

Arthur J Gallagher(AJG)

\$94.90 (As of 12/30/19)

Price Target (6-12 Months): **\$100.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/11/19)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: D

Growth: B

Momentum: F

Summary

Arthur J. Gallagher 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 bode well for growth. Its inorganic growth story seems impressive with strategic buyouts. Moreover, it is focusing on enhancing productivity and quality as part of its value creation strategy. The company's solid performance is driving cash flow and helping it to deploy capital in shareholder-friendly moves. However, escalating expenses weigh on its margin expansion. Also, high debt level increases interest expenses. Its interest coverage ratio also compares unfavorably with the industry average. Shares of Arthur J. Gallagher have underperformed the industry in a year's time.

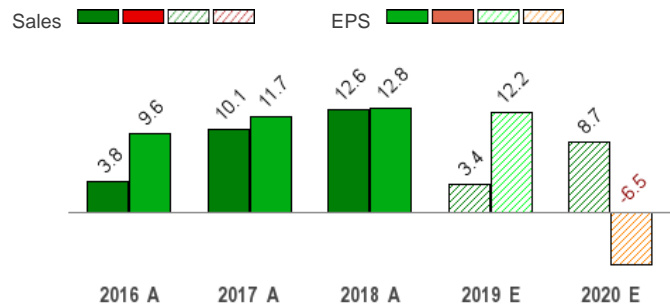
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$96.20 - \$70.44
20 Day Average Volume (sh)	679,132
Market Cap	\$17.7 B
YTD Price Change	28.8%
Beta	0.80
Dividend / Div Yld	\$1.72 / 1.8%
Industry	Insurance - Brokerage
Zacks Industry Rank	Top 31% (79 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.3%
Last Sales Surprise	-5.1%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	01/30/2020
Earnings ESP	0.0%
P/E TTM	26.3
P/E F1	24.5
PEG F1	2.5
P/S TTM	2.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,097 E	1,781 E	1,911 E	1,901 E	7,797 E
2019	1,958 A	1,625 A	1,791 A	1,794 E	7,170 E
2018	1,838 A	1,625 A	1,779 A	1,657 A	6,934 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.55 E	\$1.78 E	\$0.76 E	\$0.92 E	\$3.62 E
2019	\$1.63 A	\$0.65 A	\$0.80 A	\$0.79 E	\$3.87 E
2018	\$1.52 A	\$0.62 A	\$0.78 A	\$0.53 A	\$3.45 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 12/30/2019. The reports text is as of 12/31/2019.

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.

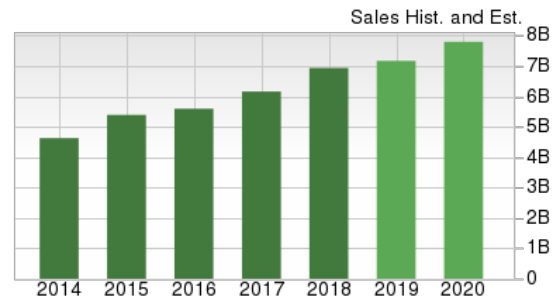
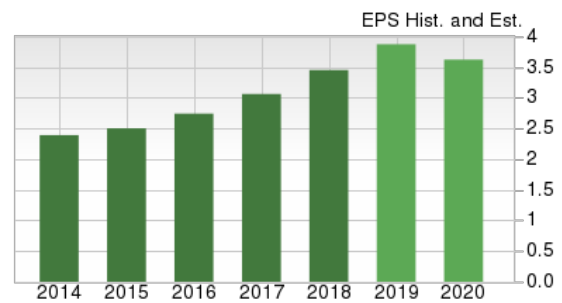
More than two-third of revenues comes from the combined brokerage and risk management segments domestically, with the remaining being generated internationally, primarily in Australia, Bermuda, Canada, the Caribbean, New Zealand and the United Kingdom. Substantially all the revenues of the corporate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

Arthur J. Gallagher operates through three segments:

The Brokerage segment (61% of 2018 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 28.8% in a year's time, underperforming the industry's increase of 37.8%. Nonetheless, solid fundamentals should help the share price move up.
- ▲ Arthur J. Gallagher boasts impressive growth, driven by organic sales and acquisition and mergers. It completed and integrated 507 acquisitions from Jan 1, 2002 through Dec 31, 2018, most of which were within its brokerage segment. In the first nine months of 2019, the company completed 38 acquisitions, which should add about \$278 million of annualized revenues. Its merger and acquisition pipeline is quite strong with about \$400 million of revenues, which is expected to fuel inorganic growth along with another \$90 million of annualized revenues from mergers announced in October 2019.
- ▲ The company's inorganic and organic growth efforts have been driving its revenues. The top line has, in fact, more than doubled in the last six years. In fact, the brokerage segment posted 5.8% organic growth in the third quarter of 2019 (driven by improved results across all divisions globally) and expanded adjusted EBITDAC margins by 68 basis points (bps). Risk Management's organic growth was 5.7%. The momentum is expected to continue. Management estimates Brokerage segment organic growth in 2019 to be 5% while the same for Risk Management is expected to be in mid-single digit. EBITDAC margin for Risk Management segment is estimated to be between 17% and 17.5% in 2019.
- ▲ 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. It estimates solid organic growth in the second half of 2019, banking on some new client wins, and thus projects organic for 2019 in the mid-single-digit range.
- ▲ 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. Also, the company has a borrowing capacity of around \$600 million. The company targets about \$1.5 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 2019, the dividend was increased by nearly 5%, reflecting a five-year CAGR of 3.6%. Arthur J. Gallagher's dividend currently yields 1.8%, better than the industry average of 1.4%.

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. Total expense grew 26% over the last four years. Escalating expenses affected operating margin, which contracted 120 bps in the last four years. Expenses increased 1.3% in the first nine months of 2019. The company must strive to maintain revenue growth higher than increase in expense, else margin will be dented.
 - ▼ Debt level at Arthur J. Gallagher increased about 49% in the last four years with leverage ratio deteriorating 1550 basis points. The high debt level has been inducing an increase in interest expenses that rose 34% over the same time frame. Interest expense increased 29.2% in the first nine months of 2019. Also, interest coverage ratio, measuring the company's ability to meet its interest payments, of 4.5 is lower than the industry's average of 5.9. A high debt ratio and lowered interest serving capability raises financial risk.
 - ▼ Further, Arthur J. Gallagher seems overvalued when compared with the broader industry. Its forward 12-month price to earnings ratio of 22.82X is higher than the industry average of 20.29X.
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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 Q3 Earnings Beat, Improve Y/Y

Arthur J. Gallagher reported third-quarter 2019 adjusted net earnings of 80 cents per share, which beat the Zacks Consensus Estimate by 1.27%. Moreover, the bottom line increased 2.6% on a year-over-year basis.

The company's performance was driven by higher adjusted revenues across Brokerage and Risk Management segments, along with strong margin expansion.

Quarter Ending 09/2019

Report Date	Oct 24, 2019
Sales Surprise	-5.09%
EPS Surprise	1.27%
Quarterly EPS	0.80
Annual EPS (TTM)	3.61

Operational Update

Adjusted revenues were nearly \$1.8 billion, which increased 0.7% year over year. However, the top line missed the Zacks Consensus Estimate by 5.1%.

Arthur J. Gallagher's total expenses increased 1.3% year over year to \$1.7 billion in the reported quarter. Higher compensation, interest, amortization and depreciation attributed to the increase.

Adjusted earnings before interest, tax, depreciation and amortization and change (EBITDAC) in estimated acquisition earnout payables grew 19.8% from the prior-year quarter.

Segment Results

Brokerage: Revenues of \$1.19 billion increased 14% year over year on higher fees, and commission, supplemental and contingent revenues.

Expenses increased 12.3% from the year-ago quarter to \$996 million.

Adjusted EBITDAC climbed 18% from a year ago to \$324.3 million and margin expanded 68 basis points (bps).

Risk Management: Revenues were up 6.3% year over year to \$211.6 million, mainly owing to higher fees.

Expenses increased 4.9% from the prior-year period to \$224.6 million.

Adjusted EBITDAC increased 7.7% year over year to \$38 million and margin grew 3 bps.

Corporate: Total revenues of \$383 million were down 22% year over year due to lower revenues from consolidated clean coal facilities.

EBITDAC was negative \$53.2 million compared with a negative \$51.4 million in the year- ago quarter.

Financial Update

As of Sep 30, 2019, total assets were \$19.1 billion, up 17.3% from 2018-end level.

At the end of the quarter, cash and cash equivalents of \$0.5 billion decreased 4.7% from 2018-end level.

As of Sep 30, 2019, shareholders' equity increased 7.4% from the Dec 31, 2018 level to \$4.9 billion.

Acquisition Update

In the quarter, the company closed 14 acquisitions with estimated annualized revenues of about \$85.1 million.

Recent News

Arthur J. Gallagher Buys Canada-Based SBW Employee Benefits – Dec 17, 2019

Arthur J. Gallagher & Co. recently acquired Halifax, Nova Scotia-based Sinclair Billard and Weld Ltd. and CJM Solutions + Inc., which do business under the name of SBW Employee Benefits. The client-focused approach and the expertise of SBW have made Arthur J. Gallagher's Atlantic Canada capabilities unique and incomparable in the market.

Arthur J. Gallagher Acquires Blueleaf Consulting – Dec 4, 2019

Arthur J. Gallagher has acquired Blueleaf Consulting Pty Ltd. to boost its financial wellbeing, consulting expertise and cross-selling opportunities

Arthur J. Gallagher Subsidiary Purchases EWI Re – Nov 21, 2019

Arthur J. Gallagher's subsidiary Artex Risk Solutions, Inc., has acquired Dallas-based EWI Re, Inc. to strengthen its capability to provide complex client solutions.

Arthur J. Gallagher Unit Acquires Horseshoe Insurance – Nov 18, 2019

Arthur J. Gallagher & Co.'s subsidiary, Artex Risk Solutions, recently concluded the acquisition of Horseshoe Insurance Services Holdings Ltd, a Bermudian insurance manager and ILS fund administrator. This buyout will not only strengthen the ILS operations of Arthur J. Gallagher but also help consolidate its position as the one of the best service providers to the world's risk capital.

Arthur J. Gallagher Acquires BonusDrive – Nov 6, 2019

Arthur J. Gallagher has acquired BonusDrive to boost the company's existing voluntary benefit offerings.

Valuation

Arthur J. Gallagher shares have gained 28.8% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and Zacks Finance sector are up 37.8% and 18.8% respectively.

The S&P 500 index is up 28% in the past year.

The stock is currently trading at 22.82X forward 12-month earnings, which compares to 20.29X for the Zacks sub-industry, 14.8X for the Zacks sector and 18.77X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.39X and as low as 12.89X, with a 5-year median of 18.26X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$100 price target reflects 24X 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	22.82	20.29	14.8	18.77
	5-Year High	23.39	20.29	16.21	19.34
	5-Year Low	12.89	14.49	12.01	15.17
	5-Year Median	18.26	16.65	13.98	17.43
P/S F12M	Current	2.27	3.18	6.56	3.41
	5-Year High	2.3	3.18	6.61	3.41
	5-Year Low	1.08	1.83	5.2	2.54
	5-Year Median	1.68	2.47	6.03	3
P/B TTM	Current	3.6	6.33	2.83	4.42
	5-Year High	3.63	6.4	2.89	4.42
	5-Year Low	1.74	3.32	1.83	2.85
	5-Year Median	2.69	4.39	2.5	3.6

As of 12/30/2019

Industry Analysis Zacks Industry Rank: Top 31% (79 out of 253)



Top Peers

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

Industry Comparison Industry: Insurance - Brokerage				Industry Peers		
	AJG Neutral	X Industry	S&P 500	AON Neutral	ERIE Neutral	WLTW Neutral
VGM Score	C	-	-	C	B	D
Market Cap	17.70 B	2.21 B	23.75 B	48.18 B	7.67 B	25.92 B
# of Analysts		4	13			
Dividend Yield	1.81%	1.29%	1.79%	0.85%	2.17%	1.29%
Value Score	D	-	-	D	D	D
Cash/Price	0.15	0.08	0.04	0.02	0.04	0.03
EV/EBITDA	18.24	18.24	13.92	23.34	18.89	17.38
PEG Ratio	2.50	1.96	2.12	1.90	NA	1.70
Price/Book (P/B)	3.60	2.97	3.32	13.65	6.85	2.59
Price/Cash Flow (P/CF)	16.41	17.95	13.73	17.95	24.97	12.90
P/E (F1)	24.58	24.07	19.56	22.74	26.69	18.46
Price/Sales (P/S)	2.49	2.97	2.67	4.42	3.12	2.97
Earnings Yield	3.81%	4.16%	5.10%	4.40%	3.75%	5.42%
Debt/Equity	0.78	0.24	0.72	1.72	0.09	0.63
Cash Flow (\$/share)	5.78	1.53	6.94	11.57	6.65	15.63
Growth Score	B	-	-	B	A	C
Hist. EPS Growth (3-5 yrs)	12.01%	12.01%	10.53%	10.42%	15.46%	10.97%
Proj. EPS Growth (F1/F0)	5.02%	12.35%	6.30%	11.92%	12.89%	12.21%
Curr. Cash Flow Growth	12.53%	4.87%	14.83%	7.57%	34.16%	2.16%
Hist. Cash Flow Growth (3-5 yrs)	19.23%	10.69%	9.00%	5.07%	10.69%	26.50%
Current Ratio	1.05	1.40	1.23	1.38	2.10	1.41
Debt/Capital	43.72%	19.63%	42.99%	63.22%	7.93%	38.90%
Net Margin	9.69%	9.34%	11.08%	13.79%	13.01%	10.07%
Return on Equity	14.38%	12.70%	17.10%	51.63%	30.65%	13.01%
Sales/Assets	0.39	0.38	0.55	0.38	1.32	0.25
Proj. Sales Growth (F1/F0)	3.93%	1.09%	2.86%	2.17%	4.18%	5.60%
Momentum Score	F	-	-	D	C	D
Daily Price Chg	0.16%	0.16%	-0.43%	0.06%	-0.25%	-0.09%
1 Week Price Chg	-0.70%	-0.48%	0.13%	-1.15%	-1.91%	-1.89%
4 Week Price Chg	2.89%	2.95%	2.78%	3.00%	-0.57%	3.26%
12 Week Price Chg	7.16%	7.31%	8.67%	9.04%	-7.32%	7.46%
52 Week Price Chg	28.76%	27.29%	27.07%	42.85%	24.54%	32.74%
20 Day Average Volume	679,132	121,948	1,731,328	803,813	86,633	493,599
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.14%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 12 week change	-0.38%	0.57%	0.14%	0.09%	2.81%	-0.14%
(Q1) EPS Est Mthly Chg	-0.90%	0.00%	0.00%	0.00%	0.00%	0.00%

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	D
Growth Score	B
Momentum Score	F
VGM Score	C

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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