Brown & Brown Inc. (BRO)

Updated November 23rd, 2020 by Josh Arnold

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	1.6%	**Market Cap:**	$13.4 B
Fair Value Price:	$36	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	02/03/21[1]
% Fair Value:	130%	**5 Year Valuation Multiple Estimate:**	-5.1%	**Dividend Payment Date:**	02/18/21[2]
Dividend Yield:	0.8%	**5 Year Price Target**	$49	**Years Of Dividend Growth:**	27
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	8.8%

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 is a very shareholder-friendly company, as its 27-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 $13.4 billion market capitalization.

Brown & Brown reported third quarter earnings on October 26th, 2020 and results were better than expected on both the top and bottom lines. Revenue was up 9% to $674 million year-over-year, beating expectations by $29 million. Commissions and fees were up 8.7% year-over-year, with organic revenue rising 4.3%; the balance of the revenue increase was from the company's steady stream of acquisitions.

Net income was $134 million in Q3, up $18 million year-over-year, or 15.9%. On a diluted, per-share basis, net income was $0.47, up 14.6% from the year-ago period. On an adjusted basis, earnings were $0.52, up 33% from last year's third quarter. Brown & Brown continues to execute its strategy of boosting the top line in order to provide operating leverage, which increases incremental profits on new revenue. Operating margin rose again in Q3, and with more acquisitions in process, we expect this will continue.

The company also raised its payout again, this time by nearly 9% to a new annualized level of 37 cents per share.

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	***$1.65***	***$2.21***
DPS	$0.16	$0.17	$0.17	$0.19	$0.21	$0.23	$0.25	$0.28	$0.31	$0.33	***$0.37***	***$0.57***
BVPS	$5.27	$5.73	$6.28	$6.90	$7.37	$7.73	$8.42	$9.35	$10.73	$12.19	***$13.44***	***$17.99***
Shares[3]	279	281	284	285	286	280	276	278	276	275	***276***	***270***

Brown & Brown has a remarkable growth track record that includes a decade-long compound annual earnings growth rate of more than 8%. The company's book value per common share has grown at a similar rate, expanding at 8%+ 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 forecast that the firm is capable of continuing to grow at 6% per year for the foreseeable future.

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[1] Estimated date
[2] Estimated date
[3] Share count in millions

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In addition, we see 8% 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. The company has also proven it is willing and able to return capital to shareholders via large dividend increases over time.

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	***28.6***	***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%***	***1.2%***

Brown & Brown has historically traded at a somewhat lofty valuation, with a 10-year average price-to-earnings ratio of 20.7. Looking ahead our fair value earnings multiple for Brown & Brown is a price-to-earnings ratio of around 22. Using our 2020 earnings estimate of $1.65 and the company's current stock price, Brown & Brown is trading at a current price-to-earnings ratio of 28.6. Valuation contraction to an earnings multiple of 22 would reduce Brown & Brown's total returns moderately if this mean reversion occurred over a five-year holding period. The stock has rallied of late, and even on higher earnings expectations, shares look quite expensive.

We see the yield rising somewhat over time as the payout rises, but primarily due to a potentially lower valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

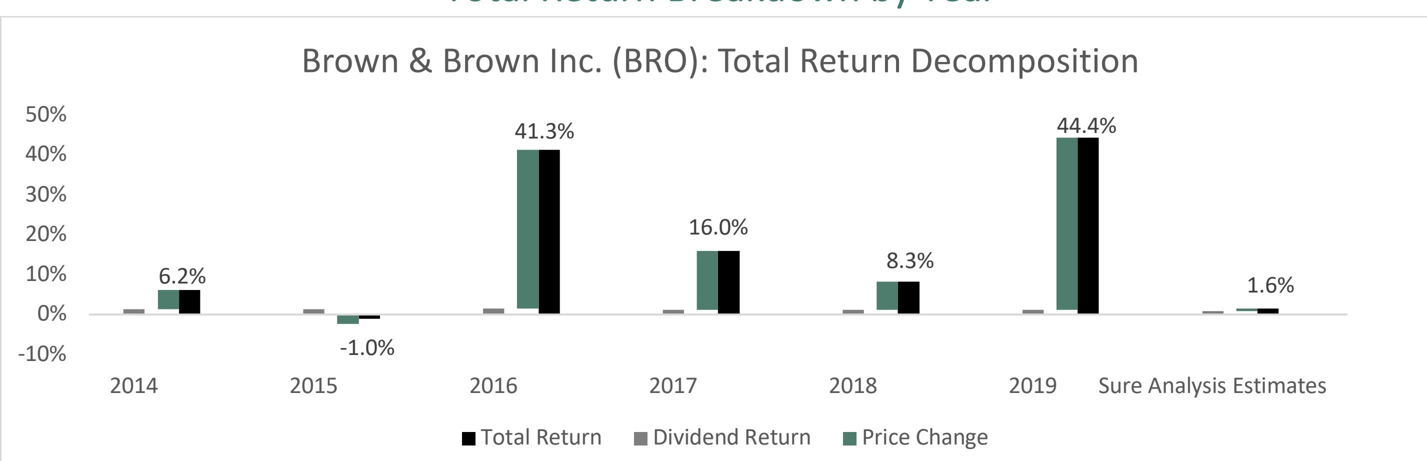
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	29%	30%	27%	26%	25%	27%	27%	20%	26%	24%	***22%***	***26%***

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. We note the company's 2020 results seem unaffected by the COVID-19 crisis.

Final Thoughts & Recommendation

Brown & Brown has many of the characteristics of a high-quality business. It has increased its dividend for 27 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 rating today. We have lowered our expected returns to 1.6% from 3.9% in out last update, due entirely to the higher valuation. Thus, we reiterate our sell rating on Brown & Brown until the valuation improves.

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.