Brown & Brown Inc. (BRO)

Updated January 29th, 2020 by Josh Arnold

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	2.8%	**Market Cap:**	$12.6B
Fair Value Price:	$33	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	02/04/20
% Fair Value:	134%	**5 Year Valuation Multiple Estimate:**	-5.6%	**Dividend Payment Date:**	02/19/20
Dividend Yield:	0.8%	**5 Year Price Target**	$49	**Years Of Dividend Growth:**	26
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	6.3%

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 16% of the company's outstanding common stock. Separately, the firm's executive officers, directors, and their family members together own a total of nearly 17% of the company. Overall, Brown & Brown appears to be a very shareholder-friendly company, as its 26-year streak of consecutive dividend increases qualifies it to be a member of the Dividend Champions list. The company should produce $2.6 billion in revenue this year, and trades with a $12.6 billion market capitalization.

Brown & Brown reported Q4 and full-year earnings on January 27th and results were very strong, sending shares up 7% following the report. Revenue for the fourth quarter was $579 million, up 14% from the year-ago period as commissions and fees were up 13.6%. Organic revenue increased by 5.2% with the balance coming from Brown & Brown's constant stream of acquisitions.

For the full year, revenue was $2.4 billion, up 19% from 2018. Commissions and fees were up 18.6% and organic revenue rose 3.6% for the year, as the company continues to post outstanding top line growth, fueled mostly by acquisitions.

Net income was $77 million in Q4, up 4.1% year-over-year, and $0.27 on a per-share basis, up 3.8%. On an adjusted basis, earnings-per-share rose 7.7% to $0.28.

For the full year, net income was $399 million, up 15.7%, and $1.40 on a per-share basis, up 14.8%. On an adjusted basis, earnings-per-share rose 13.8% to $1.40 from 2018.

We see earnings-per-share rising to $1.52 for 2020 as we forecast a ~3% organic growth tailwind, with the balance coming from more acquisitions. Brown & Brown continues to execute its playbook very well. We note that expenses have risen more quickly than revenue in the recent past, crimping margins. But overall, this remains a growth story.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.55	$0.56	$0.63	$0.74	$0.83	$0.85	$0.92	$1.42	$1.21	$1.40	***$1.52***	***$2.23***
DPS	$0.16	$0.17	$0.17	$0.19	$0.21	$0.23	$0.25	$0.28	$0.31	$0.33	***$0.34***	***$0.52***
BVPS	$5.27	$5.73	$6.28	$6.90	$7.37	$7.73	$8.42	$9.35	$10.73	$12.19	***$13.50***	***$19.84***
Shares[1]	279	281	284	285	286	280	276	278	276	275	***274***	***270***

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

[1] Share count in millions

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.

this strategy has plenty of room left to run, and forecast that the firm is capable of continuing to grow at 8% per year for the foreseeable future.

In addition, we see 9% 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.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	18.7	20.6	21.7	23.0	20.9	22.4	20.6	24.2	18.5	23.9	***29.4***	***22.0***
Avg. Yld.	1.6%	1.4%	1.3%	1.1%	1.3%	1.3%	1.3%	1.2%	1.1%	1.0%	***0.8%***	***1.1%***

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 22. Using our 2020 earnings estimate of $1.52 and the company's current stock price, Brown & Brown is trading at a current price-to-earnings ratio of 29.4. Valuation contraction to an earnings multiple of 22 would reduce Brown & Brown's total returns by -5.6% per year if this mean reversion occurred over a five-year holding period. We note that the stock is more expensive today than it has been at any time in the past decade.

Safety, Quality, Competitive Advantage, & Recession Resiliency

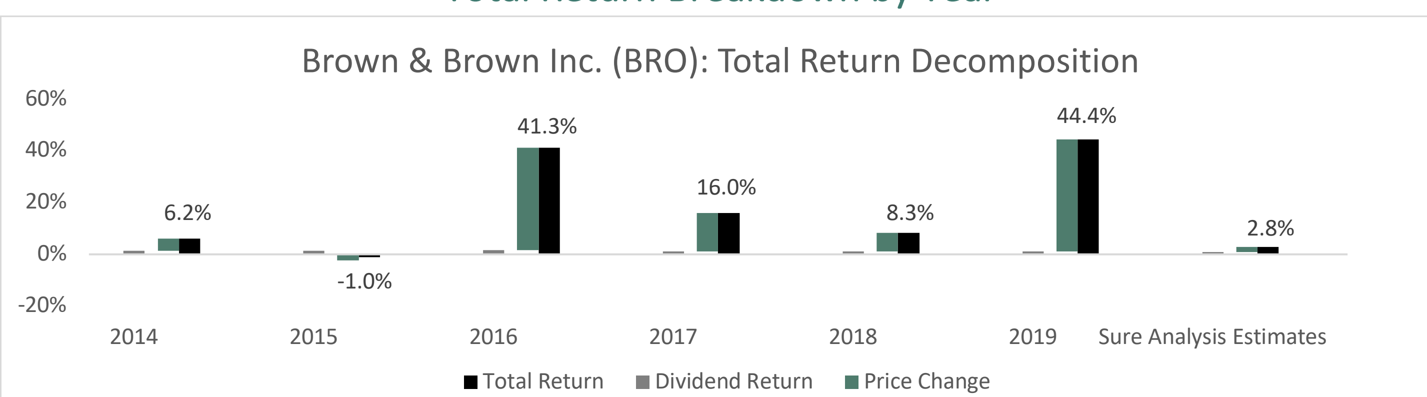
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2019	2024
Payout	29%	30%	27%	26%	25%	27%	27%	20%	26%	24%	***22%***	***23%***

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, while dividends continued to grow.

Final Thoughts & Recommendation

Brown & Brown has many of the characteristics of a high-quality business. It has increased its dividend for 26 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 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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	967	1,006	1,189	1,356	1,567	1,657	1,763	1,857	2,010	2,385
Gross Profit	479	497	581	673	756	800	838	863	941	1,077
Gross Margin	49.5%	49.4%	48.8%	49.6%	48.3%	48.3%	47.5%	46.4%	46.8%	45.1%
SG&A Exp.	7	11	16	23						
D&A Exp.	64	67	79	85	104	108	108	108	109	129
Operating Profit	278	281	322	376	425	443	469	493	501	572
Operating Margin	28.7%	28.0%	27.0%	27.7%	27.1%	26.7%	26.6%	26.6%	24.9%	24.0%
Net Profit	162	164	184	217	207	243	257	400	344	399
Net Margin	16.7%	16.3%	15.5%	16.0%	13.2%	14.7%	14.6%	21.5%	17.1%	16.7%
Free Cash Flow	286	224	196	373	360	363	393	418	526	605
Income Tax	104	107	121	140	133	159	166	50	118	127

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,401	2,607	3,128	3,650	4,956	5,004	5,263	5,748	6,689	7,623
Cash & Equivalents	273	286	220	203	470	443	516	573	439	542
Accounts Receivable	214	240	303	396	438	466	581	1,024	910	1,001
Goodwill & Int. Ass.	1,677	1,820	2,278	2,625	3,245	3,331	3,383	3,357	4,332	4,663
Total Liabilities	894	963	1,321	1,642	2,843	2,855	2,903	3,165	3,688	4,273
Accounts Payable	34	349	455	569	625	639	717	749	945	1,114
Long-Term Debt	252	251	450	480	1,198	1,145	1,074	976	1,507	1,555
Shareholder's Equity	1,506	1,644	1,807	2,007	2,114	2,150	2,360	2,583	3,001	3,350
D/E Ratio	0.17	0.15	0.25	0.24	0.57	0.53	0.46	0.38	0.50	0.46

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.0%	6.5%	6.4%	6.4%	4.8%	4.9%	5.0%	7.3%	5.5%	5.6%
Return on Equity	11.2%	10.4%	10.7%	11.4%	10.0%	11.4%	11.4%	16.2%	12.3%	12.5%
ROIC	9.5%	9.0%	8.9%	9.2%	7.1%	7.4%	7.7%	11.4%	8.5%	8.5%
Shares Out.	279	281	284	285	286	280	276	278	276	275
Revenue/Share	3.47	3.59	4.19	4.75	5.48	5.91	6.40	6.69	7.29	8.68
FCF/Share	1.03	0.80	0.69	1.31	1.26	1.30	1.43	1.51	1.91	2.20

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