Goosehead Insurance Inc.

Fewer agents, decelerating pricing: 2024 presents major challenges

Maintain Rating: UNDERPERFORM | PO: 42.00 USD | Price: 74.29 USD

Revenues/KPIs have already hit below-target inflection

With Goosehead delivering 29.3% controlled premium growth in 4Q23 and guiding to 25-30% for 2024, the company has already dropped below its long-term guidance of 30%+ growth through 2027 despite the most significant price increases in personal lines insurance in nearly 50 years. We expect the company will miss its revenue guidance of $310-320mn for 2024 as it continues to struggle to find open franchisees and to successfully convert newer franchisees into strong producers. 2024 is likely to draw a difficult comparable with 2023 as personal lines pricing decelerates.

Perceived productivity “boost” may likely prove fleeting

The company has offered new disclosures to demonstrate increasing productivity among its agents; however, these improvements seem largely a function of declining agent count (lower denominator) as opposed to improvements in new business production among productive agents. The implication of new, higher levels of productivity does not appear to be registering as improving revenue trends with 4Q23 revenue near the bottom of previous guidance and 2024 guidance below consensus (of which we expect Goosehead will ultimately miss). The combination of declining agent count and a slower pace of home/mortgage sales is weighing on new production.

Cash flow and EBITDA numbers overstated

In terms of both “adj.” EBITDA and operating cash flows, these number significantly benefitted from $24mn in share-based compensation in 2023. Over the past four years, shareholders have been, on average, diluted by just over 1% annually, which is equivalent to about $30mn+ a year at the current market cap. Operating cash flow excluding cap/ex, share-based comp and deferred taxes was just $13.1mn in 2023, or 5.0% of revenue of $261mn. Despite having grown by a 36% revenue CAGR over the last four years, “free” cash flow as a percentage of revenue has largely been in a state of decline.

Recommendation remains Underperform; PO of $42

Our PO of $42 is based upon a discounted-cash-flow analysis using our earnings projections for a 15-20% revenue CAGR through 2028 and a residual growth rate of 10%. With the company guiding to about 20% revenue growth for 2024 against the backdrop of historically high increases in personal lines insurance pricing, we believe the risk is to the downside regarding our longer-term revenue projections. With significant downside potential to our price objective, we rate shares as Underperform.

Estimates (Dec) (US$)	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**
EPS	0.55	1.23	1.67	2.46	2.46
GAAP EPS	0.03	0.58	0.93	1.66	1.60
EPS Change (YoY)	14.6%	123.6%	35.8%	47.3%	0%
Consensus EPS (Bloomberg)			1.59	2.23	3.20
DPS	0	0	0	1.30	2.58
Valuation (Dec)					
P/E	135.1x	60.4x	44.5x	30.2x	30.2x
GAAP P/E	2,476.3x	128.1x	79.9x	44.8x	46.4x
Dividend Yield	0%	0%	0%	1.8%	3.5%

28 February 2024

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Stock Data

Price	74.29 USD
Price Objective	42.00 USD
Date Established	22-Feb-2024
Investment Opinion	C-3-9
52-Week Range	43.84 USD - 92.76 USD
Mrkt Val (mn) / Shares Out (mn)	2,788 USD / 37.5
Free Float	23.4%
Average Daily Value (mn)	18.75 USD
BofA Ticker / Exchange	GSHD / NAS
Bloomberg / Reuters	GSHD US / GSHD.OQ
ROE (2024E)	0%
Net Dbt to Eqty (Dec-2023A)	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”.

Refer to important disclosures on page 13 to 15. Analyst Certification on page 11. Price Objective Basis/Risk on page 11. **12664917**

Timestamp: 28 February 2024 05:00AM EST

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Income Statement Data (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premiums	188	233	268	286	296
Net Investment Income	NA	NA	NA	NA	NA
Total Revenue	**209**	**261**	**301**	**346**	**363**
Total Cost of Benefits and Claims	NA	NA	NA	NA	NA
S,G & A (Including Commissions)	(186)	(215)	(235)	(239)	(254)
Total Operating Expenses	**(204)**	**(235)**	**(255)**	**(263)**	**(281)**
Pre-Tax Operating Earnings	**5**	**26**	**46**	**83**	**82**
Income Tax Expense	(2)	(3)	(10)	(18)	(17)
Operating Earnings After Tax	**12**	**30**	**46**	**77**	**86**
Net Income (Reported)	**1**	**14**	**26**	**52**	**56**
Diluted Shares	22	24	28	31	35
Operating Earnings Per Share	0.55	1.23	1.67	2.46	2.46
Net Income (Reported) Per Share	0.03	0.58	0.93	1.66	1.60

Balance Sheet Data (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Fixed Income Securities	NA	NA	NA	NA	NA
Total Cash and Investments	29	42	103	196	240
Total Assets	**321**	**355**	**419**	**513**	**559**
Reserves	NA	NA	NA	NA	NA
LT Debt	87	68	68	118	168
Total Liabilities	**355**	**338**	**339**	**390**	**440**
Total Equity	**(34)**	**17**	**80**	**124**	**119**
Total Equity (Ex FAS 115)	**(34)**	**17**	**80**	**124**	**119**
Book Value per Share (Reported)	3/31/2022 120000 AM	3/31/2023 120000 AM	3/31/2024 120000 AM	3/31/2025 120000 AM	3/31/2026 120000 AM
Book Value per Share (Ex FAS 115)	NA	NA	NA	NA	NA

Ratios (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Expense Ratio	98.9%	92.1%	87.9%	83.9%	85.7%
Loss Ratio	0%	0%	0%	0%	0%
Combined Ratio	**98.9%**	**92.1%**	**87.9%**	**83.9%**	**85.7%**
Avg Assets / Avg Eq (Ex FAS 115) Ratio	NM	NM	8.0x	4.6x	4.4x

Growth Rates (YoY) (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premium	41.1%	23.8%	14.9%	6.7%	3.8%
Net Investment Income	NM	NM	NM	NM	NM
Total Revenue	38.4%	24.8%	15.1%	15.2%	4.8%
Operating Earnings per Share	14.6%	123.6%	35.8%	47.3%	0%
Asset	20.0%	10.4%	18.0%	22.5%	8.9%
Reported Book Value per Share	0.8%	0.8%	0.8%	0.8%	0.8%

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	4.1%	8.9%	12.0%	16.6%	16.1%
Operating Margin	5.7%	11.5%	15.4%	22.3%	23.8%
Long Term Debt to Cap Ratio (Ex FAS 115)	163.3%	80.1%	45.8%	48.7%	58.5%
Net Income % Operating Income	4.7%	46.9%	55.5%	67.3%	64.9%
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	252,360

Quarterly Earnings Estimates

	2023	2024
Q1	0.17A	0.30E
Q2	0.41A	0.49E
Q3	0.46A	0.53E
Q4	0.28A	0.36E

Decelerating/declining KPIs

On Wednesday, February 21, Goosehead reported its year-end 2023 results. The stock reacted badly to these results (down 18%), and, following feedback from investors, we believe the negative reaction was largely based on what was perceived as a poor outcome for revenue. 4Q23 revenue of $63.0 million (just 10% higher than 4Q22) ran below our forecast of $69.3 million and consensus of $68.6 million and toward the lower end of guidance of $62-69 million. Additionally, 2024 revenue guidance of $310-320 million fell below consensus of $336 million, though ahead of our forecast of $301 million. Finally, management guidance for year-end controlled premium of $3.7-3.85 billion (25-30% above year-end 2023) falls below its 30%+ long-term guidance through "at least 2027" (reiterated as recently as October 2023), though, compared with our $3.5 billion our forecast, we expect the company will fail to reach this year end target.

> Investors seemed disappointed in revenue results for 4Q23 and the guide for 2024. We believe that the company's long-term guidance of 30%+ controlled premium growth is no longer realistically part of the outlook.

U.S. auto insurance rates ended 2023 up 20% (according to Department of Labor CPI), while U.S. homeowners' rates were up in the low-double-digit range (using Allstate and Travelers data as a proxy), albeit higher in states like Texas, California and Florida where Goosehead primarily operates. We expect that personal insurance price increases will continue to be elevated in 2024, albeit decelerating from recent peak increases, creating difficult year-over-year comparables vs. 2023. This rate of personal lines price increases has been greater in 2023 than anytime in about 50 years. The unprecedented tailwind will be less powerful in 2024. We believe the guidance to expect at least 30% premium growth through 2027 has already buckled with 4Q23 premium up just 29.3% over 4Q22 and the 25-30% guidance for 2024 (which we expect will not be achieved).

Unlike these "revenue-disappointed" investors, we have been less concerned about near-term revenue outcomes. Revenues should be/should have been outstanding and "over-growing" due to two temporary tailwinds. First, as mentioned before, personal lines insurance is in a once-in-50-year pricing peak. We have been rating and rate shares of Goosehead as Underperform despite the assumption that revenue growth should be outstanding in this environment, fully prepared for it to be temporarily boosted. In addition to-once-in-a-generation pricing, in 2023, the company was still enjoying the tailwind of pandemic-era home purchasing from 2022. The Goosehead franchise model collects just 20% royalties on new business, but 50% royalties on renewal business. The delayed waterfall effect means that revenue growth in 2023 should have still been supercharged by the home purchases of 2022 (particularly in Texas) converting from new business into a renewal. The year-over-year comparables will be much more difficult in 2024 with slower new policy production stemming from weaker new business in 2023.

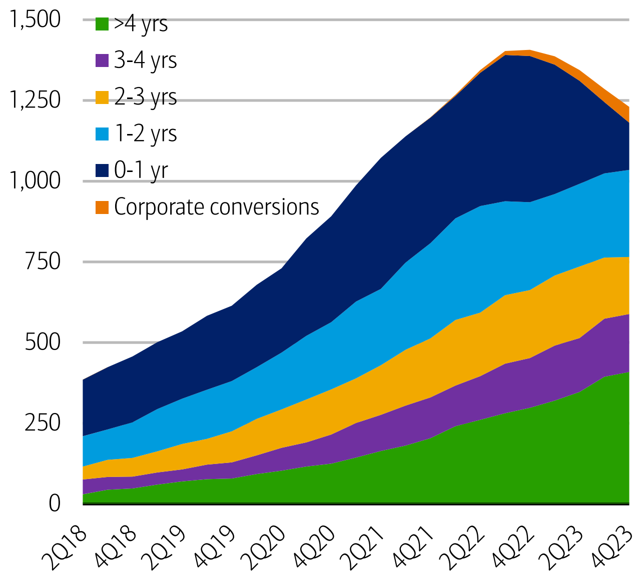
We have been arguing that investors should be focused on unit economics instead of revenue growth in two long and detailed Goosehead-specific notes published on November 14, 2023 and January 8, 2024 that continue to remain relevant even after the 4Q23 miss. We believe investors should focus on 1) franchise growth and 2) policycount growth. These inputs are the pipeline to future long-term revenue production, and these two prior notes deeply focus on those issues. Since a peak of 1,407 franchises set at December 31, 2023, the franchise count at Goosehead has fallen 13% to 1,226 one year later. Ultimately, we believe Goosehead is in the business of selling insurance agency franchises, and, right now, it is failing to deliver on that measure.

The company has had significant difficulty selling new franchises as well as difficulty matriculating the fewer number of "young" franchises into "seasoned" franchises.

Further, in anticipation of future production, the company onboarded just 54 new franchises in 2H23 as compared with 242 in 2H22 with 4Q23 onboardings of 24 being materially lower (about 55% lower) than the quarters of 2018 when Goosehead first supplied this information. While the company no longer supplies investors precise granular information about franchise vintage, 4Q23 "seasoned franchise" growth (as defined as franchises with at least two years' operating experience and/or conversions from former corporate agents) were up by about 20%, linearly decelerating from 48% growth in 1Q22 (over 1Q21).

Exhibit 1: Goosehead franchises delineated by vintage

First-year Goosehead franchises have declined precipitously. Since 2Q23, Goosehead has chosen to no longer update investors regarding the vintages of older franchises. (We have estimated 2nd through 4th+ year for 2Q23-4Q23.) Total franchise count has declined from its year-end 2022 peak.



Source: Company reports and BofA estimates

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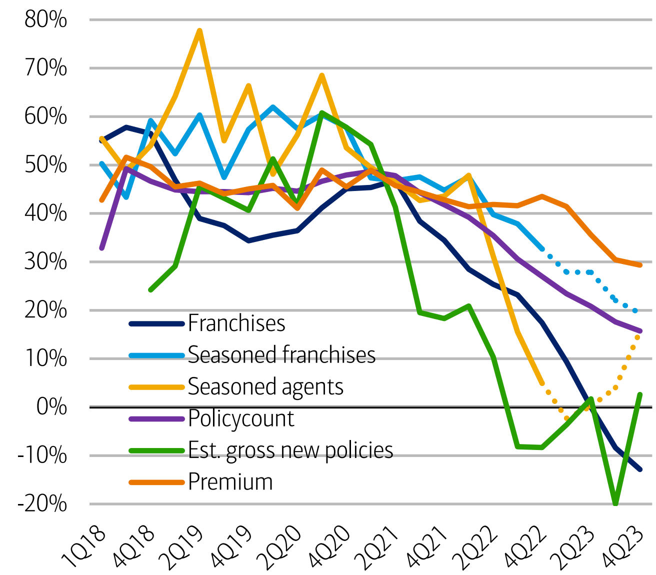
Exhibit 2: Year-over-year change in key production measures

Most key production measures at Goosehead have been in a state of multi-year deceleration (or decline) beginning in mid-2021. The exception is new policy production, which has been flat-to-negative since 3Q22, but was modestly positive in 4Q23, which may attest to improved productivity.



Source: Company reports and BofA estimates

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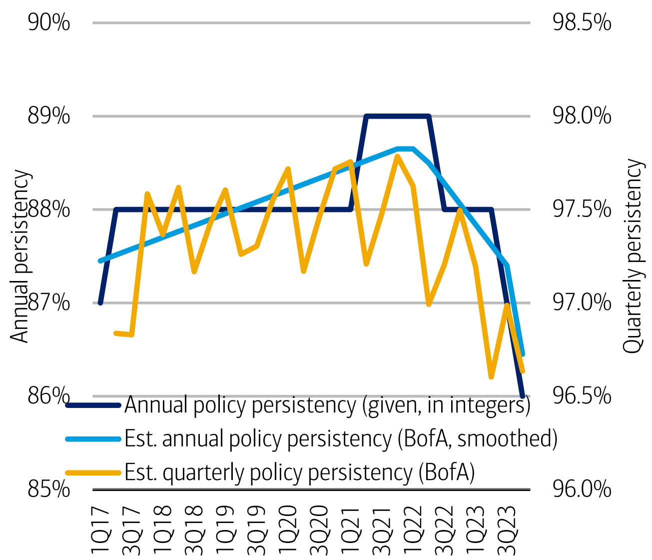
We expect this declining trend to continue with the pipeline of "young franchises" (those with less than two years' experience and not having converted from a corporate agent) down 43% to 413 from 725 a year ago. We expect this "young franchise" number to continue to decline sharply, which ultimately represents the pipeline for future business production.

Policycount and productivity

Goosehead management has argued that investors should overlook the decline in franchise count and instead focus on the productivity of remaining franchises. The company has been in the process of "culling" its book of underperforming franchises, which is improving the productivity of remaining franchises, and it has also been converting the best agents working for the Goosehead corporate agency into franchises, which is boosting the productivity of newer franchises and the franchise pool more broadly. And, potentially, there is some evidence that supports this argument.

In 4Q23, average annual policy persistency for a Goosehead controlled policy fell to 86% from 87% in 3Q23. That follows on a drop from 88% in 2Q23 to 87% in 3Q23 (as well as peaking at 89% in 2Q22). Unfortunately, Goosehead only provides this data to investors to the nearest integer. If we had this data to a hundredth or even a tenth place, we would be able to precisely convert the quarterly policies under control data from a net change to a gross change, which would tell us how many new policies the company added in a given year (or quarter with a little more time series math). Because of the integers, some estimation is required. We aimed to give these integers some "smoothness" in trying to convert these annual persistency numbers into quarterly persistency and, in turn, estimating with the number of Goosehead policies lost on a quarterly basis, rounding it to the nearest thousand of policies.

Exhibit 3: Annual policy persistency including quarterly estimates
Annual policy persistency has exhibited a sharp drop in 2H23, which requires the company to increase gross new policy additions in order to maintain net policycount growth.



Source: Company reports and BofA estimates
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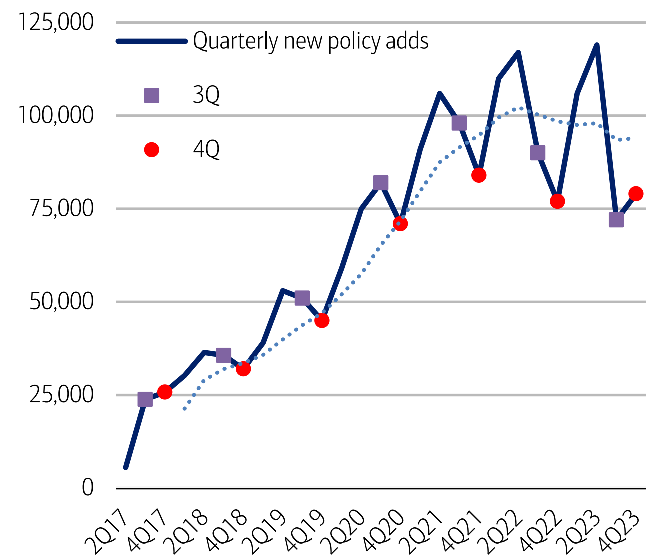
Exhibit 4: Est. gross new policycount additions imply seasonality
After very poor gross policycount production in 3Q23, Goosehead appears to have increased new policy additions to its portfolio defying a seasonal trend where the fourth quarter is the weakest annually.



Source: Company reports and BofA estimates
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As persistency declines, policycount declines more quickly. To maintain growth rates, the company would need to add incremental policies to replace those loss policies. In terms of our estimates, it implies that net policycount additions accelerated from 3Q23 levels into 4Q24. The company net grew policycount by 30k policies to 1,486k in 4Q23 despite the drop in persistency to 86%. By our math, this implies 79k gross new Goosehead policies in 4Q23. This compares with our estimate of 72k gross new policies in 3Q23.

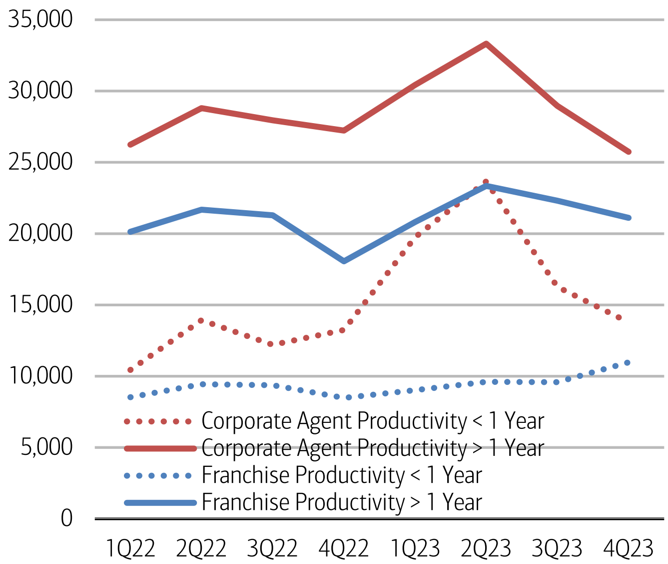
> 4Q23 policy production seems to have improved over 3Q23, despite 4Q traditionally being the worst quarter for new business generation. This may be an indication of accelerating productivity among agents.

What is interesting is that this 4Q23 defies the seasonal trend of 4Q23 being the worst quarter for business production. There are reasons for this. Typically, families tend to change homes more often prior to the beginning of a new school year (which begins often in August in the Southeast and in September elsewhere) as opposed to switching their children's schools after the beginning of a new school year. Additionally, there is a seasonal slowdown of sales that occurs in the Christmas/New Year's holiday season, making for less days of potential production. As Exhibit 4 indicates, the 3Q23 drop in production seemed to resemble what one would expect in a typical 4Q, while production in 4Q23 uncharacteristically exceeded 3Q23's. This argues that many of the things Goosehead management has said about increased productivity hold true.

In 4Q23, Goosehead began to supply investors with new key performance indicators (KPIs) around productivity. The company began to give investors data on new commission production by franchises delineated between franchises in their first year as well as franchises with a year or more experience. The data indicates that first-year franchises showed a 29% increase in productivity in 4Q23 compared with year prior, while agencies with at least one year of experience saw a 17% increase in production. This productivity increase might point directly at the higher policy count in 4Q23 vs. 3Q23. However, we aren't sure that the productivity numbers actually show that. In a prior note, we gave the example of a factory with two producers who make widgets and ask the reader to imagine that one producer can generate 10 widgets/day while the other generates none. That's 5 widgets per day per producer. When management finally gets around to eliminating the non-producing producer, productivity "rises" to 10 widgets per producer per day, even though the "producing" producer hasn't really changed work habits. When Goosehead tells investors that it is culling its franchisee force of agents producing less than 1% of volumes, it is difficult to determine if a productivity increase represents improvements in remaining per store sales or merely a slashing of the denominator. We believe it is the later.

Exhibit 5: Goosehead new business production per agent

With 4Q23, Goosehead offered new key performance indicators around agent productivity.



Source: Company filings

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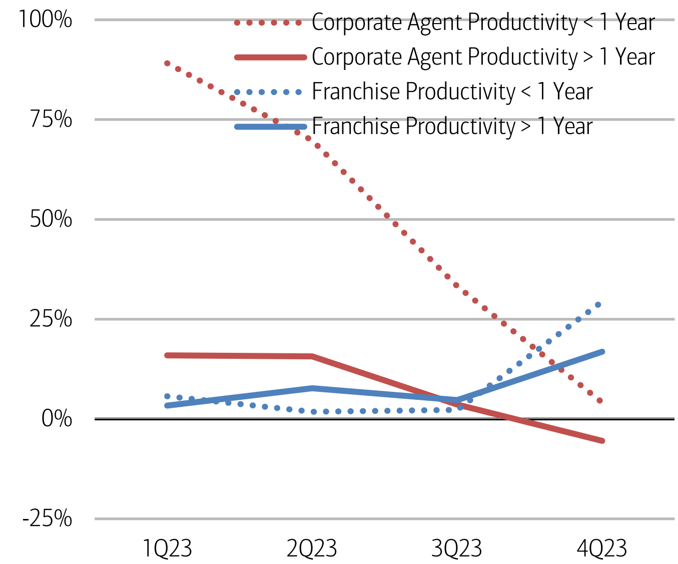
Exhibit 6: Year-over-year change in new business production per agent

The data shows significant improvements in franchise agency productiviity and significant deterioration in corporate agency productivity.



Source: Company filings

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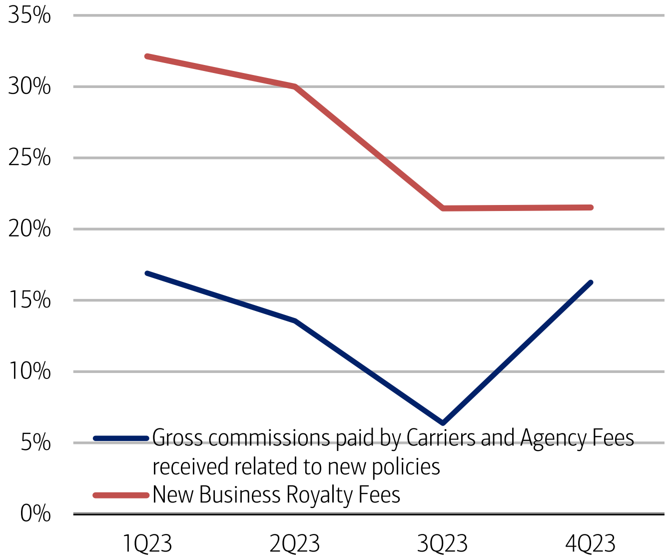
In addition to providing new franchisee productivity data, the company provided investors with new sales production of the corporate agency force delineated between first-year and more experienced agents as well. The changes in the corporate agent count have been more dramatic with the company slashing corporate agent count by 37%/50% (first-year/experienced) from a 4Q21 peak to a 2Q23 trough and then increasing the corporate agency count by 23%/(down) 8% from the 2Q23 trough through year-end 2023. The company has only provided investors with eight quarters of productivity information, but investors can see that in 1Q23, first-year corporate agent productivity surged to a staggering high of 89% as it was slashing agent count. The productivity gains seem entirely denominator induced.

Exhibit 7: Year-over-year change in income statement franchise new business compared with new KPIs on productivity

The new KPIs data, while it indeed does indicate improving productivity (note acceleration in 4Q23), does not seem to translate into an improvement in the related income statement line item (note flat growth compared with 3Q23).



Source: Company filings

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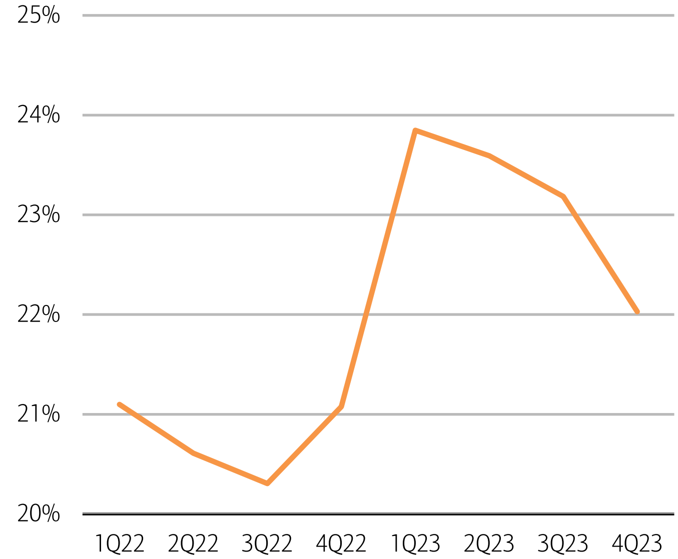
Exhibit 8: New business royalty fees / "Gross commissions paid by Carriers and Agency Fees received related to new policies"

We would have thought there would likely be some consistency between the growth rate of new business in royalty fees (on income statement) and the new gross commission productivity data supplied with 4Q23 results. However, the two do not seem to bear a relationship to one another.



Source: Company filings

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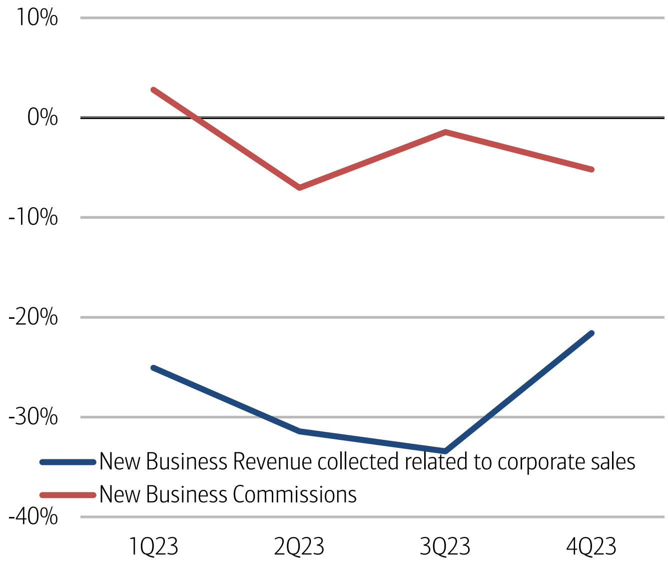
Further, we would note that these productivity statistics do not seem to correspond to production statistics as detailed in the audited income statement. The productivity data details commissions (for franchises) and sales (for corporate agents) per average agent count, which is a number given in the company's KPIs (or at least quarter end agent count is, with average available by dividing the sum of two points in time divided by two. By doing this math, we can compare New Royalty Revenues from the income statement with New Franchise Commissions from the productivity statistics (multiplied by the average agent count).

> Management has not responded to our requests for clarification on the seeming non-relationship between the new KPI productivity data and the related revenue items on the income statement. There may be some difference between how the new disclosure was calculated and how we are interpreting it.

Likewise, we can do the same calculations for the corporate agents, comparing sales from the new KPIs and new commissions on the income statement. Doing this produces numbers that do not reflect the trends seen in the revenue lines. We have asked the company to clarify the lack of correlation among these numbers, but management has, so far, been non-responsive. In the case of the corporate agent productivity data, the relationship between sales and revenue seems to bear no relationship whatsoever. We believe this is largely due to the fact that the implied productivity increases are merely a function of changing agent counts (the denominator) and not actual improvements in productivity per active agent, but yet defer to management to educate investors in this regard. It is also possible that the data in these new KPIs might be trailing 12-month data, while we have compared it against quarterly income statement results (and we think this may likely be the case). If so, this would merely serve to exacerbate the problem of a declining agent count giving the appearance of higher levels of productivity, and we would regard the data, at best, as indicting trends that may have since long past.

Exhibit 9: Year-over-year change in income statement corporate new business compared with new KPIs on productivity

Similar with the new franchise productivity data, the related corporate agency productivity data does not bear a relation to the related income statement item. We are not confident that this data indicates the potential accelerating revenue production in 2024.



Source: Company filings

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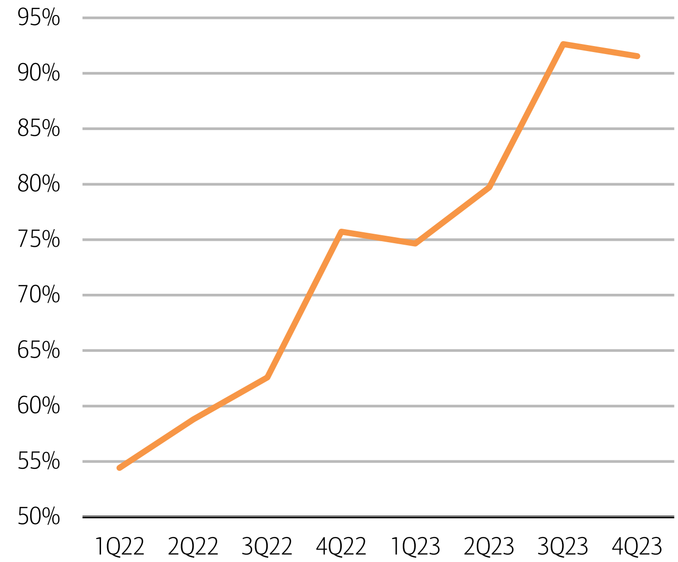
Exhibit 10: New business commissions / "New Business Revenue collected related to corporate sales"

We believe the sharply rising ratio of New business commissions / "New Business Revenue collected related to corporate sales," which corresponds to a sharply declining agency count argues that the productivity improvement may merely be a function of fewer agents (lower denominator).



Source: Company filings

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We believe one more comment regarding this new productivity data is worth noting. A seasoned corporate agent, according to the KPI data, generated approximately $26 million in new sales (in the 4Q23 data), while a seasoned franchise generated approximately $21 million in new commissions. The company has embarked on a project of converting its best performing corporate agents into franchisees and flags that as a key ingredient in rising productivity. An enterprising former corporate agent is immediately better at generating new business than a neophyte Goosehead agent and potentially can rival a seasoned franchises producer. The makes sense entirely.

> By converting its best corporate producers to franchises, Goosehead may be losing a stream of revenue it formerly controlled in full.

However, the production statistics suggest that seasoned corporate producers ($26 million) are more productive than seasoned franchises ($21 million). Further, Goosehead essentially "owns" 100% of the economics associated with a corporate agent's production (including the run-off value of that book if/when the corporate agent departs) as compared with having to share in the economics of a franchises ("owning" just 20% of new business and only 50% of renewal business for as long as the policy is active). From this, we question whether it is indeed beneficial to Goosehead shareholders for the company to be converting its best corporate agents into franchisees.

Cash flow margins appear low and stagnant

In speaking with investors, we have heard the argument that, yes, maybe management is overly bullish about its revenue growth rate. And, yes, it does appear that the company has hit some snags in terms of manufacturing new franchises. And, perhaps even, that margin expansion has not improved at the pace expected. The 4Q23 adj. EBITDA margin of 22.5% also ran below our forecast of 27.9% and consensus of 26.4%. However, some will draw attention to the fact that Goosehead generated $51 million of operating cash flow in 2023. So, yes, maybe the growth rate isn't 30%, but maybe it is 20%. At a market cap of $2.8 billion, the stock is trading 55x trailing operating cash flow, which is high, but maybe not so high for a company growing at somewhere around a 20% clip.

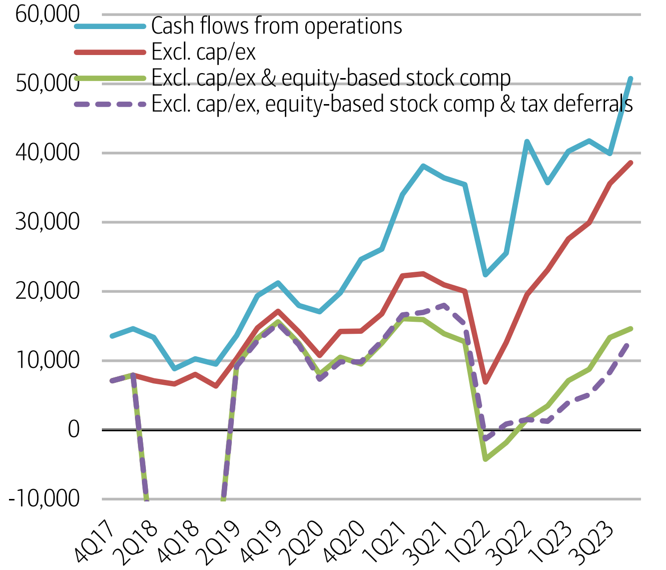
We believe investors need to make adjustments to the $50.8 million in operating cash flow for 2023. First of all, that $50.8 million does not adjust for $12.2 million of capital expenditures, which in typical investment shorthand converts cash flow from operations into “free” cash flow: $38.6 millon (73x). Second, the company deferred $1.5 million in taxes in 2023 that will have to be paid sometime lowering the “free cash flow” number to $37.1 million: (76x).

We calculate 2023 “free” cash flow of about $13 million or 5% of revenues as compared with the company disclosure of a 26.7% “adjusted” EBITDA margin. Non-cash comp hidden in sharecount dilution causes “adjusted” numbers to appear much higher than GAAP numbers.

We would then ask investors to look at one more line on the statement of operating cash flows: share-based compensation. Our view is that share-based compensation has a cost. In the same way that debt issuance might generate cash. No one would call that debt-generated cash flow “free.” The debt will have to be repaid in the future, and share-based compensation merely moves compensation off the statement of operating cash flows onto the statement of financing cash flows. Further, Goosehead management in particular has been very aggressive with hundreds of millions of dollars in stock sales annually, such that one might be forgiven for drawing little distinction between share-based comp and cash-based compensation. In 2023, share-based comp totaled $24.0 million. Investors have experienced sharecount dilution on average of 1.1-1.2% annual over each of the past 4 years (2020-2023). At a market capitalization of $2.8 billion, annual sharecount dilution of slightly in excess of 1% is equal to over $30 million annually. We would respectfully ask investors to deduct the GAAP number of $24.0 million in 2023 share-based compensation to estimate a more accurate view of truly “free” cash flow: $13.1 million. Our view is that paying a 215x multiple on trailing free cash flow might be a little much, even for a company growing revenue at, say, a 20%ish clip.

Exhibit 11: Cash flow from operations/"Free" cash flow ($ in '000s)

Significant amounts of share-based compensation give the impression that cash flows from operations have been growing. However, when adjusting out this line item, truly "free" cash flows have essentially stagnated at about $10mn annually since 2019, despite material increases in the company's size.



Source: Company filings

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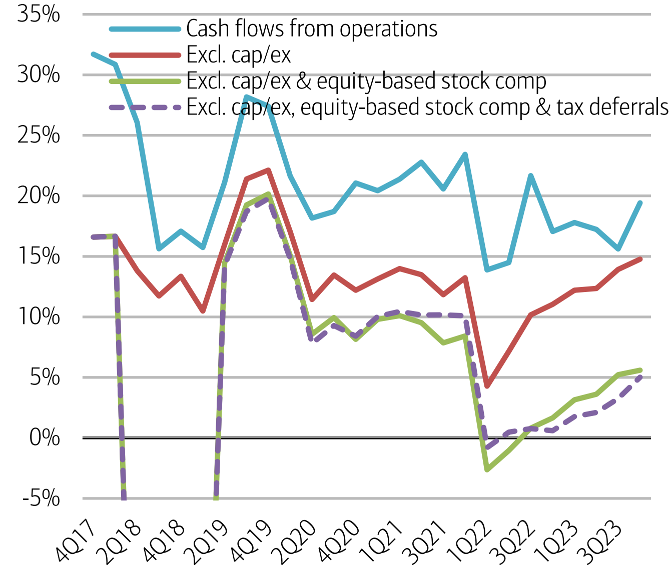
Exhibit 12: Cash flow from operations/"Free" cash flow (as a % of revenues)

2023 revenues of $261 million compares with $77 million in revenues in 2019. Truly "free" cash flows as a percentage of revenues have decline precipitously since 2019. That said, 2023 "free" cash flow as a percentage of revenue did improve from a 2022 trough.



Source: Company filings

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Additionally, we would observe that, as Goosehead grows, that it has not been able to execute on improved margins. We would note that truly "free" cash flow generation dropped sharply in 2022. As a percentage of revenue, it seems as if it has been in decline since 2019, albeit better in 2023 than in 2022. Operating cash flow less cap/ex, deferred taxes and share-based compensation of $13.1 million on a base of $261 million in revenues is just 5.0%. We are not arguing that it cannot improve, but this number is so far off from the 20-30% adjusted EBITDA numbers that the company cites in quarterly financials and its 40%+ target that we believe it, at best, is many years away from being anywhere near marrying truly "free" cash flows to this target.

Price objective basis & risk

Goosehead Insurance Inc. (GSHD)
Our $42 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%. 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.

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				
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	Allstate Corp.	ALL	ALL 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				
	American International Group	AIG	AIG US	Joshua Shanker
	Aon	AON	AON US	Joshua Shanker
	Brown & Brown	BRO	BRO US	Grace Carter, CFA
	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
UNDERPERFORM				
	Arthur J. Gallagher & Co.	AJG	AJG US	Joshua Shanker
	Chubb Ltd	CB	CB US	Joshua Shanker
	CNA Financial	CNA	CNA 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

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Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A

Quality of Earnings	Numerator	Denominator
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt – Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense

Valuation Toolkit	Numerator	Denominator
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price × Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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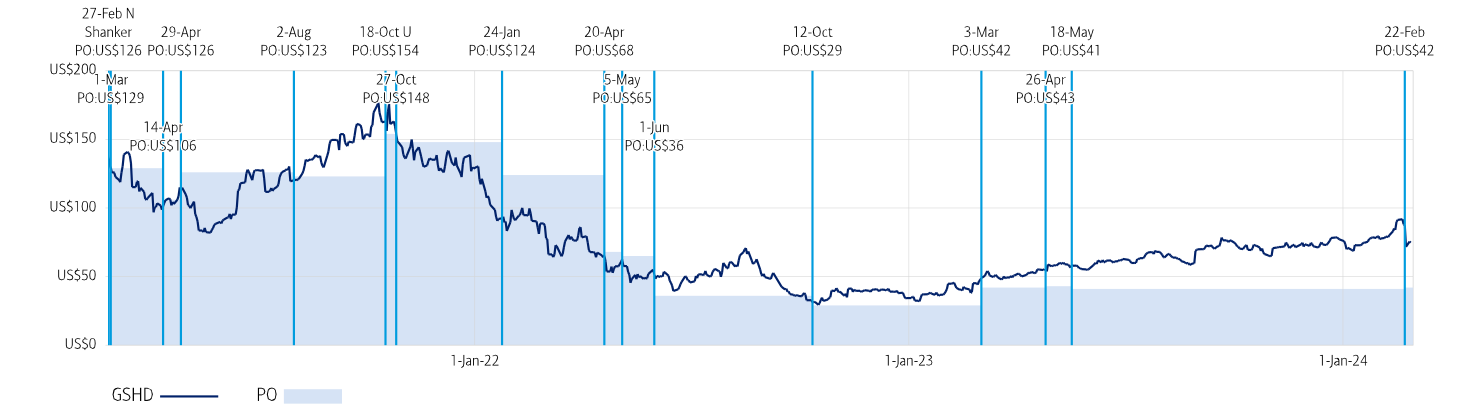
Goosehead (GSHD) Price Chart



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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
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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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
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Underperform	N/A	≥ 20%

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