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BRP Group, Inc.

Second Quarter 2023 Earnings Conference Call

August 9, 2023

CORPORATE PARTICIPANTS

Bonnie Bishop, *Executive Director, Investor Relations*

Trevor Baldwin, *Chief Executive Officer*

Brad Hale, *Chief Financial Officer*

Kris Wiebeck, *Chief Strategy Officer*

CONFERENCE CALL PARTICIPANTS

Elyse Greenspan, *Wells Fargo*

Meyer Shields, *KBW*

Pablo Singzon, *JPMorgan*

PRESENTATION

Operator

Greetings. Welcome to BRP Group Incorporated's Second Quarter 2023 Earnings Call.

At this time, all participants are in a listen-only mode. (Operator Instructions)

Please note, this conference is being recorded.

I will now turn the conference over to Bonnie Bishop, Executive Director of Investor Relations. Thank you. You may begin.

Bonnie Bishop

Thank you, Operator. Welcome to the BRP Group's Second Quarter 2023 Earnings Call. Today's call is being recorded.

Second quarter financial results, supplemental information and Form 10-Q were issued earlier this afternoon and are available on the Company's website at ir.baldwinriskpartners.com.

Please note that remarks made today may include forward-looking statements subject to various assumptions, risks and uncertainties. The Company's actual results may differ materially from those contemplated by such statements. For a more detailed discussion, please refer to the note regarding forward-looking statements in the Company's earnings release and to our most recent Form 10-Q, both of which are available on the BRP website.

During the call today, the Company may also discuss certain non-GAAP financial measures. For a more detailed discussion of these non-GAAP financial measures and historical reconciliation to the most closely comparable GAAP measures, please refer to the Company's earnings release and supplemental information, both of which have been posted on the Company's website at ir.baldwinriskpartners.com.

I will now turn the call over to Trevor Baldwin, Chief Executive Officer of BRP Group.

Trevor Baldwin

Good afternoon everyone and thank you for joining us on our Second Quarter Earnings Call. I'm joined this afternoon by Brad Hale, our Chief Financial Officer, Kris Wiebeck, our Chief Strategy Officer, and Bonnie Bishop, Executive Director of Investor Relations.

BRP had an excellent second quarter with broad-based strength on both the top and bottom lines across our segments. The power of our colleague and client franchise continues to show through in our results with organic revenue growth of 22% on the back of a difficult prior year of 24%, driving Adjusted EBITDA growth of 45% to $61.6 million, and representing a year-over-year margin increase of approximately 240 basis points to 21%.

Total revenue grew 28% and adjusted earnings per share of $0.27 was up 17% in the face of an approximate $13 million or 101% year-over-year increase in our cash interest expense in the quarter.

Insurance Advisory Solutions achieved strong organic growth of 15%, continuing to benefit from outsized new business wins and rate and exposure tailwinds in certain areas. New business revenue wins increased 28% and net new business revenue wins increased 50% for the quarter compared to the prior year.

In June and July, we officially launched and announced three new centers of excellence in private equity, venture capital and government contracting. These centers of excellence are built around insurance experts with deep experience in their field. Their talent and expertise can be tapped across the entire BRP platform to provide specialized and differentiated solutions to our clients. We expect specialization to be a key and growing component to our sustained organic growth.

Underwriting capacity and Technology Solutions grew 36% organically with the MGA of the Future platform again performing exceptionally well, up 45%, with broad-based strength across the business and building underlying momentum that should accrue to continued outperformance on a go-forward basis.

And renters growth was robust. We had our largest day ever for new business policies in June, which was already surpassed again in July. And our pipeline of new distribution partners remains incredibly strong.

In homeowners, our builder program with QBE continues to outpace expectations and the non-builder portfolio had its largest quarter ever with net written premium up 40% versus the first quarter and over 5X what we generated in the second quarter of 2022.

Our commercial umbrella business also saw strong growth in the quarter as it continues to benefit from strong new business, renewal and rate trends.

On the new product front, we successfully secured capacity for a new high net worth focused homeowners program which launched last week. And we also anticipate launching a new commercial habitational property product by the end of the third quarter.

Mainstreet Insurance Solutions delivered organic growth of 20%, driven by continued strong performance at Westwood, our personal insurance platform embedded with many of the top homebuilders in the U.S., which has grown revenue rapidly since joining BRP last April on the back of durable new business trends, higher attachment rates to new homes sold, and favorable rate dynamics.

Overall, our business continues to perform exceptionally well with broad-based top line strength and growing margin accretion trends that should accelerate in the coming quarters as we fully lap the previously concluded three-year talent and technology reinvestment cycle.

I'd like to spend a minute focusing specifically on our investments in talent. We more than doubled our number of colleagues in 2021 and 2022, adding approximately 1,000 net new colleagues per year. By the end of the third quarter of this year we will have largely absorbed the incremental run rate payroll expense from last year's hiring growth, and as these newer colleagues are ramping on our platform, their contributions are now beginning to show up in new business wins.

We have now settled into a more normalized hiring pattern, as evidenced by our hiring through July, adding fewer than 100 net new colleagues year-to-date compared to more than 600 net new colleagues in the prior-year period.

We expect our normalized hiring pace, growing contributions from colleagues onboarded in the past two years, and the completion of our three-year cycle of infrastructure investments will deliver significant operating leverage and greater scalability for our platform, and will begin to contribute materially to accelerating margin accretion over the next two quarters and into the first half of 2024.

Lastly, I am pleased to welcome Sathish Muthukrishnan to our Board of Directors. His extensive experience in digital and technology transformation at Ally Financial where he serves as Chief Information, Data and Digital Officer, will add tremendous value to BRP. Sathish chairs our newly created Technology and Cyber Risk Committee.

I also want to thank Phil Casey, who recently retired from the Board, for his contributions to BRP as a Board member and as Audit Committee Chair since our IPO. We are grateful for Phil's guidance, counsel and dedication to BRP Group and our shareholders.

I am incredibly proud of the continued strength of results our colleagues have delivered for our stakeholders. The grit and perseverance our colleagues exhibit day in and day out has enabled outstanding results for clients during a time of real challenge in pockets of the insurance marketplace. I want to thank our clients for their continued trust and confidence. The rate at which our clients continue to honor us with their renewals and the rate at which new clients choose to hire BRP over our competitors is the number one indication that the talent, technology and platform we have invested in building over the past few years is enabling sustained outlier results.

With that, I will turn it over to Brad who will detail our financial results.

Brad Hale

Thanks, Trevor, and good afternoon everyone.

For the second quarter, we generated revenue growth of 28% to $297 million. As Trevor mentioned, we generated organic growth in the quarter of 22% with all three reporting segments generating organic growth of 15% or higher in the quarter.

In Q2, we paid down our revolver by $15 million as we continue to generate cash flow from operations and manage working capital to combat rising interest rates. We made more progress in de-levering the business and still expect that organic growth and free cash flow generation will reduce our net leverage to approximately 4.5 times by year-end 2023, within our stated long-term target range.

We recorded a GAAP net loss for the second quarter of $43.7 million, or $0.40 per fully diluted share.

Adjusted net income for the second quarter of 2023, which excludes share-based compensation, amortization and other one-time expenses, was $32 million or $0.27 per fully diluted share. A table reconciling GAAP net loss to adjusted net income can be found in our earnings release and our 10-Q filed with the SEC.

Adjusted EBITDA for the second quarter rose 45% to $61.6 million compared to $42.5 million in the prior year period. Adjusted EBITDA margin was 21% for the quarter compared to 18% in the prior year period. This margin expansion can be attributed to our organic growth offset by absorbing the rollover impact of 2022 new hires. We made significant investments in 2022 that we are now one quarter away from largely absorbing. Therefore, our continued organic growth will be more accretive to margin in the back half of 2023 and into 2024.

For the full year 2023 we now expect organic growth in the high teens based on the performance we are seeing across our business year-to-date, which includes an expectation for mid-teens organic growth in Q3. Additionally, we now expect full year revenue of $1.18 billion to $1.2 billion, higher than the range of $1.16 billion to $1.19 billion we stated on the first quarter call. Finally, we are reaffirming our Adjusted EBITDA expectation to between $255 million to $265 million, and for the third quarter of 2023 we expect Adjusted EBITDA to be between $62 million to $66 million and adjusted EPS of $0.27 to $0.29 per share.

We will now take questions. Operator?

Operator

Thank you. (Operator Instructions)

Our first question is from Elyse Greenspan with Wells Fargo. Please proceed.

Elyse Greenspan

Hi. Thanks. My first question, you guys didn't raise the EBITDA target for the year, but you do expect revenue to be higher. I know from the prepared comments a couple of times you mentioned tailwinds to margins in the back half of the year, so I guess why wouldn't that EBITDA target be higher if revenue is higher and if there is tailwinds to your margins from employees that you're hiring being closer to full potential?

Brad Hale

Hey Elyse, it's Brad. We're really pleased with the margin expansion we saw in Q2 of 240 basis points. If you look through the guidance we gave for Q3, at a minimum we're expecting 400 basis points of margin expansion in Q3, so we really are living that story that we portrayed in Q1 where we're lapping the significant investments we made in 2022 and are really starting to see margin expansion in the business as we find operating leverage across really the service and admin burden in comp.

We did raise the revenue guidance based on performance year-to-date. We continue to see strong organic trends in the business that make us confident we can hit that guidance. And in terms of the full-year EBITDA, I think we've got a certain amount of conservatism in that number which we always portray, but if we can hit those results it's going to show meaningful organic growth for the year and it's going to show meaningful margin expansion going into 2024 where we anticipate we can get even further margin expansion.

Elyse Greenspan

Maybe building on that, right, you guys did say that you expect the operating leverage from the hires to benefit your margin over the next two quarters and into the first half of next year. Do you have a view of your margin profile for the next 12 months? So the next four quarters? Once we get through Q2 of '24, where do you think the margin of BRP could be once we reflect all the upcoming tailwinds?

Trevor Baldwin

Hey Elyse, this is Trevor. We're not going to get into projecting margin for '24 yet. We'll start providing guidance at the normal time period there.

What I would tell you is what I've said in the past is the mature margin profile of this business is in excess of 30% and we believe based on the amount of kind of technology and automation, particularly in our MGA, the mature margin profile is meaningfully higher than our peers.

We have been pulling pretty hard on the margin lever over the past six months or so and you're going to begin seeing that really flow through in the back half of the year and the first half of '24, but that by no means means that that margin accretion story will be done then. We're also continuing to focus on thoughtfully investing in talent in the business in a more kind of normal course way to ensure that we sustain the outlier organic growth results that you've grown accustomed to seeing from our business.

Elyse Greenspan

Then one last one, right? You guys said you'll be at that leverage target at the end of this year. Should we think about—then you'll obviously have some more capital flexibility. Should we think about a return to M&A activity in '24 and just overall like an update on M&A would be great. Thank you.

Trevor Baldwin

Yes. So we continue to kind of remain active and opportunistic around our pipeline of opportunities and keep that live. Our priority remains de-levering the business down below our long-term range of 4.5 turns, and we've got earnout liabilities that will be funded through free cash flow over the course of the next 18 months. At that point the business is going to be in a very different position from a financial flexibility perspective. We'll likely have de-levered materially, absent any further M&A, materially below kind of our target range of, call it 3 to 4.5 turns of leverage.

I would us to begin thinking about being more intentional around M&A towards the end of 2024 and certainly into 2025, but that is going to be very situational depending on the environment we find ourselves in, the quality of opportunities and deal flow that we're seeing, and the value that those opportunities present for the business based on where deals are trading.

Brad Hale

Just to add to that, Elyse, we are on the leverage trajectory that we projected. We are at 5.19 times, down from approximately 5.5 in Q1. Based on the guidance I provided for Q3, I believe we'll be in the 4.7 times range as of the end of Q3 with a path to being at 4.5 by Q4 like we've communicated previously.

So, we're meeting those targets as the year progress. As Trevor mentioned, we have got earnout liabilities we've got to address over the next 18 months, but certainly in terms of getting to the leverage profile that we've talked about to the market, we're on track to get there.

Elyse Greenspan

Thank you.

Operator

Our next question is from Meyer Shields with KBW. Please proceed.

Meyer Shields

Thanks. I've got a couple of questions about some expenses that are adjusted out in calculating EBITDA, I guess because we saw an uptick in severance expense and transactional related partnership. I guess I was a little surprised, at least on the latter one, because you haven't been doing M&A recently. I was hoping you could walk us through what's going on there.

Brad Hale

Yes. This is Brad. We did have a severance line item this quarter. We took action primarily in our back office administrative function where we were post a lot of the integration work we'd been working on in the IAS business and we looked at those colleague bases, primarily in accounting and finance and HR, and, you know, had some excess resources that post integration really weren't necessary as we had migrated to a single agency management system.

To Trevor's point previously, we've redeployed some of that capital into customer-facing roles as we continue to be aggressive about organic growth and funding that for the future, but we did take an opportunity to have a reduction in force there amongst some of our back office colleagues.

In terms of the transaction-related, we have continued to experience integration-related costs, primarily in the MGA side of the business and particularly with Westwood. As you know, Westwood was a carveout of a public company. We anticipated that that integration would be expensive. It has been even more expensive than we anticipated, albeit 100% worth it given the fantastic performance that we continue to see in the Westwood business.

I'd say the positive side, Meyer, is that by the midpoint of next year we believe we'll be largely through those integration expenses associated with Westwood and the TSA, but it has been more expensive than we anticipated throughout the integration period.

Meyer Shields

Okay, that's very helpful. Thank you so much.

Operator

(Operator Instructions)

Our next question is from Pablo Singzon with JPMorgan. Please proceed.

Pablo Singzon

Hi. Good afternoon. Can you please remind us of the earnouts you expect to pay out in cash this year?

Brad Hale

Did you say this year, Pablo? I'm sorry. You broke up.

Pablo Singzon

Yes. This year.

Brad Hale

In year it's about $35 million to $40 million in anticipated earnout payments and there's about another $75 million to $80 million that we anticipate paying in Q1 of '24.

Pablo Singzon

Okay. I think—year-to-date my numbers might be off here—but I'm looking at about $14 million of payouts, right? So you're basically implying a pick-up in the second half of the year in terms of payouts?

Brad Hale

Yes, that's correct.

Pablo Singzon

Okay. Then a question around the same lines of I guess the severance and the expense. I think, Brad, there's this line Other and I think (inaudible) expense. Do you expect more—and I think year-to-date it's running at about, call it $14 million. Do you expect that to be mostly done by the end of this year, or do you think that should also veer into '24?

Brad Hale

Yes, I expect that to be mostly done by the end of this year. Again, that's some outside temporary help and folks that are largely focused on integration as well. But as we come on the back of a lot of the MGA related integration and Westwood integration we're doing, I do expect that line to decrease substantially going into '24.

Pablo Singzon

All right. Thank you.

Operator

(Operator Instructions)

There are no more questions at this time. I would like to turn the call back over to Trevor Baldwin for closing remarks.

Trevor Baldwin

I want to thank you all for joining us on the call this evening. In closing, I wanted to thank our 4,000 colleagues for their grit and dedication to delivering for our stakeholders. I also want to thank our clients for their continued trust and confidence.

Thank you all very much and we look forward to speaking with you next quarter. Good evening.

Operator

Thank you. This will conclude today's teleconference. You may disconnect your lines at this time, and thank you for your participation.