

Arthur J Gallagher(AJG)

\$106.37 (As of 08/20/20)

Price Target (6-12 Months): **\$123.00**

Long Term: 6-12 Months

Zacks Recommendation: **Outperform**

(Since: 08/03/20)

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

Shares of Arthur J. Gallagher have outperformed its industry in a year's time. The company should continue to benefit from solid organic growth, sturdy performance across all segments and strong margin expansion. The performance of the company benefited from higher adjusted revenues across Brokerage and Risk Management segments. Its focus on tapping opportunities across the globe bodes well for growth. Its inorganic growth story seems impressive with strategic buyouts. Its solid performance is driving cash flow and helping it to deploy capital effectively. However, higher expenses weigh on margin expansion. Also, high debt level has been inducing an increase in interest expenses and lower return on equity poses financial risk. Its earnings of 94 cents per share beat the Zacks Consensus Estimate by 30.6% and increased 44.6% year over year.

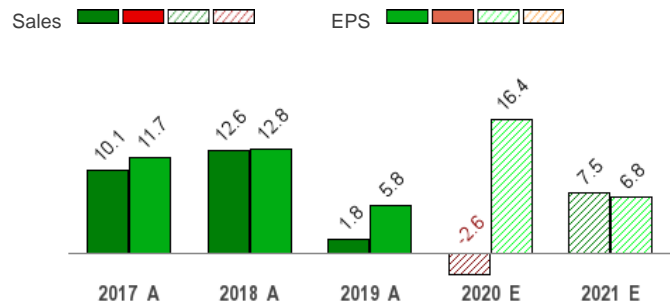
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$109.46 - \$65.09
20 Day Average Volume (sh)	774,190
Market Cap	\$20.4 B
YTD Price Change	11.7%
Beta	0.77
Dividend / Div Yld	\$1.80 / 1.7%
Industry	Insurance - Brokerage
Zacks Industry Rank	Top 17% (42 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	30.6%
Last Sales Surprise	-5.7%
EPS F1 Est- 4 week change	5.9%
Expected Report Date	10/22/2020
Earnings ESP	0.2%
P/E TTM	25.6
P/E F1	25.0
PEG F1	2.5
P/S TTM	2.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,914 E	1,650 E	1,806 E	1,776 E	7,393 E
2020	1,829 A	1,552 A	1,708 E	1,673 E	6,875 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	\$1.85 E	\$0.90 E	\$1.01 E	\$0.80 E	\$4.54 E
2020	\$1.83 A	\$0.94 A	\$0.86 E	\$0.66 E	\$4.25 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 08/20/2020. The reports text is as of 08/21/2020.

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.

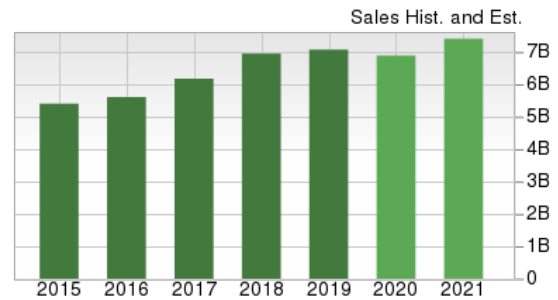
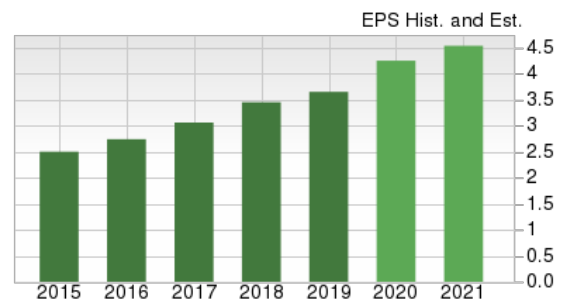
More than two-third of revenues comes from the combined brokerage and risk management segments domestically, with the remaining being generated internationally, primarily in Australia, Bermuda, Canada, the Caribbean, New Zealand and the United Kingdom. Substantially all the revenues of the corporate 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 gained 17.1%, outperforming its industry's growth of 5.6% in the past year. Strong operational environment along with a favorable outlook for segment growth will further help the shares to trend higher.
- ▲ 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 half of 2020, the company completed 12 mergers, representing about \$138.1 million of annualized revenues. The company's merger and acquisition pipeline is quite strong with about \$300 million of revenues, associated with about 40 term sheets either agreed upon or being prepared. Based on the activity experienced in July, the company believes to return to normal levels of merger activity later this year.
- ▲ 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 half of 2020, with the company registering organic growth of 2.7%. Management estimates third-quarter brokerage segment organic growth to be 5%, same as the second quarter. The company expects EBITDAC to improve in the third quarter and increase further in the fourth quarter at the Risk Management segment. This will lead full-year adjusted EBITDAC level to be on par with 2019. 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 enable Arthur J. Gallagher to enhance its shareholder value. In the first quarter of 2020, the dividend was increased by 4.7%, reflecting a six-year CAGR (2014-2020) of 3.8%. Arthur J. Gallagher's dividend currently yields 1.7%, 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.

Risks

- Arthur J. Gallagher has been experiencing an increase in expenses due to higher compensation, depreciation, amortization and operating expenses. Escalating expenses have been weighing on margins. However, in the first half of 2020, total expenses decreased 9.2% to \$2.9 billion, primarily on lower operating cost and cost of revenues from clean coal activities. Arthur J. Gallagher expects to lower expense by \$60 million to \$70 million per quarter.

In the Brokerage segment, foreign currency impact on earnings per share is estimated to be 1 cent per share in the third quarter. The company expects little impact in the fourth quarter and approximately 2 cents per share on a full-year basis. The foreign currency impact on revenues is estimated to be \$10 million in the third quarter. It will have very little impact in the fourth quarter and approximately \$20 million impact on a full-year basis.

In the Risk Management segment, the foreign currency impact on earnings per share is estimated to be minimal in the third quarter and the full year. The foreign currency impact on revenues is estimated to be little on a quarterly basis and approximately \$4 million on a full- year basis.

- 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. As of Jun 30, 2020, debt increased 13.1% to \$4.3 billion from the 2019-end level, with debt to capital ratio of 43.8%, deteriorating 150 basis points from 2019 level. Interest expense too increased 18.1% year over year to \$100.5 million in the first half of 2020. The company has about \$1.3 billion of liquidity, with \$275 million in cash on hand which are not sufficient for the company to meet its debt obligations. However, it has access to a revolving credit facility of \$1 billion which expires on 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 24 is higher than the industry average of 20.5.
 - Return on equity (ROE), a measure of how effectively the company is utilizing its shareholders' funds, underperformed the industry average. The company's ROE of 16% is lower than the industry average of 27.8%.
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Last Earnings Report

Arthur J. Gallagher Q2 Earnings Beat, Revenues Miss

Arthur J. Gallagher & Co. reported second-quarter 2020 adjusted net earnings of 94 cents per share, which beat the Zacks Consensus Estimate by 30.6%. Moreover, the bottom line increased 44.6% on a year-over-year basis.

The company's performance was driven by lower expenses, higher adjusted revenues and strong margin expansion across Brokerage segment.

Quarter Ending 06/2020

Report Date	Jul 30, 2020
Sales Surprise	-5.67%
EPS Surprise	30.56%
Quarterly EPS	0.94
Annual EPS (TTM)	4.15

Operational Update

Total revenues were nearly \$1.6 billion, down 4.5% year over year primarily due to lower fees and revenues from clean coal activities. Moreover, the top line missed the Zacks Consensus Estimate by 5.6%.

Arthur J. Gallagher's total expense decreased 9% year over year to \$1.4 billion in the reported quarter. Lower cost of revenues from clean coal activities, reduced depreciation and operating cost resulted in the downside.

Adjusted earnings before interest, tax, depreciation and amortization and change in estimated acquisition earnout payables (EBITDAC) grew 33.9% from the prior-year quarter to \$360 million.

Segment Results

Brokerage: Adjusted revenues of \$1.2 billion increased 7.7% year over year on higher commissions, fees, supplemental revenues and contingent revenues.

Expenses increased 0.5% to \$953.3 million due to higher compensation, amortization and change in estimated acquisition earnout payables. Adjusted EBITDAC climbed 33.8% to \$391.3 million while margin expanded 630 basis points (bps) to 32.6%.

Risk Management: Adjusted revenues were down 7.9% year over year to \$190.8 million, primarily due to lower fees.

Expenses decreased 5% to \$210 million due to lower compensation, operating cost and reimbursements. Adjusted EBITDAC decreased 7.4% year over year to \$33.5 million while margin contracted 10 bps to 17.6%.

Corporate: EBITDAC was negative \$35 million compared with negative \$45.9 million in the year-ago quarter.

Financial Update

As of Jun 30, 2020, total assets were \$21.3 billion, up 8.5% from 2019-end level.

Cash and cash equivalents at quarter end decreased 42.2% from 2019 level to \$349.7 million. Shareholders' equity increased 6.1% from the level as of Dec 31, 2019 to \$5.5 billion as of Jun 30, 2020.

Acquisition Update

In the quarter, the company closed four acquisitions with estimated annualized revenues of about \$13.9 million.

Recent News

Arthur J. Gallagher Boosts Portfolio With Insight Buyout - Aug 5, 2020

Arthur J. Gallagher has closed the buyout of Insight Insurance & Risk Management Ltd. The details of the transaction were not made public. The buyout will provide the acquirer a client base, particularly in the construction and sports industries, among others.

Arthur J. Gallagher Declares Quarterly Dividend — Jul 29, 2020

The board of directors of Arthur J. Gallagher declared a quarterly dividend of 45 cents per share. The dividend will be paid out on Sep 18 to shareholders of record as of Sep 4.

Valuation

Arthur J. Gallagher shares are up 11.7% in the year-to-date period and up 17.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 0.2% and 16.9% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 5.6% but down 7.9%, respectively.

The S&P 500 index is up 4.7% in the year-to-date period and up 15.7% in the past year.

The stock is currently trading at 24x forward 12-month earnings, which compares to 20.54x for the Zacks sub-industry, 16.5x for the Zacks sector and 22.77x 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 18.82x. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$123 price target reflects 27.7x 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	24	20.54	16.5	22.77
	5-Year High	26.35	21.11	16.5	22.77
	5-Year Low	12.89	14.5	11.6	15.25
	5-Year Median	18.82	17.08	14.26	17.58
P/S F12M	Current	2.83	3.27	6.22	3.7
	5-Year High	2.86	3.32	6.67	3.7
	5-Year Low	1.08	1.83	4.97	2.53
	5-Year Median	1.81	2.57	6.06	3.05
P/B TTM	Current	3.68	5.55	2.46	4.53
	5-Year High	3.9	6.85	2.91	4.56
	5-Year Low	1.74	3.33	1.72	2.83
	5-Year Median	2.77	4.65	2.53	3.75

As of 08/20/2020

Industry Analysis Zacks Industry Rank: Top 17% (42 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
eHealth, Inc. (EHTH)	Outperform	1
RLI Corp. (RLI)	Outperform	2
Aon plc (AON)	Neutral	3
BrownBrown, Inc. (BRO)	Neutral	2
Erie Indemnity Company (ERIE)	Neutral	3
MarshMcLennan 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

	AJG	X Industry	S&P 500	AON	ERIE	WLTW
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	D	C	C
Market Cap	20.37 B	1.60 B	23.46 B	45.64 B	10.22 B	26.04 B
# of Analysts	7	5.5	14	7	1	9
Dividend Yield	1.69%	0.82%	1.65%	0.89%	1.74%	1.35%
Value Score	C	-	-	D	D	C
Cash/Price	0.15	0.13	0.07	0.03	0.03	0.04
EV/EBITDA	16.93	17.34	13.34	18.77	23.41	13.54
PEG Ratio	2.47	2.65	3.00	NA	NA	NA
Price/Book (P/B)	3.68	2.49	3.12	12.35	8.56	2.49
Price/Cash Flow (P/CF)	16.99	17.01	12.60	16.50	29.30	12.05
P/E (F1)	24.32	24.05	21.61	20.27	40.52	17.65
Price/Sales (P/S)	2.91	2.87	2.44	4.16	4.07	2.81
Earnings Yield	4.00%	4.16%	4.43%	4.93%	2.47%	5.67%
Debt/Equity	0.78	0.19	0.76	1.96	0.08	0.57
Cash Flow (\$/share)	6.26	2.99	6.93	11.94	7.55	16.77
Growth Score	A	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	11.03%	13.11%	10.44%	11.54%	15.19%	13.11%
Proj. EPS Growth (F1/F0)	16.40%	4.94%	-5.53%	6.00%	-9.90%	4.50%
Curr. Cash Flow Growth	9.99%	2.81%	5.20%	-0.54%	13.54%	6.15%
Hist. Cash Flow Growth (3-5 yrs)	13.27%	13.04%	8.52%	3.75%	12.81%	30.62%
Current Ratio	1.09	2.08	1.33	2.08	1.82	1.62
Debt/Capital	43.81%	15.47%	44.50%	66.18%	7.36%	36.36%
Net Margin	10.35%	10.68%	10.13%	16.08%	11.76%	11.00%
Return on Equity	16.01%	13.50%	14.67%	64.99%	25.86%	14.32%
Sales/Assets	0.35	0.35	0.51	0.37	1.25	0.25
Proj. Sales Growth (F1/F0)	-2.57%	0.00%	-1.54%	-0.98%	1.15%	2.69%
Momentum Score	C	-	-	F	F	C
Daily Price Chg	-0.23%	-0.28%	-0.59%	-0.28%	-0.66%	-0.59%
1 Week Price Chg	0.17%	0.00%	1.09%	0.90%	0.06%	1.02%
4 Week Price Chg	2.25%	0.67%	1.91%	-5.00%	6.45%	-4.67%
12 Week Price Chg	13.16%	5.34%	6.82%	-0.85%	26.76%	-1.73%
52 Week Price Chg	17.06%	-0.13%	1.47%	1.49%	-1.75%	4.01%
20 Day Average Volume	774,190	37,115	1,873,576	1,586,676	37,115	712,589
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	5.95%	4.41%	1.79%	-0.37%	1.30%	2.01%
(F1) EPS Est 12 week change	8.18%	5.88%	3.35%	-0.27%	1.30%	1.87%
(Q1) EPS Est Mthly Chg	3.21%	1.61%	0.42%	-0.74%	0.61%	2.62%

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.

Disclosures

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