

Arthur J. Gallagher(AJG)

\$77.51 (As of 05/01/20)

Price Target (6-12 Months): **\$84.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/11/19)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: C

Summary

Arthur J. Gallagher' first-quarter bottom line beat estimates, benefiting from higher adjusted revenues across Brokerage and Risk Management segments. It should continue to benefit from solid organic growth, sturdy performance across all segments and strong margin expansion. Its focus on tapping opportunities across the globe bodes well for growth. Its inorganic growth story seems impressive with strategic buyouts. The company's solid performance is driving cash flow and helping it to deploy capital in shareholder-friendly moves. Shares have underperformed its industry year to date. However, escalating expenses due to higher operational and compensation expenses weigh on its margin expansion. Also, high debt level increases interest expenses. Its interest coverage ratio also compares unfavorably with the industry average

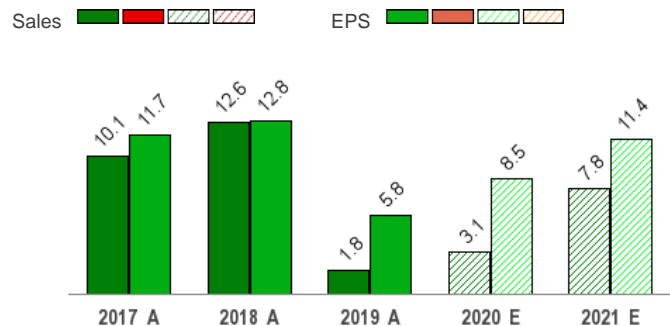
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$109.46 - \$65.09
20 Day Average Volume (sh)	1,394,453
Market Cap	\$14.7 B
YTD Price Change	-18.6%
Beta	0.69
Dividend / Div Yld	\$1.80 / 2.3%
Industry	Insurance - Brokerage
Zacks Industry Rank	Top 15% (37 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.2%
Last Sales Surprise	-11.7%
EPS F1 Est- 4 week change	-3.2%
Expected Report Date	NA
Earnings ESP	-6.1%
P/E TTM	20.1
P/E F1	19.6
PEG F1	2.0
P/S TTM	2.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,177 E	1,807 E	1,920 E	1,863 E	7,839 E
2020	1,829 A	1,642 E	1,781 E	1,698 E	7,272 E
2019	1,958 A	1,625 A	1,791 A	1,684 A	7,056 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.87 E	\$0.83 E	\$0.96 E	\$0.77 E	\$4.41 E
2020	\$1.83 A	\$0.70 E	\$0.83 E	\$0.63 E	\$3.96 E
2019	\$1.63 A	\$0.65 A	\$0.80 A	\$0.58 A	\$3.65 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/01/2020. The reports text is as of 05/04/2020.

Overview

Headquartered in Itasca, IL and founded in 1927, Arthur J. Gallagher & Co., together with its subsidiaries, provides insurance brokerage and consulting services and third-party claims settlement and administration services in the United States and internationally. While the company boasts world's largest property/casualty third-party claims administrator, it ranks world's fourth largest globally among insurance brokers based on revenues.

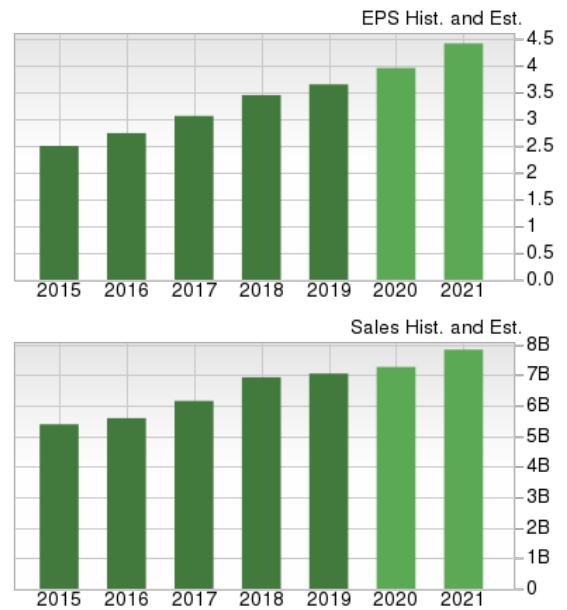
More than two-third of revenues comes from the combined brokerage and risk management segments domestically, with the remaining being generated internationally, primarily in Australia, Bermuda, Canada, the Caribbean, New Zealand and the United Kingdom. Substantially all the revenues of the corporate segment are generated in the United States.

Arthur J. Gallagher operates through three segments:

The Brokerage segment (61% of 2019 revenues) consists of retail and wholesale brokerage operations in a network of more than 550 sales and service offices located throughout the U.S. and in 29 other countries. The segment also offers client-service capabilities in approximately 140 countries. While retail brokerage operations negotiate and place property/casualty, employer-provided health and welfare insurance, and healthcare exchange retirement solutions for middle-market commercial, industrial, public entity, religious, and not-for-profit entities, the wholesale brokerage operations assist the company's brokers, and other unaffiliated brokers and agents in the placement of specialized and hard-to-place insurance programs.

The Risk Management segment (14%) provides contract claim settlement and administration services for enterprises that choose to self-insure some or all of their property/casualty coverage and for insurance companies that choose to outsource some or all of their property/casualty claims departments.

The Corporate segment (25%) reports the financial information related to our debt, clean energy investments, external acquisition-related expenses, other corporate costs and the impact of foreign currency translation. The revenues reported by this segment result almost solely from its consolidated clean energy investments.



Reasons To Buy:

- ▲ Shares of Arthur J. Gallagher have lost 16.6% wider than the industry's loss of 15.6% year to date. Nonetheless, the company's strong operational environment along with a favorable outlook for segment growth will further help the shares to increase.
- ▲ Arthur J. Gallagher boasts impressive growth, driven by organic sales, acquisitions and mergers. It completed and integrated 556 acquisitions from Jan 1, 2002 through Dec 31, 2019, most of which were within its brokerage segment. In the first quarter of 2020, the company completed eight mergers, representing about \$124.2 million of annualized revenues. The company's merger and acquisition pipeline is quite strong with about \$200 million of revenues, associated with about 30 term sheets either agreed upon or being prepared. Management believes that 2020 should be another strong year for tuck-in merger and acquisition strategy as it continues to attract entrepreneurial partners.
- ▲ The company's organic growth efforts have been driving revenues, which witnessed average revenue growth of 12% from 2016-2019. This rise has been achieved on the back of growing contribution from its Brokerage and Risk Management segments. The momentum continued through the first quarter of 2020, with the company registering organic growth of 3%. Management estimates Brokerage segment organic growth in 2020 to be 5% while the same for Risk Management is expected to be in the range of 5% to 7%. Increasing insurance rates and low unemployment should continue to provide organic growth tailwind. Also, the company expects premium rates to continue to rise, supporting growth momentum.
- ▲ Arthur J. Gallagher's revenues are geographically diversified with strong domestic and international operations with international operations contributing about one-third of revenues. The company expects international contribution to total revenue to increase, given the number and size of the non-U.S. acquisitions. Moreover, loss of clients or weakening of macro conditions in any particular country would not have any severe impact on the top line.
- ▲ Strong operational performance has been driving Arthur J. Gallagher's cash flows. This, in turn, has helped cash and cash equivalents to grow over time. The company targets about \$1.5 billion to \$1.6 billion of mergers and acquisitions with free cash and debt. A sturdy liquidity position supports Arthur J. Gallagher to pursue strategic initiatives as required.
- ▲ A strong capital and liquidity position enables Arthur J. Gallagher to enhance its shareholder value. In the first quarter of 2020, the dividend was increased by 4.7%, reflecting a three-year CAGR of 3.2%. Arthur J. Gallagher's dividend currently yields 2.3%, better than the industry average of 1.3%.

Arthur J. Gallagher remains focused on tapping opportunities in the U.K., Australia, New Zealand, Canada and the U.S.

Reasons To Sell:

- ▼ Arthur J. Gallagher has been experiencing an increase in expenses due to higher compensation and operating expenses. Escalating expenses have been weighing on margins. Operating margin contracted 92 bps in 2019. However, Arthur J. Gallagher expects to lower expense by \$50 million to \$75 million per quarter
- ▼ Debt level at Arthur J. Gallagher has been increasing over the years with deterioration in debt to capital ratio. High debt level has been inducing an increase in interest expenses. At the end of first quarter of 2020, debt increased 13.1% sequentially while debt to capital ratio deteriorated about 400 basis points. The ratio also compared unfavorably with industry average of 24.7%. Interest expense too increased 25.6% year over year in the first quarter of 2020. Nonetheless, the company has about \$1.1 billion of liquidity, with \$300 million in cash on hand and \$800 million on a revolving credit facility, expiring June 2024. For the next two years, Arthur J. Gallagher has \$175 million of debt maturities due
- ▼ Further, Arthur J. Gallagher seems overvalued when compared with the broader industry. Its forward 12-month price-to-earnings ratio of 18.6 is higher than the industry average of 16.6.

Escalating expenses due to higher compensation and operating expenses that are hurting margins, debt level leading to unfavorable leverage ratio, and unfavorable interest coverage ratio are concerns.

Last Earnings Report

Arthur J. Gallagher (AJG) Q1 Earnings Top, Revenues Fall Y/Y

Arthur J. Gallagher reported first-quarter 2020 adjusted net earnings of \$1.83 per share, which beat the Zacks Consensus Estimate by 5.2%. Moreover, the bottom line increased 12.3% on a year-over-year basis.

The company's performance was driven by higher adjusted revenues across Brokerage and Risk Management segments.

Quarter Ending 03/2020

Report Date	Apr 30, 2020
Sales Surprise	-11.67%
EPS Surprise	5.17%
Quarterly EPS	1.83
Annual EPS (TTM)	3.86

Operational Update

Total revenues were \$1.8 billion, down 2.9% year over year.

Arthur J. Gallagher's total expenses increased 9.5% year over year to \$1.5 billion in the reported quarter. Higher compensation, reimbursements, interest, and amortization costs resulted in this escalation.

Adjusted earnings before interest, tax, depreciation and amortization and change (EBITDAC) in estimated acquisition earnout payables increased 3.1% from the prior-year quarter.

Segmental Results

Brokerage: Revenues of \$1.4 billion increased 9.5% year over year on higher fees, and commission, supplemental and contingent revenues.

Expenses jumped 5.7% from the year-ago quarter.

Adjusted EBITDAC climbed 5.8% from the year-ago level to \$495.5 million and margin contracted 120 basis points (bps).

Risk Management: Revenues were up 5.5% year over year to \$211.8 million, mainly owing to higher fees.

Expenses rose 4.4% from the prior-year period to \$223.9 million.

Adjusted EBITDAC improved 2.9% year over year to \$35.3 million but margin contracted 10 bps.

Corporate: Total revenues of \$181.8 million were down 51.2% year over year due to lower revenues from consolidated clean coal facilities and lower royalty income from clean coal licenses.

EBITDAC was a negative \$23 million compared with a negative \$65.4 million in the year- ago quarter.

Financial Update

As of Mar 31, 2020, total assets were \$20.8 billion, up 6.1% from the 2019-end level.

At the end of the quarter, cash and cash equivalents of \$2633.2 million increased 0.4% from the 2019-end level.

As of Mar 31, 2020, shareholders' equity decreased 2.8% to \$5.1 billion from the level on Dec 31, 2018.

Dividend Update

The board of directors approved a quarterly cash dividend of 45 cents per share. The dividend will be paid out on Jun 19, 2020 to shareholders of record on Jun 5.

Acquisition Update

In the quarter, the company closed eight acquisitions with estimated annualized revenues of about \$124.2 million.

Recent News

Arthur J. Gallagher Strengthens Portfolio With MMT Buyout – Mar 16, 2020

Arthur J. Gallagher & Co. has closed the buyout of McConnell, Manit & Trout Insurance Services, LLC (MMT).

We believe MMT is a strategic fit for Arthur J. Gallagher. This is because the buyout will provide the acquirer significant growth opportunities and is likely to boost its expertise in several key industries.

Arthur J. Gallagher Acquires Insurance Broker CMS – Mar 2, 2020

Arthur J. Gallagher & Co. has acquired full-service wholesale insurance broker CMS, LLC.

The addition of CMS to Arthur J. Gallagher's portfolio will provide the acquirer solid market presence in construction and real estate.

Valuation

Arthur J. Gallagher shares are down nearly 16.6% in the year-to-date period and 4.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 15.7% and 24.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 2.4% and 19.5%, respectively.

The S&P 500 index is down nearly 9.6% in the year-to-date period and 0.4% in the past year.

The stock is currently trading at 18.55x forward 12-month earnings, which compares to 16.59x for the Zacks sub-industry, 15.27x for the Zacks sector and 20.71x for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.35x and as low as 12.89x, with a 5-year median of 18.53x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$84 price target reflects 19.72x forward 12-month earnings.

The table below shows summary valuation data for AJG

Valuation Multiples - AJG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.55	16.59	15.27	20.71
	5-Year High	26.35	21.01	16.17	20.71
	5-Year Low	12.89	14.5	11.19	15.19
	5-Year Median	18.53	16.66	13.93	17.44
P/S F12M	Current	1.96	2.71	4.96	3.28
	5-Year High	2.68	3.31	6.69	3.44
	5-Year Low	1.08	1.83	4.96	2.54
	5-Year Median	1.76	2.52	6.05	3.01
P/B TTM	Current	2.85	5.09	2.13	3.86
	5-Year High	3.9	6.85	2.9	4.55
	5-Year Low	1.74	3.33	1.71	2.84
	5-Year Median	2.73	4.57	2.52	3.64

As of 04/30/2020

Industry Analysis Zacks Industry Rank: Top 15% (37 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
eHealth, Inc. (EHTH)	Outperform	2
Aon plc (AON)	Neutral	3
Brown & Brown, Inc. (BRO)	Neutral	3
Erie Indemnity Company (ERIE)	Neutral	2
Fanhua Inc. (FANH)	Neutral	NA
Marsh & McLennan Companies, Inc. (MMC)	Neutral	3
Everest Re Group, Ltd. (RE)	Neutral	3
Willis Towers Watson Public Limited Company (WLTW)	Neutral	3

Industry Comparison Industry: Insurance - Brokerage				Industry Peers		
	AJG	X Industry	S&P 500	AON	ERIE	WLTW
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	2	3
VGM Score	B	-	-	B	B	C
Market Cap	14.70 B	1.98 B	20.61 B	41.27 B	7.97 B	23.60 B
# of Analysts	7	5.5	14	8	1	9
Dividend Yield	2.32%	1.27%	2.11%	0.99%	2.24%	1.48%
Value Score	C	-	-	D	D	C
Cash/Price	0.18	0.10	0.06	0.02	0.04	0.04
EV/EBITDA	12.56	13.71	11.87	16.66	18.59	12.40
PEG Ratio	1.99	2.04	2.47	NA	NA	1.57
Price/Book (P/B)	2.77	2.51	2.67	11.99	7.03	2.27
Price/Cash Flow (P/CF)	12.54	15.34	10.66	14.46	23.58	10.63
P/E (F1)	19.57	19.90	19.01	17.55	26.82	15.65
Price/Sales (P/S)	2.08	2.50	2.10	3.72	3.22	2.57
Earnings Yield	5.11%	5.03%	5.05%	5.70%	3.73%	6.39%
Debt/Equity	0.73	0.34	0.72	1.92	0.08	0.60
Cash Flow (\$/share)	6.26	2.99	7.01	11.94	7.55	16.77
Growth Score	A	-	-	B	A	C
Hist. EPS Growth (3-5 yrs)	11.61%	12.03%	10.88%	10.83%	16.20%	12.02%
Proj. EPS Growth (F1/F0)	8.41%	6.19%	-7.32%	10.74%	6.11%	6.86%
Curr. Cash Flow Growth	9.99%	6.15%	5.92%	-0.54%	13.54%	6.15%
Hist. Cash Flow Growth (3-5 yrs)	13.27%	11.82%	8.55%	3.75%	12.81%	30.62%
Current Ratio	1.02	1.06	1.23	1.52	2.03	1.55
Debt/Capital	42.25%	24.65%	43.84%	65.77%	7.80%	37.66%
Net Margin	9.63%	9.63%	11.08%	13.91%	12.79%	11.55%
Return on Equity	15.33%	14.90%	16.44%	55.95%	29.27%	14.46%
Sales/Assets	0.37	0.37	0.54	0.38	1.29	0.26
Proj. Sales Growth (F1/F0)	4.79%	3.74%	-1.42%	3.13%	4.10%	4.61%
Momentum Score	C	-	-	B	B	D
Daily Price Chg	-1.47%	0.00%	-2.39%	1.21%	-3.24%	1.73%
1 Week Price Chg	-9.95%	-2.46%	-1.74%	-8.00%	-1.99%	-9.30%
4 Week Price Chg	-0.33%	3.01%	17.07%	9.80%	10.31%	12.55%
12 Week Price Chg	-25.32%	-16.79%	-18.53%	-24.80%	8.10%	-14.65%
52 Week Price Chg	-5.30%	-5.27%	-9.82%	-2.16%	-5.25%	-0.12%
20 Day Average Volume	1,394,453	76,144	2,641,413	1,439,897	125,710	1,221,608
(F1) EPS Est 1 week change	-2.11%	-0.92%	0.00%	-0.88%	0.00%	-0.95%
(F1) EPS Est 4 week change	-3.20%	-2.60%	-6.62%	-2.00%	0.00%	-1.31%
(F1) EPS Est 12 week change	-4.23%	-3.69%	-13.28%	-2.39%	-3.16%	-1.54%
(Q1) EPS Est Mthly Chg	-6.64%	-4.31%	-11.97%	-4.39%	0.00%	-2.16%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	A
Momentum Score	C
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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