Brown & Brown Inc. (BRO)

Updated September 15th, 2019 by Josh Arnold

Key Metrics

Current Price:	$36	**5 Year CAGR Estimate:**	3.8%	**Volatility Percentile:**	14.4%
Fair Value Price:	$28	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	77.8%
% Fair Value:	129%	**5 Year Valuation Multiple Estimate:**	-4.9%	**Growth Percentile:**	79.0%
Dividend Yield:	0.9%	**5 Year Price Target**	$41	**Valuation Percentile:**	21.1%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	22.1%

Overview & Current Events

Brown & Brown Inc. is a leading insurance brokerage firm that provides risk management solutions to both individuals and businesses, with a focus on property & casualty insurance. Brown & Brown has a notably high level of insider ownership. At the end of the most recent fiscal year, Brown & Brown's Chairman, J. Hyatt Brown, and his son, J. Powell Brown, collectively and beneficially owned approximately 15.8% of the company's outstanding common stock. Separately, the firm's executive officers, directors, and their family members together own a total of 16.7% of the company. Overall, Brown & Brown appears to be a very shareholder-friendly company, as its 25-year streak of consecutive dividend increases qualifies it to be a member of the Dividend Champions list. The company should produce $2.4 billion in revenue this year, and trades with a $10 billion market capitalization.

Brown & Brown reported Q2 earnings on July 22nd and results were quite strong, driven by recent acquisition activity. The company saw revenue rise 22% to $575 million. Organic revenue growth came to 4% during the quarter, while acquisitions made up the balance.

Employee compensation and benefits rose 23% in the quarter, while operating expenses were up 17%, so Brown & Brown achieved a small measure of operating leverage on these two key line items.

Adjusted operating margin rose marginally from 29.1% to 29.3%, but that slight gain was offset by a slightly higher effective tax rate. In total, Brown & Brown saw earnings rise 25% on a dollar basis year-over-year, while earnings-per-share rose 26%. The difference was due to a slightly lower share count against last year's second quarter.

We're updating our estimate for this year to $1.40 from $1.45 after Q2 results, given that margins didn't improve in Q2 despite materially higher revenue. Still, we expect a nice year of growth against 2018, fueled by continued acquisition activity, and we think Brown & Brown's outlook remains strong.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.54	$0.55	$0.56	$0.63	$0.74	$0.83	$0.85	$0.92	$1.42	$1.21	***$1.40***	***$2.06***
DPS	$0.16	$0.16	$0.17	$0.17	$0.19	$0.21	$0.23	$0.25	$0.28	$0.31	***$0.32***	***$0.52***
BVPS	$4.82	$5.27	$5.73	$6.28	$6.90	$7.37	$7.73	$8.42	$9.35	$10.73	***$11.60***	***$17.05***
Shares[1]	275	279	281	284	285	286	280	276	278	276	***274***	***273***

Brown & Brown has a remarkable growth track record that includes a decade-long compound annual earnings growth rate of 8.4%. The company's book value per common share has grown at a similar rate, expanding at 8.3% per year over the last ten years. Brown & Brown's growth strategy is both simple and sustainable. Over the years, the company has actively acquired smaller insurance brokerage firms and integrated them into its larger operating base. We believe that this strategy has plenty of room left to run, and believe that the firm is capable of continuing to grow at 8% per year for the foreseeable future. In addition, we see 10% annual growth in the dividend for the foreseeable future given that Brown & Brown has exhibited strong earnings growth over time, and its strategy is sustainable.

[1] Share count in millions

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.3	18.7	20.6	21.7	23.0	20.9	22.4	20.6	24.2	18.5	***25.7***	***20.0***
Avg. Yld.	1.6%	1.6%	1.4%	1.3%	1.1%	1.3%	1.3%	1.3%	1.2%	1.1%	***0.9%***	***1.3%***

Brown & Brown has historically traded at a somewhat lofty valuation, with a 10-year average price-to-earnings ratio of 20.7. Looking ahead, we believe that the firm's valuation will moderate as it continues to grow and its business matures. More specifically, our fair value earnings multiple for Brown & Brown is a price-to-earnings ratio of around 20. Using our 2019 earnings estimate of $1.40 and the company's current stock price, Brown & Brown is trading at a current price-to-earnings ratio of 25.7. Valuation contraction to an earnings multiple of 20 would reduce Brown & Brown's total returns by ~5% per year if this mean reversion occurred over a five-year holding period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

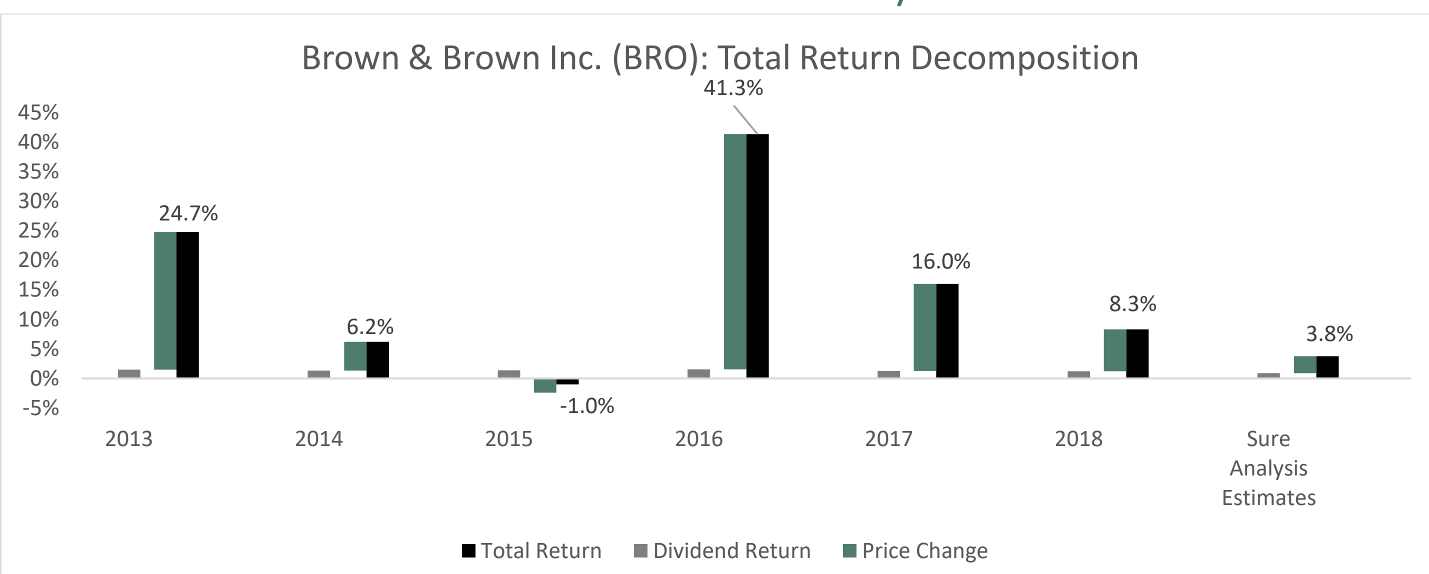
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	29.6%	29.1%	30.4%	27.0%	25.7%	25.3%	27.1%	27.2%	19.7%	25.6%	***22.9%***	***25.1%***

Brown & Brown's competitive advantage comes from its willingness to execute small and frequent acquisitions. This growth-by-acquisition strategy gives the company an enduring opportunity to continue growing its business for the foreseeable future. Brown & Brown is also modestly recession resistant. The company's earnings-per-share declined by just 20.5% during the worst of the 2007-2009 financial crisis.

Final Thoughts & Recommendation

Brown & Brown has many of the characteristics of a high-quality business. It has increased its dividend for 25 consecutive years, and company insiders own a great deal of its outstanding stock. With that said, its valuation is too rich to earn a buy recommendation today after yet another strong rally. Valuation contraction could more than offset the company's strong expected earnings growth and its modest dividend yield. With low projected total returns, and with the stock trading well in excess of a robust fair value estimate, we rate Brown & Brown as a sell. Should shares revert to fair value, we would be more compelled by this very high-quality company.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	968	967	1006	1189	1356	1567	1657	1763	1857	2010
Gross Profit		479	497	581	673	756	800	838	863	941
Gross Margin	0.0%	49.5%	49.4%	48.8%	49.6%	48.3%	48.3%	47.5%	46.4%	46.8%
SG&A Exp.	492	7	11	16	23					
D&A Exp.	63	64	67	79	85	104	108	108	108	109
Operating Profit	269	278	281	322	376	425	443	469	493	501
Operating Margin	27.8%	28.7%	28.0%	27.0%	27.7%	27.1%	26.7%	26.6%	26.6%	24.9%
Net Profit	153	162	164	184	217	207	243	257	400	344
Net Margin	15.8%	16.7%	16.3%	15.5%	16.0%	13.2%	14.7%	14.6%	21.5%	17.1%
Free Cash Flow	210	286	224	196	373	360	363	393	418	526
Income Tax	101	104	107	121	140	133	159	166	50	118

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2224	2401	2607	3128	3650	4956	5004	5263	5748	6689
Cash & Equivalents	197	273	286	220	203	470	443	516	573	439
Accounts Receivable	209	214	240	303	396	438	466	581	1024	910
Goodwill & Int. Ass.	1543	1677	1820	2278	2625	3245	3331	3383	3357	4332
Total Liabilities	854	894	963	1321	1642	2843	2855	2903	3165	3688
Accounts Payable	17	34	349	455	569	625	639	717	749	945
Long-Term Debt	267	252	251	450	480	1198	1145	1074	976	1507
Shareholder's Equity	1370	1506	1644	1807	2007	2114	2150	2360	2583	3001
D/E Ratio	0.20	0.17	0.15	0.25	0.24	0.57	0.53	0.46	0.38	0.50

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.1%	7.0%	6.5%	6.4%	6.4%	4.8%	4.9%	5.0%	7.3%	5.5%
Return on Equity	11.7%	11.2%	10.4%	10.7%	11.4%	10.0%	11.4%	11.4%	16.2%	12.3%
ROIC	9.8%	9.5%	9.0%	8.9%	9.2%	7.1%	7.4%	7.7%	11.4%	8.5%
Shares Out.	275.0	278.6	280.5	284.0	285.2	285.8	280.2	275.6	277.6	275.5
Revenue/Share	3.52	3.47	3.59	4.19	4.75	5.48	5.91	6.40	6.69	7.29
FCF/Share	0.76	1.03	0.80	0.69	1.31	1.26	1.30	1.43	1.51	1.91

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.