

Broker Channel Check

Conversation With Broker Suggests Challenges for 2012

We recently had a conversation with a private insurance broker. The broker, based in the Midwest, is a typical middle-market broker with clients that have an average of several hundred employees. The broker has a good complement of property-and-casualty and employee benefit related commissions/fees. Here are the highlights:

Organic Growth: The prospect of a weakening U.S. economy is not just headlines, as it is becoming apparent in his client base. For his clients, business appeared to begin slowing down in May and June—not across the board, but enough to make a difference. The client base is service-oriented with the biggest industry concentrations in food service, healthcare, and construction. His organic growth rates had been very strong in first half because of a combination of new producers and exposure growth for new clients. He expects organic growth to remain positive in the second half of the year, but to be down materially from first-half levels.

Rates: The broker stated that premium rates were moving from negative to flat over the last several months. Workers' compensation has been the major driver of rate improvement, moving from a range of negative 5% to negative 10%, to a range of 0% to 5%. Even general liability, which was negative earlier this year, is moving closer to flat. Several larger carriers are being more disciplined and even retrenching, particularly from the workers' compensation marketplace. To date, much of the upward pressure in workers' compensation had come from California and Florida, but this discussion shows that pricing pressure is spreading to other parts of the country (this broker has mainly a Midwestern client base).

Contingents: The broker is seeing a material decline in contingents and expects this to continue in the near term. Contingent commissions were down by roughly 35% in 2011 versus 2010 and he expects them to be down by another 35% in 2012. The main driver of lower contingents is declining underwriting profitability (i.e., higher loss ratios). His overall book of business, which is a middle-market Midwestern book, is experiencing an increased level of losses. The higher losses are not just related to workers' compensation or catastrophes, but are relatively broad-based across a number of product lines. In addition, carriers are putting further pressure on these revenues sources by switching some of these arrangements from contingent to supplemental.

Financial Services | Insurance Brokers

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Aon Corporation

Stock Rating: **Outperform**
Company Profile: **Established Growth**
Symbol: AON (NYSE)
Price: \$43.55 (52-Wk.: \$36-\$55)

Arthur J. Gallagher & Co.

Stock Rating: **Market Perform**
Company Profile: **Established Growth**
Symbol: AJG (NYSE)
Price: \$25.83 (52-Wk.: \$24-\$32)

Brown & Brown, Inc.

Stock Rating: **Market Perform**
Company Profile: **Established Growth**
Symbol: BRO (NYSE)
Price: \$19.16 (52-Wk.: \$18-\$27)

Marsh & McLennan Companies, Inc.

Stock Rating: **Market Perform**
Company Profile: **Established Growth**
Symbol: MMC (NYSE)
Price: \$27.30 (52-Wk.: \$23-\$32)

Willis Group Holdings Public Limited Company

Stock Rating: **Outperform**
Company Profile: **Established Growth**
Symbol: WSH (NYSE)
Price: \$35.91 (52-Wk.: \$29-\$42)

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Benefit Commissions: Commission growth is still positive in 2011, but growth is roughly half of what it was in 2010. In part, this decline is being caused by greater stress, and ultimately, churn in the business. The stress from higher healthcare rates and more complexity is causing more clients to shop and change brokers. The company is actually winning a fair amount of business, but also losing clients at the same time. From a revenue perspective, the trend is for carriers to switch to fee or per member per month arrangements. The broker still has the ability to negotiate inflation increases on fee arrangements with clients.

Acquisitions: Acquisition multiples have moved up. A larger deal (\$20 million-plus) can attract 7 times to 8 times EBITDA and up to 10 times including earnout. Particularly on the larger end, there is more of a supply/demand imbalance with a number of the public and larger private brokers aggressively pursuing deals and only a handful of larger deals in the market. One of the newer private brokers just completed its first large deal. Even at the small end of the market, brokers are aggressively pursuing deals that may have been too small several years ago.

Bottom Line: The combination of slowing growth, lower contingents, and higher acquisition multiples should create a tougher 2012 environment for the U.S.-oriented middle-market brokers.

Additional information is available upon request.

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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	8
Market Perform (Hold)	31	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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