Inside P&C

by The Insurance Insider

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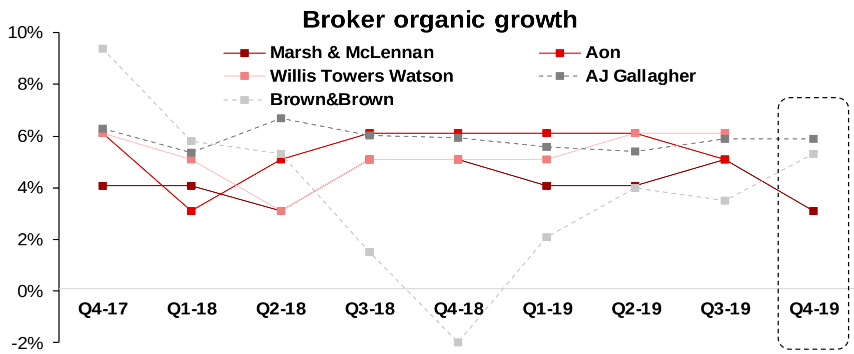
BROKER BONANZA: MMC, AJ GALLAGHER, TRUIST



On Thursday we got a better look at broking trends as three new companies added to the mix of available data following Brown & Brown earlier this week.

Perhaps most significantly, MMC reported Q4 results that included slowed organic growth but expanded margins, in line with the company's and street's expectations. Beyond the headline number, there were both brighter and darker spots within normal quarterly volatility, including consulting margins slightly below the company's guidance and double-digit organic at Guy Carp for second consecutive quarter (more earnings details below).

Though there was nothing out of the ordinary in the report, it presents an opportunity to make a first summary of the JLT deal. This is especially true considering Q4 is JLT's highest revenue quarter, and there was upgraded guidance on cost savings to $350mn from the initially expected $250mn.

In short, MMC management insists they view JLT as a growth play versus a cost savings play, and it may very well eventually become so over time. But in our view, it has so far been unfolding as an expense synergy story with a free option on growth.

Given Q1 will be the last quarter where MMC's YoY comparisons are impacted by JLT, the broker's growth performance from here will be highly watched. In the industry where growth is a main barometer of success, below average organic growth numbers may put pressure on MMC's valuation if it becomes to be seen as a medium term talent leakage problem rather than a short term, synergy driven "choppiness" that can easily be offset through expense reductions controlled by management. Notably, Marsh's organic growth in EMEA turned negative in Q4 and Latam growth remained the lowest in over a decade for second consecutive quarter, the two big JLT regions. This remains something to watch.

On other broker results, **AJ Gallagher** surprised on brokerage margins that expanded by ~150bps above 50bps guidance telegraphed last quarter. The broker attributed 50bps to "normal" margin expansion, 50bps to higher contingents and 50bps to shifted seasonality due to recent acquisitions. Outside financial statements, AJ Gallagher reported further rate increases. What stood out to us was the additional color this quarter on "unhappy" clients causing the broker to do more work on developing new solutions, shopping the market and guiding the clients (more details below).

Truist Insurance Holdings, formerly known as BB&T Insurance Holdings, also reported its Q4 results yesterday. The organic growth for the quarter was 7.9%, a slowdown versus 8.7% in Q3:19 on the legacy firm, but still significantly higher than peer brokers.

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Index	QTD	YTD
Large Cap	**(0.7)%**	**(0.7)%**
Regional	**0.8%**	**0.8%**
Specialty	**4.2%**	**4.2%**
Personal	**4.1%**	**4.1%**
Bermuda	**3.2%**	**3.2%**
Florida	**(8.7)%**	**(8.7)%**
Brokers	**7.0%**	**7.0%**
IPC Select	**0.6%**	**0.6%**
S&P 500	**1.6%**	**1.6%**
S&P Fin.	**(0.8)%**	**(0.8)%**

Source: S&P Global, Inside P&C

MMC: GROWTH SLOWS IN Q4

- ***Organic growth slowed to 3% (from 5% in Q3:19 and Q4:18) dragged by Marsh and Oliver Wyman***
- ***Operating margins led by Risk & Insurance***
- ***JLT cost synergies upgraded to $350mn from $250mn***
- ***Guidance for wider firm-wide margins in 2020***

In its Q4 report that included JLT's strongest quarter for the first time, **Marsh & McLennan** announced adjusted EPS of $1.19, marginally better than the consensus of $1.18, and higher than $1.09 a year ago.

EXHIBIT: MMC Q4 RESULTS SUMMARY

Source: Company reports, S&P Global, Inside P&C

Marsh & McLennan	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	YoY var.
Revenue ($mn)						
Consolidated	3,712	4,071	4,349	3,968	4,264	14.9%
Marsh	1,804	1,737	2,156	1,902	2,219	23.0%
Guy Carpenter	102	663	392	273	152	49.0%
Mercer	1,228	1,155	1,260	1,280	1,326	8.0%
Oliver Wyman	577	518	540	505	559	-3.1%
Organic growth						
Consolidated	5.0%	4.0%	4.0%	5.0%	3.0%	(200bps)
Marsh	6.0%	5.0%	4.0%	5.0%	3.0%	(300bps)
Guy Carpenter	5.0%	6.0%	-3.0%	11.0%	10.0%	500bps
Mercer	2.0%	0.0%	2.0%	3.0%	4.0%	200bps
Oliver Wyman	7.0%	7.0%	13.0%	7.0%	-2.0%	(900bps)
Adjusted operating margin						
Consolidated	21.0%	26.2%	22.8%	16.9%	21.9%	93bps
Risk & Insurance	23.8%	33.6%	27.8%	17.4%	25.7%	191bps
Consulting	20.3%	18.0%	18.0%	18.7%	19.7%	(63bps)
Adj. EPS analyst estimate	1.04	1.45	1.13	0.70	1.18	8.3%
Adj. EPS actual	1.09	1.52	1.18	0.77	1.19	9.2%
Surprise	4.8%	4.8%	4.4%	10.0%	0.8%	-

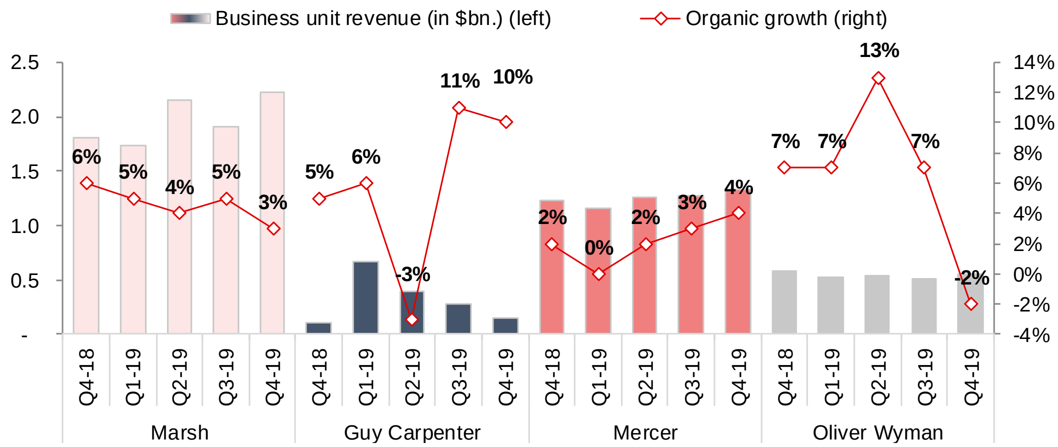
All-in-all organic growth slowed to 3% from 5% in Q4:18 and Q3:19. The biggest contributors to the slowdown were Marsh and Oliver Wyman, in line with management guidance in the previous quarter.

Marsh slowed (to +3% from +5% QoQ) due to dis-synergies in Q4, which is also JLT's seasonally strongest quarter, and tough YoY revenue comparison. Oliver Wyman slowed (to -2% from +7% QoQ) due to volatile nature of the business as management guided in the last quarter.

On the bright side, Guy Carpenter grew 10% following the 11% last quarter amid integration with JLT Re. Note, Q4 is a seasonally smallest revenue quarter for Guy Carpenter.

EXHIBIT: MMC ORGANIC GROWTH BY BUSINESS UNITS

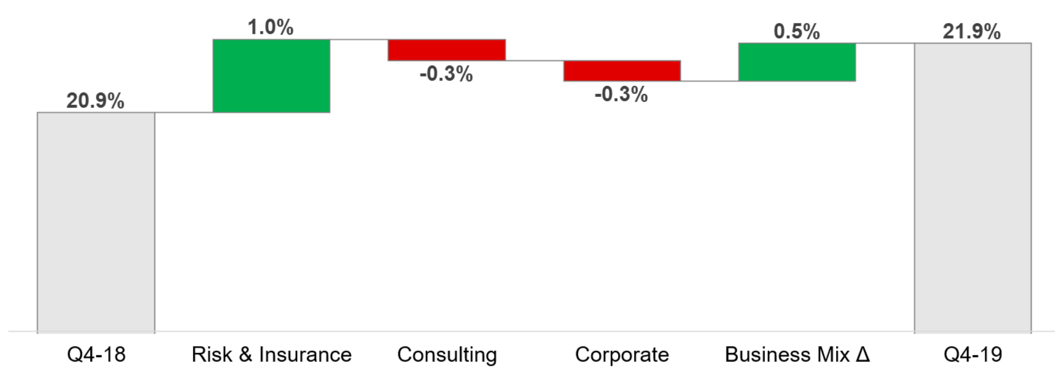
Source: Company reports, Inside P&C



On profitability, the broker expanded adjusted operating margin by 100bps, driven by margin expansion in Risk & Insurance and mix shift to the higher margin consulting business, partially offset by a slight margin compression in Consulting and Corporate segments (see chart below).

EXHIBIT: MMC Q4 OPERATING MARGIN CHANGE ATTRIBUTION

Source: Company reports, Inside P&C



JLT expense synergies upgraded

Last quarter, MMC announced it was ahead of schedule on cost synergies with the update on the exact estimate to be provided in Q4. According to Q4 conference call comments, the upgraded guidance is $350mn from the initially estimated $250mn with associated costs increased to $625mn (plus $75mn non-cash charges) from initially estimated $375mn.

The cost synergies for 2019 were $125mn versus $75mn initial and the broker expects to realize full $350mn of expense synergies through 2021.

First-quarter 2020 outlook

Looking forward, the company provided guidance on a number of items:

- **Firm-wide margins** to expand in the full year of 2020.
- **Consulting margins** will likely see YoY compression in Q1:20 as employee benefit margins at JLT are seasonally low in Q1, as well as due to the volatile nature of the segment. For the full 2020 year, consulting margins are expected to increase.
- **Interest expense** in Q1:20 if approximately $130mn, flat QoQ.
- **No share repurchases** in 1H:20 due to deleveraging and acquisition initiatives
- **Integration dis-synergy** headwinds will likely remain in Q1:20 across geographies

AJ GALLAGHER: "OUR CLIENTS ARE NOT HAPPY"

- ***Organic growth of 5.8%, in line both YoY and QoQ, as brokerage growth increased and risk management slowed***
- ***Margin improvement of 138bps led by 157bps in brokerage and 16bps compression in risk management (without levelizing FX)***
- ***Higher rates may induce higher expenses as unhappy clients require better guidance and new solutions.***

AJ Gallagher reported organic growth of 5.8%, in line with Q3:19 and Q4:18. Brokerage revenue grew organically by 6.1%, higher than at any point in 2019. Risk management slowed to 4.7%, versus 5.5% guidance telegraphed last quarter, but in line with mid-single digit outlook provided during December investor day.

On the bottom line, the broker reported Q4 earnings of $0.58 per share, beating consensus estimate of $0.53 and above last year's Q4 EPS of $0.53.

EXHIBIT: AJ GALLAGHER Q4 RESULTS SUMMARY

Source: Company Reports, Inside P&C

AJ Gallagher						
	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	YoY var.
Revenue ($mn)						
Consolidated	1,623	1,958	1,625	1,791	1,684	3.7%
Brokerage	1,002	1,382	1,131	1,196	1,193	19.0%
Risk management	202	203	209	212	215	6.1%
Corporate	419	372	285	383	277	-34.0%
Organic growth						
Consolidated	5.8%	5.5%	5.3%	5.8%	5.8%	(2bps)
Brokerage	5.6%	5.7%	5.8%	5.8%	6.1%	50bps
Risk management	6.7%	4.1%	3.0%	5.7%	4.7%	(200bps)
Adjusted EBITDAC margin						
Consolidated	21.7%	33.1%	25.0%	25.8%	23.0%	138bps
Brokerage	22.5%	35.6%	26.4%	27.2%	24.1%	157bps
Risk management	17.3%	17.0%	17.5%	18.0%	17.1%	(16bps)
Adj. operating income ($mn)	189.9	417.2	261.0	285.4	255.7	34.6%
Adj. operating margin	15.8%	26.3%	19.5%	20.3%	18.2%	240bps
Adj. EPS analyst estimate	0.52	1.61	0.61	0.79	0.53	0.0%
Adj. EPS actual	0.53	1.63	0.65	0.80	0.58	9.4%
Surprise	1.9%	1.2%	6.6%	1.3%	9.4%	-

On margins, the broker outpaced its own outlook as Brokerage adjusted EBITDAC margin expanded by 157bps versus 50bps guidance and Risk Management was within 17.0-17.5% guided range.

AJ Gallagher's 2020 outlook included:

- Busy pipeline of tuck-in M&A's.
- Brokerage margin expansion of 50-70bps given organic growth is in upper 5% range.
- Risk management organic growth of 5-7% for the year 2020 and the margin in the upper range of 17%.

Commenting on rate environment, management noted that they view the current market as “firm” and cited that their recent survey of P&C producers suggests that the momentum continued into 2020.

As rates continue to pick up every quarter, AJ Gallagher shared that the changing environment and unhappy clients are complicating the broker’s job.

AJG	*“Our clients are not happy. As an industry, we trained for well over a decade clients to expect reductions ”.* **- CEO Pat Gallagher**

AJG	*“In an environment where rates are increasing, it takes more work by our teams to develop creative solutions, shop the market and guide our clients, that increases our costs somewhat ... However, we can offset these rising costs and still expand margins”.* **- CFO Douglas Howell**

This serves a premise for brokers to start the “pushback” rhetoric, with carriers facing the complex tradeoffs where too much pricing and unhappy clients may lead to the premium leakage to alternative markets and self-insurance.

EXHIBIT: AJ GALLAGHER PRICING DISCLOSURE

Source: Company reports, Inside P&C

	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19
US retail					
Commercial auto	5%	5%+	4% on average	5% overall	5.5%
Property	5%	5%+			
Workers comp	-1%				
US casualty & specialty		2%			
US wholesale					
Commercial auto	4%	4%+	5-6% (many in property 10%+)	Approaching 6%	7.0%
Property	4%	4%+			
Casualty	3%	3%+			
Workers comp	<-3%				
UK retail					
Overall retail	Flat+	3%	3%	3% (higher QoQ)	3.5%
Professional liability	5.0%	5%+	3%	3% (a touch higher QoQ)	7%
Property	Flat+	1-2% for most lines			
Marine					
Commercial auto					
Casualty					
London Specialty Operations		5% (10%+ in cat exposed)	8% (more in D&O, E&O and property)	Appoaching double-digits	5-10%
	Q4-18	**Q1-19**	**Q2-19**	**Q3-19**	
Canada					
Property	4%		7-9%	8% (property more than 10%)	5.0%
Commercial Auto	<4%		7-9%		
Professional Lines					
Casualty	<4%		0%+		
Australia & NZ					
Casualty & Specialty	5%+	4-6%	7%	5-6%	New Zealand 4% Australia 7%
Property	9%				

TRUIST CONTINUES STRONG GROWTH OF LEGACY BB&T

- ***Organic growth of 7.9%, versus 8.7% in Q3:19 on the legacy BB&T***
- ***Rates increase 5%, up from 4% in Q3, 3-3.5% in Q2 and 0-2% in Q1***
- ***EBITDA margin contracts by 110bps to 23.4%.***

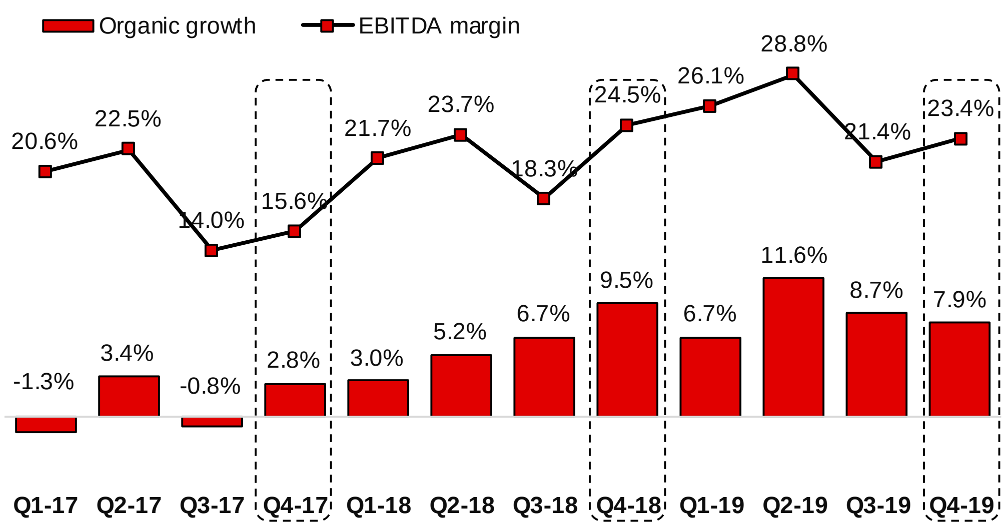
Truist Insurance Holdings' Q4 financial disclosures has not included YoY comparisons as its holdings company Trust Financial Corp now operates as a newly formed entity resulted from the merger of equals between BB&T and SunTrust banks.

However, since former SunTrust had essentially no insurance brokerage operations prior to the merger, we use the legacy BB&T insurance unit's results as a comparison basis for Truist Insurance Holdings.

The broker continued the legacy firm's strong organic growth in Q4 at 7.9%, albeit at a slowest pace since Q2:19.

The EBITDA margin of 23.4% was lower YoY by 110bps, but still substantially higher than before IHOP's (Insurance Holdings Organization Program) initiatives

As the conference call participants focused on the merged firm's (operated as combined organization in Q4 for only 24 days since the merger close) core operations outside insurance brokerage, limited details were provided on the drivers behind the financial results and YoY variations of the key metrics.



According to the rhetoric around the strategy of the merged firm, Truist's insurance unit will mostly maintain the direction of the legacy firm at executing the IHOP 32 initiatives of the recent years that has been producing positive results.

This research report was written by Insider Publishing's Research team which includes Gavin Davis, James Thaler, Gianluca Casapietra, and Dan Lukpanov.