, our focus appropriately was on the insurance distribution system's amazing resilience in the face of COVID-19. As we now put pen to paper a year later, we see the median organic growth for 2022 at 10.2%, nearly two percentage points higher than last year's record-breaking results. On the surface this is nothing short of amazing but does raise questions about the factors driving these results. We can continue to recognize our industry's resilience, but two other factors are also driving these record-breaking metrics: inflation and an unprecedented five straight years of P&C rate increases. We will look at each of these factors in this year's commentary and consider what it all means to us as we look to the future.

Organic Growth: The Numbers

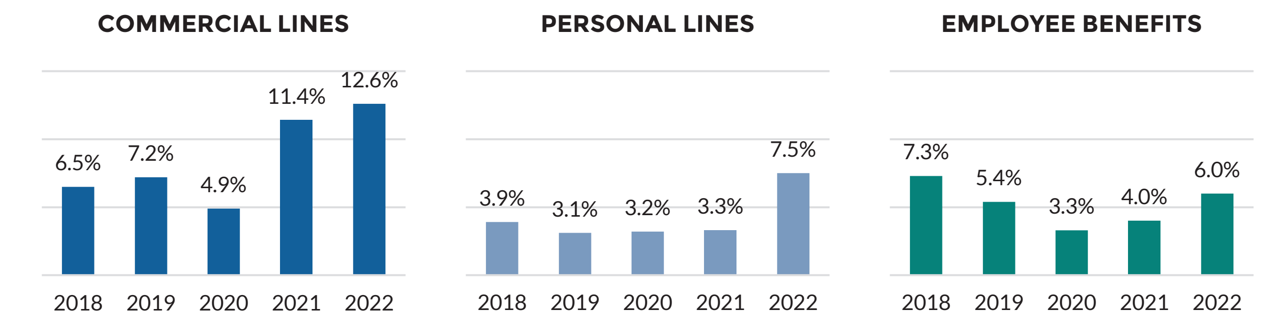
The 10.2%, Q4 2022 Organic growth results are the highest annual results ever achieved. You can see below the quarterly results for Q4 of 2008 through Q4 of 2022. The year end (Q4) results are shown in red.

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

Source: Reagan Consulting Growth and Profitability Survey

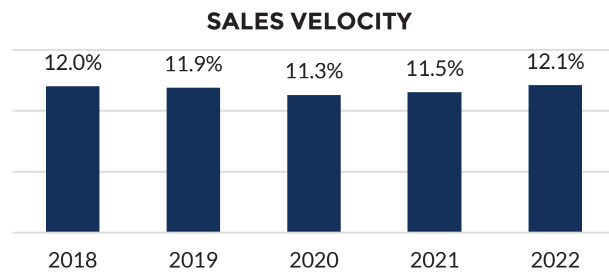
We got to the 10.2% firm wide median growth with some varied results by product line. Median Commercial Lines organic growth was at 12.6%, Personal Lines at an amazing 7.5%, and Employee Benefits falling behind Commercial Lines for the fourth year in a row.

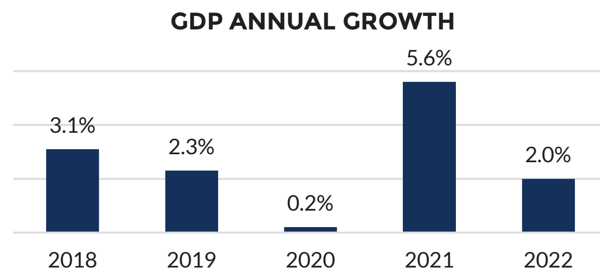
ORGANIC GROWTH BY PRODUCT LINE (Q4 RESULTS)



Source: Reagan Consulting Growth and Profitability Survey, Q4 results

What is Driving These Record Organic Growth Numbers?





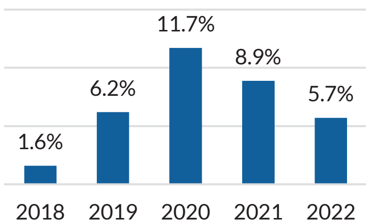
Source: Bureau of Economic Analysis and Reagan Consulting Growth and Profitability Survey, Q4 results

When we consider what is driving these numbers, let's start with eliminating what is not driving the numbers. When we look at the Sales Velocity (amount of new business as a percentage of prior year revenues), we can see in the table to the right that 2022 was a good year but it was only a hair higher than the results achieved over the prior four years. New business is not the driver. When we look at the strength of the economy, as measured by annual growth of GDP, we see horrendous results in 2020 (the start of Covid), recovery in 2021 and then a material deceleration in 2022, as we head into what many believe will be some form of recession in 2023. These results certainly suggest that the economy is not driving organic growth but is creating some headwind and will likely provide even more headwind in 2023.

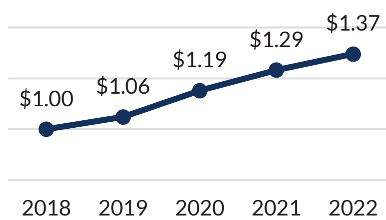
Now let's focus on what is driving these superior organic growth results. The first is an unprecedented five straight years of a meaningful tightening P&C marketplace. Included below are the actual annual P&C rate increases for the past five years. Recognizing that the rate increases in one year are applied on top of the rates from the prior year, the net impact is cumulative. As can be seen in the second table below, the dollar of premium in 2018 rises to $1.37 in 2022. The majority of P&C revenue comes from commissions paid as a percentage of the premiums so there is a direct correlation between premium growth and agency revenue growth and the impact of this is material.

The second major factor impacting growth is inflation. Some of the impact of inflation is baked into the rate increases discussed above (i.e., premiums have to go up to cover rising claims cost). Inflation also impacts exposure base as payrolls, receipts and property values all rise directly with inflation. When you combine the increase of rate with the increases in the exposure base, it has a direct and material impact on organic growth.

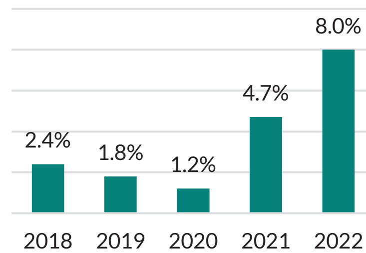
P&C ANNUAL RATE INCREASES



CUMULATIVE TIGHT MARKET IMPACT
(PREMIUM DOLLAR RISE)



INFLATION

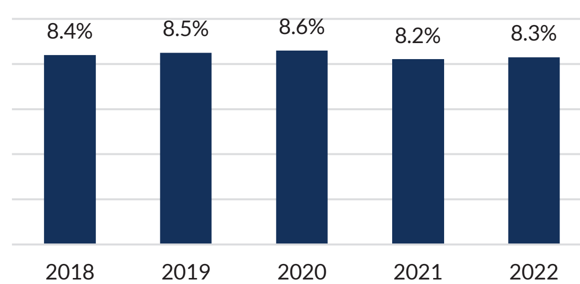


Source: Bureau of Economic Analysis, CIAB, Reagan Consulting Growth and Profitability Survey, Q4 results

What About Profitability?

Historically about a third of the profits of an insurance agency come from contingent and bonus income. It is interesting to see just how consistent contingents, as a percentage of total net revenues, have been over the past five years (in the range of 8.2% to 8.6%).

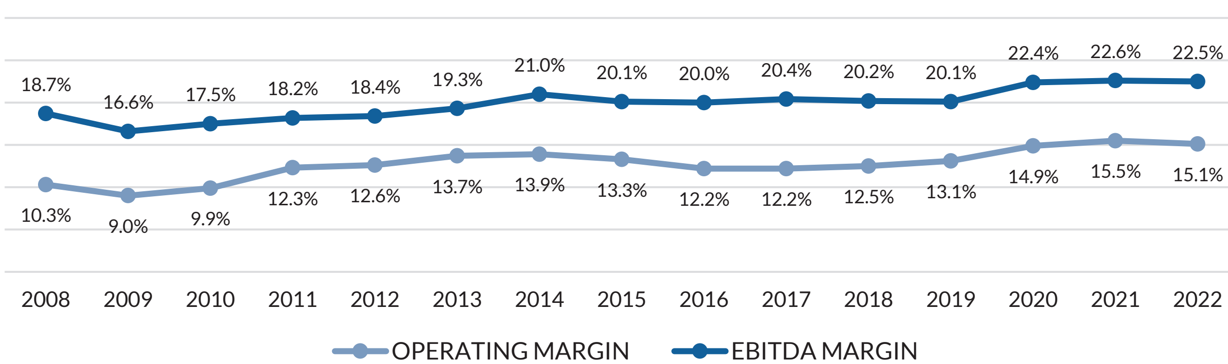
CONTINGENT INCOME



Source: Reagan Consulting Growth and Profitability Survey, Q4 results

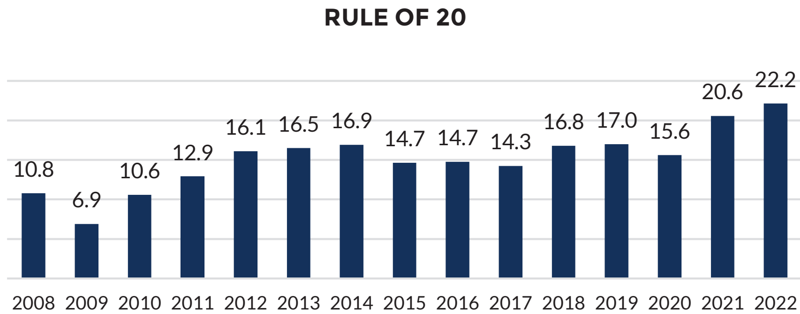
The resulting EBITDA and operating margins are also shown in the following chart. As can be seen, EBITDA, as a percentage of net revenues, has been level over the past three years, which on the surface is a bit surprising. With organic growth of over 10%, one would generally expect profit margins to rise. However, it has been well-documented that inflationary pressures and labor shortages have been driving compensation up across our industry. We believe this is affecting what would otherwise be profit margin gains. You add to this the increase in the T&E expenses that were reduced materially in 2020 due to Covid, but have returned in 2021 and 2022, and we see the resulting profits staying at a consistent level.

EBITDA MARGIN & OPERATING MARGIN



Source: Reagan Consulting Growth and Profitability Survey, Q4 results

Finally, we have included the Rule of 20 scores measuring the combined relative performance of organic growth and 50% of profitability. The results are materially higher than they have been in the past 15 years based on solid profits and high organic growth. This is all good.



Source: Reagan Consulting Growth and Profitability Survey, Q4 results

What Can We Take Away from These Results?

The Private Equity investors within our industry know how to make money and they know what drives the best returns – a flow of quality acquisitions, organic growth and margin lift. With all that is going on, we anticipate that the M&A activity and valuations for quality, strategic acquisitions will stay strong. There will likely be a drop off for less strategically valuable firms. As a result, we will see even more attention given to increasing organic growth and profit margins for PE backed firms and continued attention given by the public brokers and privately held firms.

The 10.2% median organic growth in 2022 is encouraging for all agents and brokers but, if we see (1) the economy going into some form of recession, (2) the inflation numbers come down (which we all hope they will and the fed is doing a lot to make happen) and (3) the P&C rates moderate or even go down, the organic growth numbers will likely decelerate and downward pressure will weigh on EBITDA margins. These are all external factors beyond our control. What is within our control is the ability to do a better job on account retention, increase new business sales and improve operating efficiencies. For the acquirers, the integration of what has been acquired and the elevation of new business production are both going to be a focus and a priority. Integration efforts can be difficult and applying pressure to generate more new business can both be disruptive to the staff, particularly those that have been acquired and preferred things the way they used to be. The disruption of staff will create lift-out and hiring opportunities for privately held, PE backed and public brokers.

In spite of the uncertainty ahead, the 2022 results confirm that this is a fantastic industry and a great place to be, no matter what part of the distribution system you find yourself in. At the same time, the ability to effectively navigate organizations through the marketplace in the years to come is going to continue to require skill, wisdom and finesse. Leaders must create and maintain cultures that will attract and retain top talent. Leaders must make strategic bets on which value-added services and resources customers will embrace that will truly differentiate them in the marketplace. Simultaneously, leaders need to achieve operating results that will drive attractive returns while they build and maintain a capital structure that supports their growth strategy. What do you need to do? Keep your eyes open. Stay informed. Do not assume it is business as usual. Play both offense and defense. Be creative and take risks. Most of all, enjoy the journey. Our industry has done an exceptional job of adapting to a wide variety of challenges in recent decades and seems well poised to continue to prosper.