

Goosehead Insurance Inc.

Increasing near-term EPS but slowing matriculation into mature agencies

Reiterate Rating: UNDERPERFORM | PO: 41.00 USD | Price: 57.35 USD

We are notably increasing our EPS due to inflation

CPI for auto insurance and continuing rate increases at companies like Progressive and Allstate lead us to believe that 1) commission growth is likely to be higher than previously estimated. However, 2) it also suggests to us that contingent commissions will be depressed for a longer period of time as the personal insurance markets struggle for profitability. Net-net this contributes to EPS growth overall for shares of Goosehead.

Successful franchises are likely to be less common

While higher earnings are good for Goosehead's near-term earnings results, we believe it will become increasingly more difficult for newer franchises to get traction, slowing new business growth over the longer-term. In 2022, 16% of 3rd year franchises failed to matriculate into 4th year franchises, 28% of 2nd year franchises failed to progress into 3rd year franchises and 30% of 1st year franchises failed to become 2nd year franchises. Onboardings of new franchises declined by 27% in 1Q23 (83 vs. 113 in 1Q22), and we forecast this number to further drop to about 50/quarter in 2024 with a higher proportion of 1st and 2nd year franchises catching traction.

Vivint transaction gives a window into value of a policy

On May 11, Goosehead announced that it had acquired Vivint Smart Home's insurance book of more than 15,000 policies for \$5.5mn, valuing the transaction at \$360/policy. This same math would value Goosehead's 1.4mn policies at around \$500mn, though Goosehead's franchise policies have a shared economics with the franchisee making them less valuable compared with a "corporate-owned" policy. Of course, Goosehead's agents can pursue new policies and can appoint new agents, so the business is certainly worth more than the run-off value of existing policies.

Price objective falls to \$41; remains Underperform

The persistency of higher interest rates drives the discount rate on future cash flows goes to 12% from 11% as we increase our long-term growth assumption to 10% from 7.5%. However, previously we our valuation underestimated the impact of non-cash compensation. Given its persistency as a form of remuneration, we are ascribing it cash value to represent the dilutive impact on shareholders ownership. These changes, alongside higher near-term EPS and declining maturation trends among franchises, tend to offset one another to various degrees, ultimately causing the PO to decline. Downside to our PO in a weakening housing market drives our Underperform rating.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	0.48	0.55	1.26	1.62	2.05
GAAP EPS	0.27	0.03	0.56	0.86	1.21
EPS Change (YoY)	-29.4%	14.6%	129.1%	28.6%	26.5%
Consensus EPS (Bloomberg)			0.99	1.43	1.97
DPS	1.63	0	0	0	1.30
Valuation (Dec)					
P/E	119.5x	104.3x	45.5x	35.4x	28.0x
GAAP P/E	212.4x	1,911.7x	102.4x	66.7x	47.4x
Dividend Yield	2.8%	0%	0%	0%	2.3%

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Timestamp: 18 May 2023 03:20PM EDT

18 May 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	43.00	41.00
2023E EPS	0.96	1.26
2024E EPS	1.22	1.62
2025E EPS	1.64	2.05

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Stock Data

Price	57.35 USD
Price Objective	41.00 USD
Date Established	18-May-2023
Investment Opinion	C-3-8
52-Week Range	29.23 USD - 71.04 USD
Mrkt Val (mn) / Shares Out (mn)	2,152 USD / 37.5
Average Daily Value (mn)	12.20 USD
BofA Ticker / Exchange	GSND / NAS
Bloomberg / Reuters	GSND US / GSND.OQ
ROE (2023E)	0%
Net Dbt to Eqty (Dec-2022A)	NA
ESGMeter™	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

iQprofileSM Goosehead Insurance Inc.

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Earned Premiums	133	188	247	295	343
Net Investment Income	NA	NA	NA	NA	NA
Total Revenue	151	209	274	329	391
Total Cost of Benefits and Claims	NA	NA	NA	NA	NA
S,G & A (Including Commissions)	(135)	(186)	(229)	(269)	(308)
Total Operating Expenses	(145)	(204)	(251)	(291)	(334)
Pre-Tax Operating Earnings	6	5	24	39	57
Income Tax Expense	2	(2)	(3)	(6)	(9)
Operating Earnings After Tax	10	12	31	46	66
Net Income (Reported)	5	1	14	24	39
Diluted Shares	20	22	24	28	32
Operating Earnings Per Share	0.48	0.55	1.26	1.62	2.05
Net Income (Reported) Per Share	0.27	0.03	0.56	0.86	1.21

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Fixed Income Securities	NA	NA	NA	NA	NA
Total Cash and Investments	29	29	69	130	210
Total Assets	268	321	363	423	501
Reserves	NA	NA	NA	NA	NA
LT Debt	118	87	85	85	135
Total Liabilities	337	355	349	348	397
Total Equity	(69)	(34)	14	75	103
Total Equity (Ex FAS 115)	(69)	(34)	14	75	103
Book Value per Share (Reported)	3/31/2021	3/31/2022	3/31/2023	3/31/2024	3/31/2025
	120000 AM	120000 AM	120000 AM	120000 AM	120000 AM
Book Value per Share (Ex FAS 115)	NA	NA	NA	NA	NA

Ratios (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Expense Ratio	101.0%	98.9%	93.0%	91.1%	89.8%
Loss Ratio	0%	0%	0%	0%	0%
Combined Ratio	101.0%	98.9%	93.0%	91.1%	89.8%
Avg Assets / Avg Eq (Ex FAS 115) Ratio	NM	NM	NM	8.8x	5.2x

Growth Rates (YoY) (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Earned Premium	40.3%	41.1%	30.9%	19.8%	16.0%
Net Investment Income	NM	NM	NM	NM	NM
Total Revenue	29.3%	38.4%	30.9%	20.2%	18.6%
Operating Earnings per Share	-29.4%	14.6%	129.1%	28.6%	26.5%
Asset	44.1%	20.0%	13.0%	16.6%	18.3%
Reported Book Value per Share	0.8%	0.8%	0.8%	0.8%	0.8%

Performance Metrics (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Operating ROE	NA	NA	NA	NA	NA
Operating ROE (Ex FAS 115)	NA	NA	NA	NA	NA
Operating Return on Average Assets	4.3%	4.1%	9.0%	11.7%	14.3%
Operating Margin	6.5%	5.7%	11.3%	13.9%	16.9%
Long Term Debt to Cap Ratio (Ex FAS 115)	240.7%	163.3%	85.7%	53.0%	56.6%
Net Income % Operating Income	55.3%	4.7%	44.3%	53.3%	59.3%
Amtz of DAC % Pretax Profit bef Amtz of DAC	0%	0%	0%	0%	0%

Company Sector

Insurance - Non-Life

Company Description

Goosehead is attempting to build a large-scale personal lines insurance brokerage company using a unique sales and service model. The company operates through its own agents as well as franchise agents. Goosehead leads with homeowners business, which is typically stickier than auto insurance. Customer retention is high in this space and Goosehead keeps a larger percentage of renewal business.

Investment Rationale

Goosehead is a rapidly growing business, and we believe it is well-positioned for continued growth moving forward due to a strong pipeline of potential franchises and its unique business model of separating sales from client services. We estimate 15-20% revenue CAGR over 2025E-27E. That said, we believe that the current share price already reflects the strong growth outlook. At a 11% discount rate on future cash flows, we believe the stock is more than fully valued, risking downside.

Stock Data

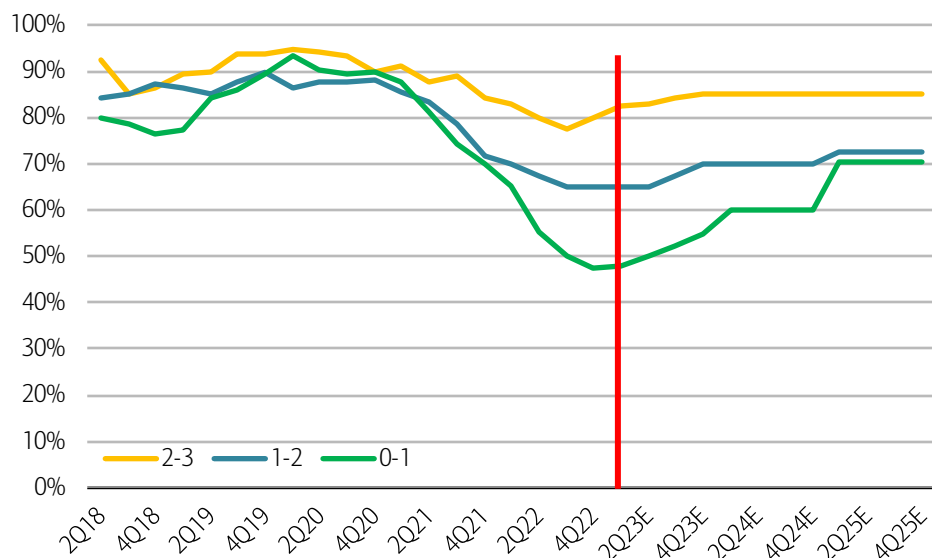
Average Daily Volume 212,705

Quarterly Earnings Estimates

	2022	2023
Q1	0.04A	0.17A
Q2	0.16A	0.34E
Q3	0.24A	0.34E
Q4	0.11A	0.39E

Exhibit 1: Percentage of Goosehead franchises that mature to the following year

There has been a notable decline in franchise matriculation at Goosehead. The company says it is undertaking efforts to cull underperforming franchises, and we are modeling improvement in franchise success. However, weaker new housing sales will act as a headwind for newer franchises to successfully build a core renewal book that justifies the economics of remaining focused on their Goosehead franchise.

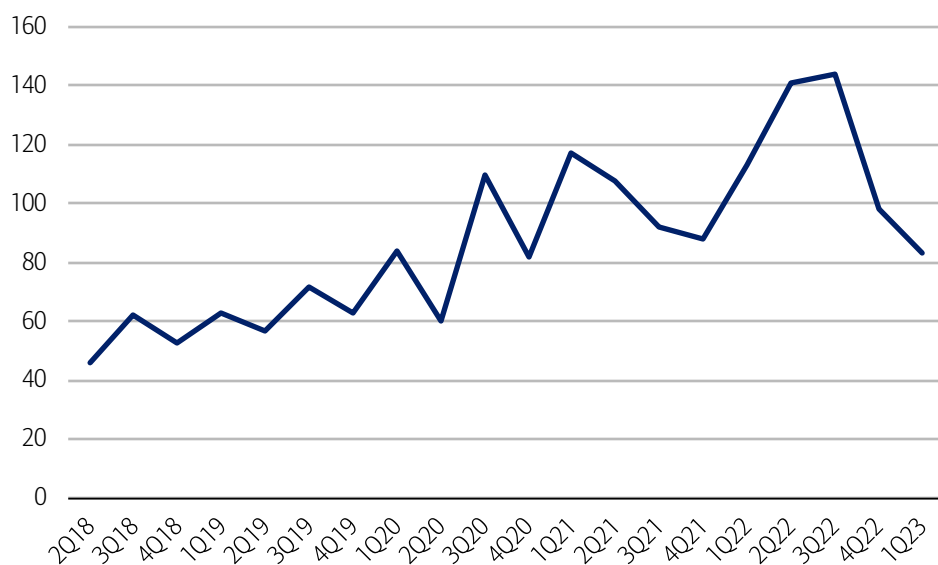


Source: Company filings and BofA Global Research estimates

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Exhibit 2: New franchise onboardings at Goosehead

After a sudden peak in 2Q22 and 3Q22, onboardings of new franchises has materially declined over the past two quarters and is down 27% from 1Q22 levels with 83 launches in 1Q23. As the failure rate of newer franchises is more commonly known, we believe it will be increasingly difficult to find new franchisees to start their businesses. We estimate 50-65 new franchises per quarter through YE2024.



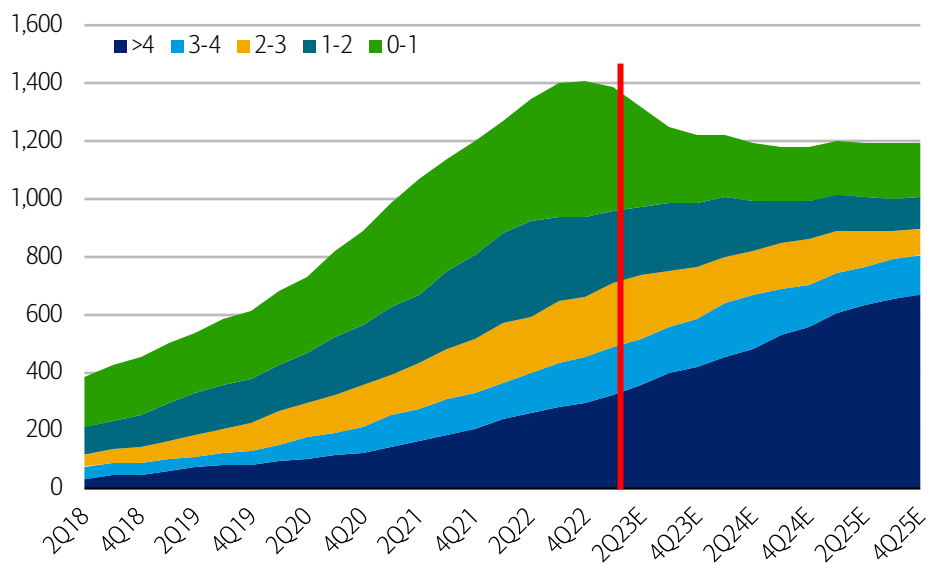
Source: Company filings

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Exhibit 3: Number of Goosehead franchises by vintage

Fewer onboardings of new franchises and less reliable matriculation into healthy franchises is likely to slow the pipeline to a healthily operating and mature franchise. Fewer onboardings in 2023 and 2024 should lead to fewer 2nd year franchises in 2024 and 2025. Fewer 2nd year franchises in 2024 and 2025 should lead to fewer 3rd year franchises in 2025 and 2026. And, ultimately, the number of franchises graduating from 3rd to 4th year declines in 2026 and 2027.



Source: Company filings and BofA Global Research estimates

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Price objective basis & risk

Goosehead Insurance Inc. (GSHD)

Our \$41 price objective is based on discounted-cash-flow analysis using our earnings projections for a 15-20% revenue CAGR through 2028 and a residual growth rate of 10% (previously 7.5%). The 10% residual growth rate runs ahead of mature large-cap brokers, but smaller outfits have tended to grow more quickly. We select an 12% discount rate to reflect the surge in interest rates beginning last in 2021. Still a 4% yield on 10-Year Treasury securities is lower than most historical periods.

Downside risks are disintermediation of the agency sales model to captives and direct channels as well as declining interest from potential franchisees. Upside risks are acceleration in franchise growth and increased pace of homeownership.

Analyst Certification

I, Joshua Shanker, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Allstate Corp.	ALL	ALL US	Joshua Shanker
	American International Group	AIG	AIG US	Joshua Shanker
	Arch Capital	ACGL	ACGL US	Joshua Shanker
	Assurant	AIZ	AIZ US	Grace Carter, CFA
	BRP Group, Inc.	BRP	BRP US	Joshua Shanker
	Cincinnati Financial Corporation	CINF	CINF US	Grace Carter, CFA
	Corebridge Financial	CRBG	CRBG US	Joshua Shanker
	Everest Re	RE	RE US	Joshua Shanker
	Intact Financial	IFCZF	IFCZF US	Grace Carter, CFA
	MetLife	MET	MET US	Joshua Shanker
	Progressive	PGR	PGR US	Joshua Shanker
	RenaissanceRe	RNR	RNR US	Joshua Shanker
	The Hartford	HIG	HIG US	Joshua Shanker
	Voya	VOYA	VOYA US	Joshua Shanker
	W.R. Berkley	WRB	WRB US	Joshua Shanker
NEUTRAL				
	Aon	AON	AON US	Joshua Shanker
	CNA Financial	CNA	CNA US	Joshua Shanker
	Lincoln National	LNC	LNC US	Joshua Shanker
	Principal Financial Group	PFG	PFG US	Joshua Shanker
	Prudential Financial	PRU	PRU US	Joshua Shanker
	The Hanover	THG	THG US	Grace Carter, CFA
	Trupanion	TRUP	TRUP US	Joshua Shanker
	Unum	UNM	UNM US	Joshua Shanker
UNDERPERFORM				
	Arthur J. Gallagher & Co.	AJG	AJG US	Joshua Shanker
	Axis Capital	AXS	AXS US	Joshua Shanker
	Chubb Ltd	CB	CB US	Joshua Shanker
	Goosehead Insurance Inc.	GSHD	GSHD US	Joshua Shanker
	Lemonade, Inc.	LMND	LMND US	Joshua Shanker
	Marsh McLennan	MMC	MMC US	Joshua Shanker
	Selective	SIGI	SIGI US	Grace Carter, CFA
	Travelers Cos	TRV	TRV US	Joshua Shanker
	Willis Towers Watson	WTW	WTW US	Joshua Shanker



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +
Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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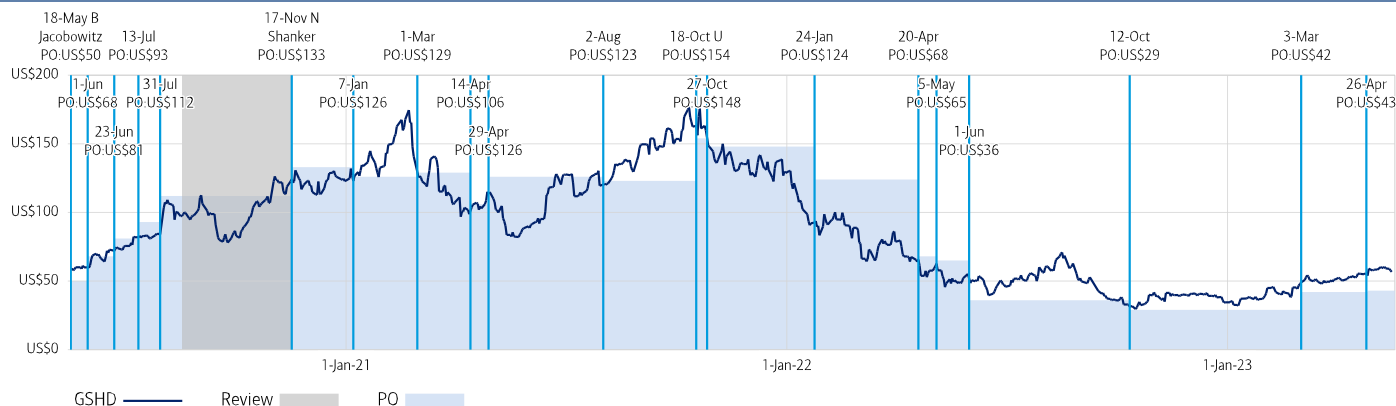
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Disclosures

Important Disclosures

Goosehead (GSHD) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Financial Services Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	152	52.41%	Buy	92	60.53%
Hold	73	25.17%	Hold	44	60.27%
Sell	65	22.41%	Sell	41	63.08%

Equity Investment Rating Distribution: Global Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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