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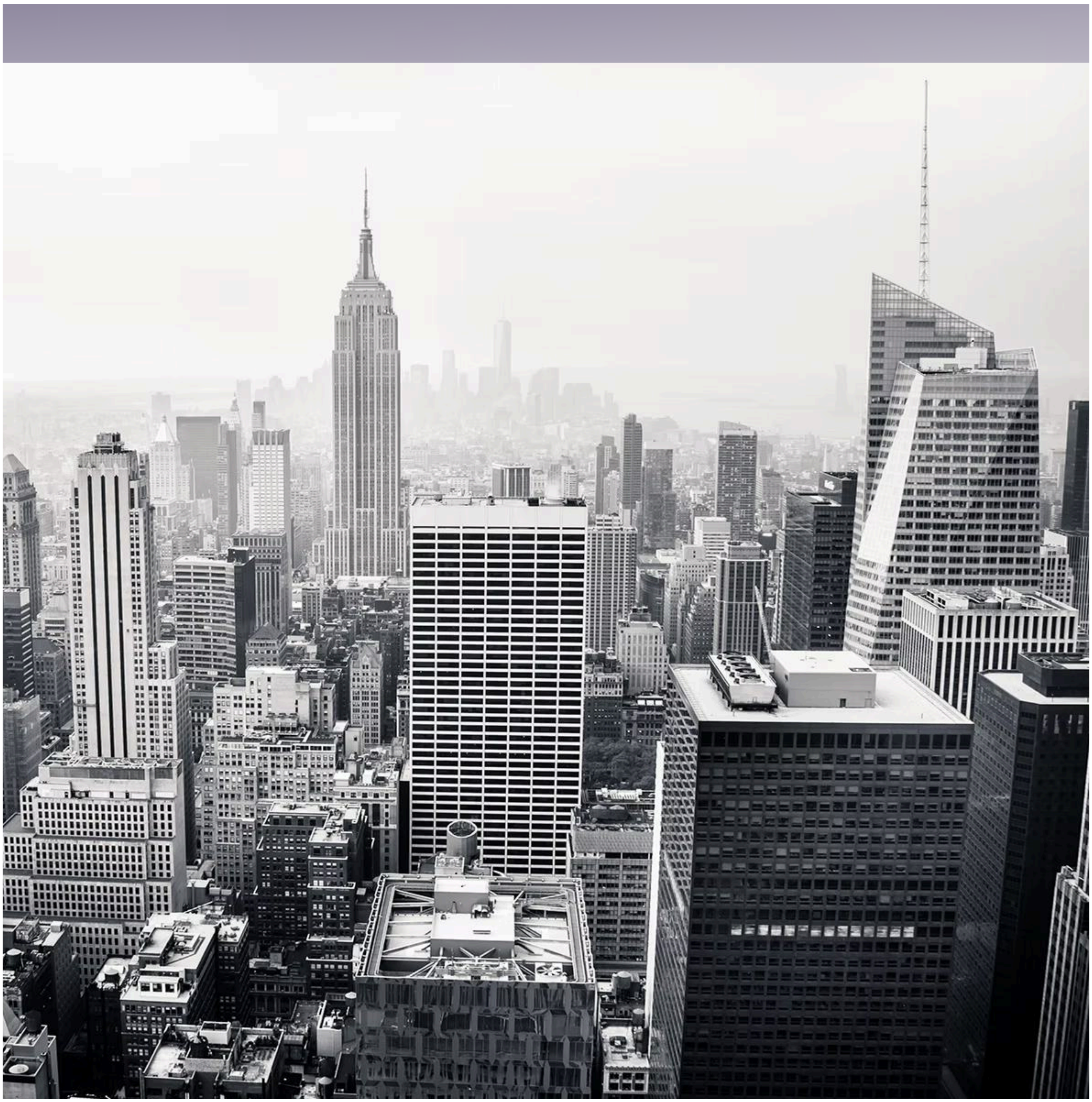
Opportunities Abound

THE EMPIRE STRIKES BACK:

SICA | FLETCHER'S TAKE ON THE ARTHUR J. GALLAHER (NYSE : AJG) / ASSURED PARTNERS DEAL

Case Study



OVERVIEW

From 2000 to 2010, public insurance brokers such as Arthur J. Gallagher (NYSE: AJG) and Brown and Brown (NYSE: BRO) accounted for the majority of insurance broker acquisitions. Private equity investment in insurance brokers started in earnest around 2007, and by 2014, most of the deal activity was generated by private equity sponsored insurance brokers.

This trend has continued, and private equity sponsored brokers consistently dominate acquisition activity in the insurance brokerage space. For example, the 2024 Sica Fletcher (SF) Agency & Broker Buyer Index reflects PE sponsored brokers accounting for 88% of all deal activity, with the publicly traded brokers accounting for the rest.

On December 9, Arthur J. Gallagher (NYSE: AJG) announced it entered into an agreement to acquire private equity-backed Assured Partners. Here are our takeaways from AJG's acquisition of Assured.

DEAL TERMS

AJG, the third largest insurance broker in the US, is acquiring Assured Partners, the 11th largest insurance broker in the US. At the time of the announcement, Assured had pro forma revenue of $2.9 billion and pro forma EBITDA of between $938 million and $1.1 billion depending on whether we use AJG's or Assured's version of EBITDA.

The press release from AJG states the following:

"Under the agreement, Gallagher will acquire Assured Partners for a gross consideration of $13.45 billion, representing a pro forma EBITDAC multiple of 14.3x. After giving effect to an estimated $1.0 billion deferred tax asset (DAT), net consideration is approximately $12.45 billion. The net consideration EBITDAC multiple is 11.3x after giving effect to the deferred tax asset and estimated synergies."

OUR ANALYSIS

Our view is that this is a great deal for AJG. The transaction is expected to be 10-12% accretive to AJG's trailing 12-month earnings per share immediately.

As indicated in the press release, if we add in what AJG expects to generate in synergies and the benefit from the nearly $1 billion deferred tax asset AJG will assume as part of the deal, AJG is effectively paying 11.3x for Assured. For Sica Fletcher, that 11.3x stands out given the sheer size of Assured. In 2024, we conducted sale processes for over 50 insurance brokers with $1-25 million of EBITDA. In those processes, the average multiple paid was 11.5x EBITDA guaranteed at close, with a range between 9.0x and 14.5x.

In the Assured transaction, AJG acquired a whopping $1 billion of EBITDA for slightly less than the average valuation that was paid in all the sale processes we ran in 2024. In addition, had AJG bought 50 agencies and aggregated the EBITDA, it would have required far more transaction costs, resources, and time than those expended in the Assured transaction. Another way to think of this from AJG's perspective: it just did multiple decades' worth of acquisitions in one fell swoop.

At 11.3x EBITDA, AJG's expected go forward return is the reciprocal of the multiple, or 8.8%. Assured's three-year revenue CAGR is 19%, and its pure organic growth is 6% (if we strip out the impact of acquisitions). If we take the expected return of 8.8% plus the 6% of organic growth, the expected return is 14.8% on a $13.5 billion deal. This return excludes any further upside from Assured's aggressive acquisition program. Combining this return with other expected synergies, it is possible for AJG to generate 18-20% returns on a $13.5 billion investment!

In our view, the valuation paid by AJG for Assured makes this the best acquisition we have seen in over a decade.

FINANCING

When we consider the financing of the deal, the transaction gets even better for AJG. To finance the $13.5 billion purchase price (before the DTA), AJG issued $8.5 billion of new equity and $5 billion of debt. For the debt, AJG issued senior notes with different maturities and a blended interest rate of approximately 5.15%. A private equity sponsor would be looking at much higher interest rates to finance an acquisition of this scope, most likely in the 7-10% range (SOFR 4.3% + 300-550bps).

As we described in the prior section, we estimate unlevered returns in the AJG/Assured transaction at about 15%. When you factor in the impact of the financing of the transaction, representing leverage of 5x EBITDA at an average rate of 5.15%, we estimate potential returns in the high teens or greater.

Those are private equity types of returns. However, a private equity firm would be unable to pull off those returns in this transaction due to their cost of debt and limited upside of growing a business that already has $1 billion of EBITDA.

HERE IS ANOTHER INTERESTING FACT

Based on the data we maintain in the SF Agency & Broker Buyer Index, Assured has closed 91 acquisitions over the past two years. That means that Assured acquired 91 different management teams and integrated 91 agency management systems and businesses. Consider the amount of work required to find and integrate this number of companies. Assured already took care of those headaches.

SCALE

To give you a sense of the magnitude of the impact of this transaction, consider this fact → In the past 20 years, AJG has acquired around $100 million of revenue a year of retail property & casualty and employee benefits business. If you assume an average margin of 30%, that represents about $30 million of EBITDA a year. At that pace, it would take AJG 36 years to acquire $1.1 billion of EBTIDA. With the Assured transaction, AJG did it in one shot!

Furthermore, as noted by AJG, many of the deals Assured did were small tuck-ins and not even available in market auctions. In fact, AJG only had access to about 6% of the deals that Assured closed.

WAS THIS A GOOD DEAL FOR ASSURED'S SHAREHOLDERS?

We have established that this was a great deal for AJG. Was it a good deal for Assured's shareholders? In our view, the answer is yes; this was a solid deal for Assured shareholders.

A home-run deal would have been a higher multiple such as 17x for Assured. However, this type of multiple would have required a strategic buyer and a more competitive situation. For Assured, there were no other strategic acquirers available. Most strategic acquirers are simply too small to contemplate an acquisition of this magnitude. Of the potential buyers of size, Aon had acquired NFP in April 2024 and Marsh acquired McGriff in November 2024. Given the make-up of Assured's middle market business, only two ideal strategic partners remained, AJG and Brown and Brown. Given the ill will and litigious history of Assured and Brown, Brown was never a realistic option. That left AJG as the only viable alternative.

For a private equity deal, 17x is not feasible for a deal of this size and in the current market environment. The reason is because of how private equity firms structure their transactions to generate the returns required by their investors, as well as due to the sheer size of Assured's business.

Let us explain → Private equity firms pitch returns in the high teens to their investor base, given the past performance. These high teen returns are after their two-and-twenty fee structure, i.e., a 2% annual management fee and 20% of the returns generated by the investments. To achieve these returns, PE firms must target 20%-30% gross returns. For the past decade, PE has achieved these targeted returns by relying on two factors:

1 Multiple arbitrage (buy at a lower multiple and sell at a much higher multiple)

2 Financial leverage (buy with inexpensive debt).

This formula has produced spectacular results and has led the insurance brokerage sector to become one of the darlings of the PE industry. That same approach could not be applied to an acquisition of Assured. If an acquirer paid 17x for Assured, the expected return would be 5.8% plus Assured's prospective growth of 6%. That produces 11.8% of return before factoring in leverage. Senior debt, even for the best credit deals in today's high interest rate environment, is in the range of 7-10%. Given today's high-interest rate environment, it is difficult to generate 20%-30% gross returns by using financial leverage when your starting point is 11.8%.

Our view is that if Assured had $250 million of EBITDA instead of over $1 billion, they could have traded for 17x; this is because the buyer base is much larger at that size and there is at least the potential to grow the business at a rapid pace. Given that Assured had over $1 billion of EBITDA, the universe of buyers was limited to a few public brokers.

It looks like Assured traded for between 12x-13x their version of pro forma EBITDA. This appears to be a solid deal for shareholders given that it provided liquidity to shareholders at what is a high multiple historically. After all, the average EBITDA for most public brokers in 2010 was around 10x. Perhaps Assured could have held on for a slightly higher valuation in the future, but this was a case of *"bird in the hand is worth two in the bush."*

All in all, we believe that Assured's shareholders should be thrilled to receive 12x-13x pro forma EBITDA for 100% liquidity in today's high-interest rate environment.

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ABOUT SICA | FLETCHER

Sica | Fletcher is a strategic and financial advisory firm focused exclusively on the insurance industry.

The firm was founded in 2014 by Michael Fletcher and Al Sica, two of the industry's leading insurance M&A advisors who have closed over $19 billion in insurance agency and brokerage transactions since 2014.

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