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BRP Group, Inc.

First Quarter 2022 Earnings Conference Call

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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

Meyer Shields, *KBW*

Elyse Greenspan, *Wells Fargo*

Adam Klauber, *William Blair*

Pablo Singzon, *JPMorgan*

Josh Shanker, *Bank of America Merrill Lynch*

Weston Bloomer, *UBS*

PRESENTATION

Operator

Greetings, and welcome to the BRP Group, Inc. First Quarter 2023 Earnings Call.

At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Bonnie Bishop, Executive Director, Investor Relations. Please go ahead, ma'am.

Bonnie Bishop

Thank you, Operator.

Welcome to the BRP Group's First Quarter 2023 Earnings Call. Today's call is being recorded.

First 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.

Also, I would like to remind everyone that, effective January 1, 2023, and as reflected in our reporting for the quarter, BRP now operates with three segments, versus the four we have reported on historically, as our legacy Medicare segment was merged into Mainstreet Insurance Solutions. Additionally, our legacy Middle Market segment has been rebranded to Insurance Advisory Solutions, and our legacy Specialty segment has been rebranded to Underwriting, Capacity & Technology Solutions.

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

Trevor Baldwin

Thanks, Bonnie.

Good afternoon, everyone, and thank you for joining our First Quarter Earnings Call.

I will start with a few remarks, followed by Brad, who will address select financial and business highlights from the quarter. Then, Brad, Kris and I will answer questions.

We had a strong start to the year, highlighted by organic growth of 23%, building on 16% organic growth in the first quarter of 2022, and representing the highest first quarter organic growth since our IPO, driven by outstanding performance across our business. We achieved total revenue growth of 36% year-over-year, showcasing the continued strong client demand for our advice and solutions across the platform. Adjusted EBITDA was $79 million, in line with our expectations.

Insurance Advisory Solutions, formerly Middle Market, had strong organic growth of 14%, benefiting from robust new business and rate and exposure lift that exceeded expectations. Underwriting, Capacity & Technology Solutions, formerly our Specialty segment, grew 56%, and our MGA of the Future platform again performed exceptionally well. Standouts included outstanding growth in our multifamily product suite, continued acceleration in the buildout of our homeowners business, and outsized growth from our habitational-focused commercial umbrella program that joined MSI via our 2021 partnership with JGS, that now fully flows through organic growth. In Mainstreet Insurance Solutions, we saw organic growth of 20% in the first quarter.

Additionally, Westwood, which joined in May of 2022, as the largest acquisition in the history of BRP, continues to perform exceptionally well, despite headwinds in the U.S. residential real estate market. Through the end of April, which represents their first full year with BRP, Westwood generated approximately $112 million of annualized gross revenue, up 36% from the $82 million run rate that we underwrote at the time of the closing last year. Year one of the Westwood partnership has been a significant success, and is a testament to the strength of the franchise Alan and his team have built. We believe the Westwood team has a very bright future ahead.

Over the past three years, we've invested heavily in building capabilities that will power long-term organic growth and free cash flow generation. These investments included the addition of many talented colleagues and a significant technology buildout to position us for a more digital and tech-enabled future. To frame the significance of the scale of these investments, we more than doubled the size of our colleague base over the past two years, adding approximately 1,000 net new colleagues per year.

As I shared during our call in February, we have concluded this major reinvestment cycle in our business and shortly will have fully absorbed the run rate payroll from prior year headcount growth. While we are just beginning to see the benefits of these investments in our organic growth, we expect to begin seeing these investments earning-into our margin and earnings profile this year, and believe that the structural advantages these investments have enabled will yield sustainable revenue growth and operational efficiency over the long term.

To give you a sense for the more normalized rate of growth in headcount necessary to sustain our top line growth momentum, through the first four months of 2023, we added a net total of approximately 40 new colleagues, which represents a rate that we believe is sufficient to support our current top line growth trajectory for the next 18 to 24 months.

Additionally, we continue to remain opportunistic with respect to the M&A marketplace, but reaffirm that we do not currently expect to execute any material partnerships in 2023, as we remain committed to deleveraging and continue to expect the market to soften over the balance of 2023, a trend we are starting to see. Price transparency takes time, and it is our current belief that if we are patient, we will see a better environment into which we can put shareholder capital to work.

In summary, we once again delivered high organic growth, a direct result of the value our colleagues continue to deliver to clients day-in and day-out. Despite stress in certain areas of the insurance marketplace, our diversified and resilient business model continues to allow us to execute for all our stakeholders. I'd like to thank our clients for their trust and confidence, and our colleagues for tirelessly driving the positive client outcomes that result in our strong performance.

With that, Brad will detail our financial results.

Brad Hale

Thanks, Trevor, and good afternoon, everyone.

For the first quarter, we generated revenue growth of 36% to $330 million. We generated organic growth in the first quarter of 23%, with all three reporting segments generating double-digit organic growth in the quarter. In Q1, we paid down the revolver by $20 million. Looking through the balance of the year, we expect the combination of our organic growth and continued free cash flow generation will reduce leverage to 4.5 times, or less, back within our stated long-term range.

We recorded a GAAP net loss for the first quarter of $25.9 million, or $0.24 per fully diluted share. Adjusted net income for the first quarter of 2023, which excludes share-based compensation, amortization and other one-time expenses, was $49.2 million, or $0.42 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 first quarter rose 8% to $79 million, compared to $73 million in the prior year period. Adjusted EBITDA margin was 24% for the quarter, compared to 30% in the prior year period. This margin decline was due to the change of seasonality in our business and recognizing a significant proportion of the approximately $46 million of incremental annualized payroll expense from prior year headcount growth that had not yet been fully absorbed. The changes in seasonality are primarily due to the Westwood partnership, as well as large partnerships closed in the fourth quarter of 2021, that have resulted in Adjusted EBITDA margin that is now approximately six points lower in Q1, and which we expect to be higher for the remaining quarters, resulting in full year margin expansion.

For the full year 2023, we now expect organic growth in the mid-teens, higher than our previous guidance of the high-end of 10% to15%, and which, based on the performance we are seeing across our business year to date, includes an expectation for mid-teens organic growth in Q2. Additionally, we now expect full year revenue of $1.16 billion to $1.19 billion, higher than the previously stated range of $1.14 billion to $1.17 billion, and we are raising our Adjusted EBITDA expectation to $255 million to $265 million, up from $250 million to $260 million, stated previously. For the second quarter of 2023, we expect Adjusted EBITDA to be between $55 million to $60 million and Adjusted EPS of $0.27 to $0.29 per share.

These expectations reflect strong growth despite our anticipation of a continued challenging macro backdrop, which includes the potential for ongoing dislocation in the banking system and potential for pullback in credit from impacted institutions, as well as higher interest rates relative to recent years. Despite these headwinds, we delivered record first quarter 2023 results, which reinforce our confidence that the investments of the last few years will drive operating leverage, revenue growth and durable cash flow for years to come.

We will now take questions. Operator?

Operator

Thank you, sir. We will now be conducting a question-and-answer session. (Operator Instructions) One moment, please, while we poll for questions.

The first question we have is from Meyer Shields from KBW. Please go ahead.

Meyer Shields

Great, thank you. Trevor, if I could start, you talked about expectations of continued softening, and I was hoping you could flesh that out a little bit. Because, while some of that seems to be manifesting in, let's say, D&O, there are also sort of widespread expectations of a reaccelerating hard market in property. I was hoping you could break down what you're seeing right now in that context.

Trevor Baldwin

Hey, Meyer, good evening. The softening was a comment specific to pricing in the M&A marketplace relative to valuation, and so what I would say about that is that, while headline multiples being paid have not really come down meaningfully, what we have seen is that pro forma EBITDA margin that deals are transacting off of has compressed approximately 300 basis points, based on the data that we've seen. So, while not a headline multiple compression, it does—that is a reduction in price.

I think, to your point on insurance pricing, I'd say there's some limited pockets of softening a la public D&O, workers compensation, but, broadly speaking, I'd say the property insurance marketplace is the most challenging our professionals have seen in their career, and insurance lines, generally speaking, are all seeing positive pricing pressure.

Meyer Shields

Okay. I probably misunderstood what you had said, and thanks for the clarification. On that last note, though, I was hoping you could talk a little bit about the potential for market share gains because of the complexity of the property market. I get that concept a lot and I was hoping that you could talk about what's actually going on in the marketplace.

Trevor Baldwin

Yes, no, it's a great question, Meyer, and this is exactly the type of market that we really do exceptionally well in. Complexity and challenges in the market, they lend themselves to the benefit of larger, more sophisticated platforms, and so the depth and breadth of our talent, the sophistication of the tools and resources that we can bring to bear on behalf of our clients, they make a bigger difference today than they would in a more benign market, and that's showing through in our results; I mean, obviously, the headline OG at 23%, you know, up meaningfully year-over-year from the prior quarter, but as I break down the underlying components of that organic growth, it becomes an even better story.

As we've talked about in the past, we really view there to be kind of four drivers for organic growth, and, from my perspective, the first, and the most important, is new business, how many new clients did you win, what's the market share you're taking, and when you look at the building blocks of our organic growth of 23.4%, 21.4% of that 23% came from winning new clients. So, the vast majority of our organic growth is being driven by net new client logos, and that's up from 16.4% in the prior year period.

Other than that, the persistency continues to be strong and in line with year-over-year. The impact from growth in contingence is relatively nominal, and the impact from rate and exposure was plus 4.1%, up nominally from 4.0% in the prior year period.

So, I think it's a good story and speaks to, you know, this is the type of market where we can really take share.

Meyer Shields

All right, that was phenomenal. Thank you so much.

Trevor Baldwin

Thanks, Meyer.

Operator

The next question we have is from Elyse Greenspan from Wells Fargo. Please go ahead.

Elyse Greenspan

Thanks. Good afternoon. My first question. Trevor, you mentioned you guys hired 40 new colleagues to support your growth over the next 18 to 24 months. Does that mean that you don't expect incremental hiring from here, because you kind of—was the comment meant to imply that you've frontloaded the hiring, given the growth that you see in front of you?

Trevor Baldwin

So, let me parse through that, Elyse. What I shared is through April, we've hired net 40 colleagues into the business, and that is a good run rate expectation of the ongoing hiring need of the business in order to support the continued high level of organic growth. The contrast is we're not hiring the net 1,000-plus colleagues a year that we have been for the past two-and-a-half years. As you know, we went through a three-year period of a significant reinvestment program into talent and technology, building the platform for the future, and so our platform is built, our infrastructure is ready. We've been building the solutions, the product sets, the capabilities, and the intelligent automations kind of throughout our go-to-market and business processes, and we're ready to scale effectively and efficiently from here.

Elyse Greenspan

That's helpful. Then, you guys gave this mid-teens organic growth guidance for the second quarter. Can you give us a sense of what's embedded within that guide for your three segments?

Trevor Baldwin

Yes, I mean, we're not going to—we don't provide guidance at the segment level, Elyse, but what I would tell is that what's implicit in that guide is continued high-level performance across all three of segments. Baked into that guide is the expectation of the continued challenging macro backdrop. I think everybody's aware of the dynamics relative to the banking industry, credit capacity drying up, interest rates having moved 500 basis points over the course of the past year, and there's known impacts and there's some unknown impacts. Largely, our clients are still performing well. There's pockets of softness in a couple of industry sectors, but all that's built into the expectations we've set for the balance of the year. I think that just speaks to the kind of remarkable resiliency of this industry, and then, more specifically, how well positioned our platform is to take share and continue to add value for our clients.

Elyse Greenspan

You guys mentioned you paid down the revolver by $20 million in the quarter. I think you guys, Brad usually will give us a sense of where interest expense should trend at current rates. Do you have a sense? Do you want to just kind of set expectations there?

Brad Hale

Yes. So, there's been, obviously, a slight tick-up in the rate environment since our last call, so now we would project net cash interest expense of approximately $105 million to $110 million at the current base rate.

Elyse Greenspan

Thank you.

Operator

Thank you. (Operator Instructions)

The next question we have is from Adam Klauber from William Blair. Please go ahead.

Adam Klauber

Thanks. I'm sorry if you mentioned it earlier, but could you discuss how Westwood is going, given—you know, it seems like housing, new housing is coming back. I guess, if you could give us some indication, if you haven't. Sorry if I missed it.

Trevor Baldwin

Yes, no, Adam, happy to. As I mentioned earlier in the call, through April, Westwood generated approximately $112 million of gross revenue, up about 37% from what we underwrote when we closed on that transaction a year ago, so nothing—I mean, just absolutely exceptional performance from Alan and the team there.

More specifically, to how is that business performing today and how do we expect to continue to perform over the balance of the year, the short answer is we feel really good about how we're positioned and their ability to continue to deliver double-digit growth for the balance of the year.

As we look at kind of the dynamics in play there, while new home closings are down slightly, our new policies sold is up mid-single-digits, largely as a result of an increase in our attachment rate to the new homes that are being sold by our builder partners, as well as new business premium, which is up mid-single-digits, for that same reason, as well as rate that's been taken in the book. So, we feel well positioned. Based on what we're seeing from a lead flow standpoint, we would expect the business to continue to perform very strong through the balance of the year. I think, again, it just speaks to the resilience of our industry, the Westwood platform, more specifically, and the value they're able to add at point of transaction, which is represented in the increased attachment rates we're seeing to those new homes sold.

Adam Klauber

You mentioned rate, obviously, rates are up in homeowners, and I think you mentioned—is there a nice tailwind on the renewal book and, even just a ballpark, how much is that, you know, is it that helping on the increased premium rates on the renewal book?

Trevor Baldwin

Yes, there's no doubt it's helping, Adam. We're seeing policy level persistency in the mid- to high-80s, and then we're seeing kind of a low-teens rate impact on the book, and when you put that in a blender, premium retention on our renewal book hovering around 100%.

Adam Klauber

Great, that's a great sign. Switching over the margin for a second, and I know there's a lot of seasonal variations, so it's a little—we would expect some back and forth. Is there any way you can give us direction on which quarters we can expect to be stronger over the next couple of quarters from a margin standpoint?

Brad Hale

Yes, Adam, it's Brad. We'll continue to give a total EBITDA guide in each of the subsequent quarters, similar to what we did on this call. I would just say, largely, we do expect margin expansion on the full year and to sort of cover up the degradation we saw because of the seasonality in Q1.

Adam Klauber

Okay, okay. Sorry, this is a real, I guess, small question, but in net income and EBITDA, you had other add-back of $12 million of other, and last quarter, it was $14 million. What sort of items are going in there?

Brad Hale

Are you referencing the combination of translation-related in other, Adam?

Adam Klauber

It's the item that's swelled by $12.3 million this quarter.

Brad Hale

I have other add-back and Adjusted EBITDA at $7.3 million.

Adam Klauber

On EBITDA, yes, I think I've got—yes, I think that's the same one. Yes, it's similar, it's the same (inaudible).

Brad Hale

Yes, what's captured there is one-time costs. We continue to work on advanced data strategy, we've got some outside temporary help in there, as well as some recruiting fees on some significant hires we made throughout Q1, as well as some one-time legal fees and other one-time costs.

Adam Klauber

Okay, that's helpful. Then, as far as cash and cash equivalents, the first quarter in the industry, it's always a more challenging quarter for cash flow, so that makes sense. I guess, two related questions. Do you think cash flow is going to start turning positive the next couple of quarters—well, maybe just start with that one and then I'll ask the next one.

Brad Hale

Yes, Adam, I just wanted to direct you to Page 3 of our supplement and walk through the free cash flow calculation a little bit. Yes, as you mentioned, the first quarter's always a little challenging. We've got bonus payouts from prior year. In addition, we recognize large AR for our employee benefits renewals that occur in Q1, but the associated AP doesn't show up, because a lot of times those are directly billed by the carriers, so you do get a bit of a timing impact to Q1, and, as you said, you see that across our competitors. If you look—and that's one of the reasons we calculate adjusted free cash flow, and you can see the adjusted is down about 17% year-over-year. That's really entirely interest-driven, and you can see we added a calculation this quarter just to show the impact of cash interest on our business. You can see, if you back that out, we're actually up about 17%. So, we are, from a business standpoint, seeing expanded cash flow, but, as I mentioned, there are some timing differences there in Q1.

Adam Klauber

Again, not looking for exact guidance, but should that begin turning around the second or third quarter, do you think?

Brad Hale

We do expect, for the full year, to be generating, as we said previously, between $100 million and $120 million of free operating cash flow.

Adam Klauber

Okay, okay, and the next question is related, but the first quarter is weak, so it always looks a little more disproportionate, but cash and cash equivalents, if I'm right, are around $81 million. What's the minimum that you like to operate with, as far as cash and cash equivalents?

Brad Hale

Our minimum would be about $60 million, that we could operate with comfortably.

Adam Klauber

Okay, okay, and I'm not putting—well, I'll just ask, but I'm assuming—well, I'll ask, are you expecting that to come up as cash flow turns positive, or are you looking at outside sources?

Brad Hale

No, I mean, we'll manage working capital and utilize that free cash flow, to the extent we can, to pay down the revolver and reduce our interest expense, and be opportunistic about that.

Adam Klauber

Okay.

Trevor Baldwin

Yes, Adam, this is Trevor. I think the point to take there is we can run super-efficiently from a working capital standpoint, and so our intent is to continue to sweep excess free cash flow under the revolver to reduce outstanding debt, and we can come in and out of that working capital line, as needed.

Adam Klauber

Sure. Okay, that's super-helpful. Thanks, guys.

Trevor Baldwin

Thanks, Adam.

Operator

The next question we have is from Pablo Singzon from JPMorgan. Please go ahead.

Pablo Singzon

Hi, thanks. The first question's for Trevor. I just wanted to follow up on your comment about hiring. I was hoping you could flesh out the leverage implicit in the business model today, I presume compensation doesn't track revenue growth one-for-one, and I was hoping you could provide more context on that point. I guess, more broadly, do you expect leverage in the comp line, as well as in the OpEx? Thanks.

Trevor Baldwin

Yes, the short answer, Pablo, is we do expect leverage in both the comp and OpEx line. As we've talked about, we're kind of at the conclusion of a three-year reinvestment cycle, that was significant, as we built out the talent base and the technology infrastructure to propel us forward in our vision of delivering durable, double-digit organic growth and significant free cash flow and earnings leverage. We are in the beginning, early days of kind of earning-in that significant reinvestment, which we'll earn-in over approximately three years, and we expect to see meaningful margin accretion and productivity enhancement as we continue to grow the business onto that platform that we've built.

Pablo Singzon

Okay, and then the second question is for Brad, just to follow up on Adam's question about, I guess, other expenses. Other expenses and M&A expenses or integration expenses, should we assume that persists through 2023, and if you have a view on how much those expenses would be?

Brad Hale

If you look, we are meaningfully down from Q4, but the Q1 amount, I think, is a good expectation of the run rate for 2023, in terms of integration and other one-time expenses.

Pablo Singzon

Okay, and then the last one …

Trevor Baldwin

Pablo, we would expect it to come pretty meaningfully next year. That's largely tied to the transition of Westwood, added to the platform.

Pablo Singzon

Yes, understood, and then the last question for me, I guess, for Brad. How much cash earn-outs do you expect to pay out in 2023? Thank you.

Brad Hale

The pure cash earn-out that we'd expect to pay in 2023 would be somewhere between $45 million and $50 million.

Pablo Singzon

Got it. Thank you.

Trevor Baldwin

Thanks, Pablo.

Operator

Thank you. (Operator Instructions)

The next question we have is from Josh Shanker from Bank of America. Please go ahead.

Josh Shanker

Yes, thank you. I'm going to try Adam's questions again. You guys have better information than I do. Is the seasonality playing out the exact way you thought it would, in terms of adjusted operating margins at the beginning of the year? I got it wrong, but you guys probably got it right. Is everything going according to plan?

Brad Hale

Yes, it is.

Josh Shanker

So, we can look at the 1Q '23 seasonality and move that forward to 1Q '24, as we think about how it's going to—it's role in the playout of how you earn the expenses and the revenues?

Brad Hale

Yes.

Josh Shanker

The lightness of the margin in 1Q, is that because expenses are heavy at Westwood or expenses are heavy and revenues are lighter than the rest of the year?

Trevor Baldwin

It is both.

Josh Shanker

It's both, okay. I guess, as we think forward, which quarter do you expect to have the highest, I guess, adjusted margins in the year?

Trevor Baldwin

Josh, we're not going to provide quarter-by-quarter guidance yet. As Brad shared, we'll continue to share an EBITDA and growth expectation for the following quarter on each call.

Josh Shanker

Okay. I tried my best. Thank you.

Operator

Thank you. The last question we have is from Weston Bloomer from UBS. Please go ahead.

Weston Bloomer

Hi, thank you. I was hoping you could expand on the growth that you saw in Specialty this quarter. I'm not sure if you're giving organic specifically for MGA or other lines, but maybe could you break out how much of the business is currently renters today versus from other lines of business. I think at your Investor Day, you said the umbrella and residential was around $300 million in premium. Any updates there would be great. Thank you.

Trevor Baldwin

Yes, hey, Weston. What I would tell you is renters certainly represents a minority of the premium in revenue that we're generating in the MGA, and while it's still continuing to grow exceptionally well, the good news is some of the recent products we've brought online are growing even faster, which is really proving out our strategy of building that conveyor belt of new products that we can be launching each and every year to continue to drive a growth factory as we build more and more proprietary products. So, I would expect renters to continue to become a smaller proportion of the overall premium we place and the revenue we generate, but continue to be a meaningful and important source of growth and value in the MGA overall.

Weston Bloomer

Great, and then on your comment that 21% of the organic was from winning new clients, is that pretty broad-based by segment or is it specialized in one segment, or any geographic focus?

Trevor Baldwin

No, that's pretty broad-based. If you look at kind of new business and its contribution to OG as a relative kind of proportion, that's fairly consistent across the segments. That's really the story of how we drive the outsized organic growth we do, is we take market share and we win more new business than our peers do.

Weston Bloomer

Got it. I know Medicare is within the broader Mainstreet segment now, but with 1Q being kind of the active enrolment season, can you just give an update on the success of that business?

Trevor Baldwin

Yes, they had a good, real solid annual enrolment period, and we continue to expect strong results out of that part of the Mainstreet Solutions segment.

Weston Bloomer

Great, thank you.

Operator

Thank you, sir. There are no further questions at this time. I would now like to turn the floor back over to Trevor Baldwin for closing comments. Please go ahead, sir.

Trevor Baldwin

I'd like to thank everyone for joining us on the call this evening. I want to thank our 4,000 colleagues for their commitment, their hard work and dedication to Baldwin Risk Partners. I look forward to speaking with all of you next quarter.

Operator

Thank you, sir. Ladies and gentlemen, that does concludes today's conference. Thank you for joining us. You may now disconnect your lines.