

Arthur J. Gallagher & Co.

In-line result for 4Q23; 7-9% organic growth guidance for 2024

Reiterate Rating: UNDERPERFORM | PO: 205.00 USD | Price: 237.75 USD

Gallagher reports 4Q23 op. EPS of \$1.85

This result is in line with our forecast and Consensus. Better Corporate and Risk Management segment earnings offset modestly lower-than-expected results in the Brokerage segment. Following decelerating organic growth data from peer MarshMcLennan earlier today, AJG stock traded down modestly with the group. While 4Q23 results followed management's prior guidance, investors could react negatively to a merely "in line" result in the context of disappointing peer results and lofty valuations in the brokerage space.

Brokerage in line with guide; modestly misses estimates

Brokerage organic growth of 7.2% landed within the prior guided range of 7-7.5% but was modestly below our 7.5% forecast. Given Gallagher's historical propensity to post growth at the high end (or above) the guided range, investors could be disappointed in this result, even though it fit squarely into management's prior comments. Margins expanded ~50bps on an FX-adjusted basis to 31.6%, in line with the company's outlook, but modestly missed our forecast of 31.8%. The company reiterated guidance for 7-9% organic growth for 2024E; we forecast at the lower end of the range, expecting decelerating nominal GDP growth to weigh on results as the year progresses.

Management noted that, partly weighing on the 2024 organic growth outlook were a number of larger business transactions in the early part of 2023.

Risk Management and Corporate exceed expectations

Risk Management organic growth of 13.2% matched guidance and exceeded our forecast. Segment margins of 21.0% also surpassed our forecast of 20.2% and prior company expectations to modestly exceed 20%. We have increased our forward organic growth outlook to better reflect guidance of 9-11% for 2024E, although, similar to the brokerage segment, we forecast at the lower end of the range. Corporate losses were also favorable to our forecast and the company's outlook, providing a modest boost to results.

Price objective to \$205

Upon integrating 4Q23 results into our model, our EPS forecasts are essentially flat. Our PO rises to \$205 from \$203, reflecting 130% of the year-ahead S&P 500 P/E multiple (18x vs prior 17.5x) on our 2025E EPS, plus \$4/sh for the discounted value of deferred tax credits. Downside vs our PO underlies our Underperform recommendation.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.74	8.76	10.02	10.87	11.90
GAAP EPS	5.19	4.42	7.57	8.51	9.49
EPS Change (YoY)	11.4%	13.2%	14.4%	8.5%	9.5%
Consensus EPS (Bloomberg)			10.05	11.28	12.59
DPS	2.04	2.20	2.40	2.56	2.72
Valuation (Dec)					
P/E	30.7x	27.1x	23.7x	21.9x	20.0x
GAAP P/E	45.8x	53.8x	31.4x	27.9x	25.1x
Dividend Yield	0.9%	0.9%	1.0%	1.1%	1.1%

25 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	203.00	205.00
2024E EPS	10.03	10.02
2026E EPS	11.91	11.90
2024E DPS	2.32	2.40

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Stock Data

Price	237.75 USD
Price Objective	205.00 USD
Date Established	25-Jan-2024
Investment Opinion	B-3-7
52-Week Range	174.45 USD -254.00 USD
Mrkt Val / Shares Out (mn)	51,330 USD / 215.9
Free Float	98.9%
Average Daily Value	241.75 USD
BofA Ticker / Exchange	AJG / NYS
Bloomberg / Reuters	AJG US / AJG.N
ROE (2024E)	0%
ESGMeter™	High

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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iQprofileSM Arthur J. Gallagher & Co.

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premiums	NA	NA	NA	NA	NA
Net Investment Income	149	366	311	204	204
Total Revenue	8,551	10,072	11,469	12,309	13,285
Total Cost of Benefits and Claims	(23)	0	0	0	0
S,G & A (Including Commissions)	NA	NA	NA	NA	NA
Total Operating Expenses	(7,224)	(8,887)	(9,288)	(9,827)	(9,583)
Pre-Tax Operating Earnings	1,327	1,185	2,181	2,482	3,701
Income Tax Expense	(211)	(219)	(492)	(567)	(650)
Operating Earnings After Tax	1,666	1,922	2,229	2,440	2,695
Net Income (Reported)	1,114	970	1,684	1,909	3,046
Diluted Shares	215	219	222	224	226
Operating Earnings Per Share	7.74	8.76	10.02	10.87	11.90
Net Income (Reported) Per Share	5.19	4.42	7.57	8.51	9.49

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Fixed Income Securities	NA	NA	NA	NA	NA
Total Cash and Investments	4,964	27,879	NA	NA	NA
Total Assets	38,908	51,616	NA	NA	NA
Reserves	NA	NA	NA	NA	NA
LT Debt	5,563	7,006	0	0	0
Total Liabilities	29,718	40,801	0	0	0
Total Equity	9,190	10,815	0	0	0
Total Equity (Ex FAS 115)	9,190	10,815	0	0	0
Book Value per Share (Reported)	43.37	49.91	57.21	65.39	74.50
Book Value per Share (Ex FAS 115)	NA	NA	NA	NA	NA

Ratios (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Expense Ratio	NM	NM	NM	NM	NM
Loss Ratio	NM	NM	NM	NM	NM
Combined Ratio	NA	NA	NA	NA	NA
Avg Assets / Avg Eq (Ex FAS 115) Ratio	4.1x	4.5x	9.5x	NM	NM

Growth Rates (YoY) (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premium	NM	NM	NM	NM	NM
Net Investment Income	46.4%	144.9%	-14.9%	-34.4%	0%
Total Revenue	4.2%	17.8%	13.9%	7.3%	7.9%
Operating Earnings per Share	11.4%	13.2%	14.4%	8.5%	9.5%
Asset	16.7%	32.7%	NM	NM	NM
Reported Book Value per Share	5.6%	15.1%	14.6%	14.3%	13.9%

Performance Metrics (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Operating ROE	NA	NA	NA	NA	NA
Operating ROE (Ex FAS 115)	NA	NA	NA	NA	NA
Operating Return on Average Assets	4.6%	4.2%	NM	NM	NM
Operating Margin	19.5%	19.1%	19.4%	19.8%	20.3%
Long Term Debt to Cap Ratio (Ex FAS 115)	37.7%	39.3%	NM	NM	NM
Net Income % Operating Income	66.9%	50.4%	75.5%	78.2%	113.0%
Amtz of DAC % Pretax Profit bef Amtz of DAC	0%	0%	0%	0%	0%

Company Sector

Insurance - Multi-line

Company Description

Arthur J. Gallagher is the world's fourth-largest insurance broker, providing insurance brokerage and risk management services via a network of subsidiaries. It places P/C reinsurance, and surplus lines, and manages employee benefits programs. Risk management services, performed through Gallagher Basset Services, include: claims management, loss control consulting and workers' compensation investigations.

Investment Rationale

Gallagher appears well-positioned to take advantage of business leakage from industry consolidation. Additionally, the economic recovery is likely to provide an organic revenue boost while margins face pressure from the resumption of T&E spend. Despite our operational positivity, we believe this is already well-reflected in the valuation, which we believe presents downside. Underperform.

Stock Data

Average Daily Volume 1,016,836

Quarterly Earnings Estimates

	2023	2024
Q1	3.03A	3.45E
Q2	1.90A	2.23E
Q3	2.00A	2.29E
Q4	1.85A	2.06E



Price objective basis & risk

Arthur J. Gallagher & Co. (AJG)

Our \$205 price objective for shares of Arthur J. Gallagher is based on 130% of the S&P 500's year-ahead consensus P/E multiple (18x) on Gallagher's fully-taxed earnings (incl. amortization) plus \$4 per share based on our estimation of the discounted time value of Gallagher's deferred tax credits. The price of the stock has from time to time extended through the long-term trading range of 100-130% of the S&P 500's P/E multiple for the insurance peers, and we are forecasting a reversion towards the upper bound of that trading range as the economy recovers from the COVID19 recession. Our revenue forecast assumes top line tailwinds from the economic recovery, partially offset by margin pressure as T&E spend resumes post-pandemic. A GAAP tax increase in 2022 could slow GAAP earnings growth, though its cash impact is minimal as the company utilizes its deferred tax assets.

Upside risk to our PO would likely stem from organic growth in excess of peers and our forecast. Downside risks: decelerating organic growth, operating margins could see compression as travel and entertainment expenses resume. Integration risk for the recent reinsurance brokerage acquisition.

Analyst Certification

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US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Aflac	AFL	AFL US	Joshua Shanker
	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
	Axis Capital	AXS	AXS US	Joshua Shanker
	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 Group Ltd	EG	EG US	Joshua Shanker
	Intact Financial	YIFC	IFC CN	Grace Carter, CFA
	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
	Brown & Brown	BRO	BRO US	Grace Carter, CFA
	CNA Financial	CNA	CNA US	Joshua Shanker
	Lincoln National	LNC	LNC US	Joshua Shanker
	Marsh McLennan	MMC	MMC 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

US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	Arthur J. Gallagher & Co.	AJG	AJG US	Joshua Shanker
	Chubb Ltd	CB	CB US	Joshua Shanker
	Goosehead Insurance Inc.	GSHD	GSHD 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

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

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

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

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

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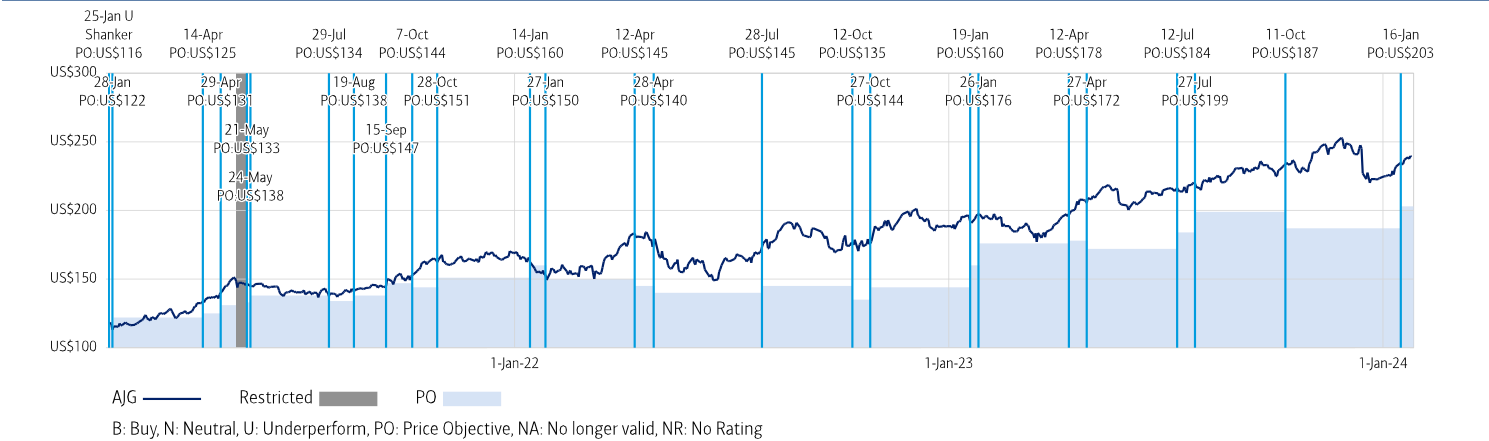
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AJ Gallagher (AJG) Price Chart



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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{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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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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