Brown & Brown Inc. Q3 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

Thank you, Mr. Brown. [Operator Instructions].

Now, we go first to Keith Walsh with Citi

Keith Walsh - Citigroup

Good morning everyone.

J. Hyatt Brown - Chairman and Chief Executive Officer

Hi Keith.

Keith Walsh - Citigroup

Hi, just a couple of questions. First? and I appreciate the explanation about Florida I guess I was surprised like everyone else it deteriorated so quickly. Besides pricing where are the levers that you can pull to fix this and do we enter a period of easier growth comps as we get into 2008 and I have a follow up

J. Hyatt Brown - Chairman and Chief Executive Officer

Well, I think your easier growth comps is probably correct. What we are going through I mails from this year that never occurred before in Florida and so we, to get into what I would call a steady state will probably going to be the second quarter of next year so from now through the end of the fourth quarter and end of the first quarter we are still going to be having a very difficult kind of market place now there are lots of opportunities to write new business don't ever realize that Florida isn't a growth state and Florida is a growth state and of course what happens is, is that we do have some great programs that are using to expand in Florida but the bottom line is that probably casualty is going to continue to go south in Florida cause it has not gone south as much as it has in other parts of the country and everyone is thinking well no hurricanes this year and so next year is? 12 months off and don't worry about it till then. So, does that answer the question?

Keith Walsh - Citigroup

Yes, that's helpful. And then I guess the second question I have, just looking at the $13.1 million year-to-date I guess $8.6 million in the quarter of books of business that you had sold I mean that's by far and away the largest number I have seen in my model here going back several years you know what exactly is driving that are these under performing blocks of business

J. Hyatt Brown - Chairman and Chief Executive Officer

Well, what happens when you have a market that the pricing is declining where you have people who have sold books of business or agencies to us. Sometimes they get a little enamored with not having to work to hard, and therefore, things start to deteriorate a little bit and it becomes apparent? they might be better for us to part. The other thing that we are always dealing is we are always looking for slices of business that are under performing. Now an example of that would be trucking business. Trucking business on the left is high hazard trucking for which we have none of at the movement. That is going to be max 15% to 20% margin and you know we're not going to do 15% to 20% margin business so all of those kinds of things or conflicts going on within our organization so each of our profit centers because it is the income of the leader of that profit center depending on growing the profits and the margins of they are constantly looking for ways to A) write more business and B) make a higher margin on those lines that already riding and of course as we become more sophisticated across the company and countries about lines that are the most profitable we? our people are responding and so in this kind of market it's a good time to take a look at all of those areas and in a softer market if you have any kind of slice of business that has been kind of over looked because you say, well its not doing quite so well. That all of a sudden focus is upon those slices and we're making those decisions as we go forward.

Keith Walsh - Citigroup

Yes thank you.

Operator

We'll go next to Chuck Hamilton at FTN Midwest

J. Hyatt Brown - Chairman and Chief Executive Officer

Okay Chuck.

Chuck Hamilton - Ftn Midwest

Good morning everyone. Two questions for you this morning. The first question I guess deals with supplemental commissions. I see that in second quarter ?07 at the end of the quarter, a little bit more than 3.2 million in that quarter of the net commissions in this quarter, do you know how much was related to supplementals?

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Yes Chuck. It was $1.5 million.

Chuck Hamilton - Ftn Midwest

1.5 and of course that's included then in your growth calculation for organic revenue.

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

That is correct.

Chuck Hamilton - Ftn Midwest

Okay and I know you folks don't look at this but maybe you got a sense of it is we take a look year over year to the quarter. We're showing a 12% increase in other operating expenses. Do you have a sense of what percentage of that is organic expense growth that is striping off the affected bringing in the acquisitions and also the sales of these, excuse me, sales of these books of businesses as well.

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Talking on the first part there is mostly expenses are coming in from the acquisition. Most of them are not normally at our same margin, but there's no one particular line that's really out of whack and as I kind of described, if you take out the book of business sale its about $1 million worth of costs that are in there, but it's really just all over the board. Various costs. Its really they went up a little bit, but it's mainly the salt or revenue that kind of showed the margins up and I'm not sure if I have understood the second part of your question.

Chuck Hamilton - Ftn Midwest

Right. I guess it's just adjusting the expense growth to also include the fact that you've taken out expenses with sale books of business, the producer's expenses.

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Yes, but that doesn't show up quite as quickly. You know because you're only talking about one month of revenue expense so that'd be marginal.

Chuck Hamilton - Ftn Midwest

Right. I guess the last part of that would be with the gain on books, excuse me, gain on the sale of books of business $8.6 million. Do you have a sense how much that translates into revenues that will not appear in future periods that will annualize revenues that have foregone with that sale?

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Yes, it's about $4 million and $4.5 million worth of annualized revenues.

Chuck Hamilton - Ftn Midwest

Okay.

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

And the total gain of that was about $7.2 million.

Chuck Hamilton - Ftn Midwest

Okay.

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

A quarter. I think, Chuck, also to give you a little more light around the issue of acquisitions, and in many cases may be not most, but in many, we do have moving expenses. For instance, we acquired recently the JP Morgan personalized operation which is in a suburb of Wilmington, Delaware and in their I guess, data center, so we have to move immediately and move to a new location et cetera. That all, you know, is a move to the kind of expenses that are one time expenses, but we have to anyway. That happens in almost every? some of those types of expenses happen almost every acquisition.

Chuck Hamilton - Ftn Midwest

Okay. I was just trying to get to sense of it since we're showing organic revenue growth wouldn't it be great if we could see organic expense growth so that we can then monitor the ongoing expenses compared to the ongoing revenue stream?

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Right.

Chuck Hamilton - Ftn Midwest

Thank you, gentlemen.

Operator

We'll go next to Michael Grasher of Piper Jaffray.

Michael Grasher - Piper Jaffray

Hi, I guess Cory in his initial remarks mentioned the 15 years toughest environment. As you look at today's marketplace, I mean this the most difficult environment that you can remember or do you see any difference in today's market compared to say 1998-1999 time period?

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Well if you look at just the market we have the Florida situation.

Michael Grasher - Piper Jaffray

Yes.

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Then it's about like 98-99 and we've also seen back in really ?80 to ?83 that's before most you all were born so we won't go into that, but yes we've seen this before.

Now the Florida situation is really an outgrowth the fact in two years we had very abnormal hurricane activity which forced the prices up very substantially and then no hurricane activity one year and hopefully none and then this year and so all of a sudden you have a big up and a big down and the big down instead of being a more, sort of like a pyramid going down on the other side of the pyramid. A level sort of reduction. It was a 50% reduction or 60% reduction overnight. So that is an issue that we just never had faced before.

Michael Grasher - Piper Jaffray

Understood, then in terms of the carriers themselves the underwriters, are they behaving any differently than across the country than what you would have expected?

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

I think generally speaking, I think that underwriters are probably a little better positioned today than in ?98 and ?99 to make underwriting decisions on pricing and one of the reasons is that I think the systems are a little more effective and efficient. The other thing though that makes this a difficult call is if you look at the large group of the risk bearers as reported in business insurance you will see command loss sequence ratio of about 90% to 92%. That never happened before but its because of Sarbanes Oxley, and there aren’t redundant reserves even though some of those reserves are being released into the income stream now which creates this very, very good command loss expense ratio. However, at a recent meeting of the Greenbuyer, I was very surprised to hear a couple of companies that are well-known companies and well run companies and regional in nature indicating that they thought that this year they would have recently closed to 100% combined. I was very surprised at that. Now the risk bearers are saying that because of Sarbanes Oxley, the turn is going to be a lot faster then in the past and I’m not convinced with that frankly.

Michael Grasher - Piper Jaffray

Interesting and then if you look at government intervention. Obviously this applies to Florida a great deal but across the country with California and I think you mentioned Arizona, New York being involved in workers’ comp as well. Aside from workers’ comp, has there been so much government intervention historically?

J. Hyatt Brown - Chairman and Chief Executive Officer

No, there is really not.

Michael Grasher - Piper Jaffray

Relative to today?

J. Hyatt Brown - Chairman and Chief Executive Officer

Yes, the market is working quite well. Really what happened is, is there is really less government intervention. As an example, a monopolistic state with Nevada up until about four or five years ago, they then took the state fund and made it into a non-profit and now it’s a profit making organization I believe and they are writing workers’ comp like crazy, and of course, they are using agent. Another monopolistic state West Virginia that had been monopolistic forever was losing their ears and hat and teacup in the fund. And so, they rolled off the fund, created a new company, I think the name which is Brickyard and it’s now being? is now? not for profit. In West Virginia, an agents and brokers are accessing that market, and next year anybody can come in. So, there is a movement towards having a competitive marketplace. When you have a crisis situation and you get people in political positions where they think they have to respond, because of the screaming and yelling of the populace, like we have in Florida, then all of a sudden, you are going to have a short-term Neanderthal approach. Now, has this happened before? It did, in the 60’s and 70’s. The same thing happened on automobile liability insurance, and there was a huge pike over whether or not we had no fault liability and the? what was then called the assigned risk plan for auto liability grew by leaps and bounds, and everybody was griping and complaining well. Over a period of time, the marketplace smoothed out and now the liability for private passenger is very, very competitive and has been for 10 years. So, you have these peaks and valleys, where you have a catastrophe exposure and the catastrophe exposure in the United States and as I see it is quake in California and it’s wind along of the coastal areas from Brownsville all the way to probably New York City, and of course, the most difficult and the scarcest catastrophe exposure is a cat for a level four hurricane coming into the bottom end of Manhattan. So, that's? but that's part of why the insurance companies are in the risk bearing business. They are in business to transfer risks and to take risks.

Michael Grasher - Piper Jaffray

Sure. And now, I wanted transfer over to Jim and just ask a question on the acquisitions. Given the market, has there been a surge in the pipeline due to the market, or has the pipeline remained stable in terms of opportunity? I mean it seems like this quarter and even you comments potentially reaching $100 million reflect? do reflect an increase in opportunity, can you speak a little bit more about this?

Jim W. Henderson - Vice Chairman and Chief Operating Officer

Yes, there does seem to be an increase surge in the activity. And if you? the product conversations with those who are selling, you can? you got demographics involved, you got markets involved. Demographics, the baby boomers that are looking at what do I do now, the family doesn't want to take the business over? the people inside really can't buy it. And so, this is one of those conditions that we feel like that is creating a lot more activity. So, we are pleased with the? we always have a certain amount of flow. There seems to be more than last year. We also are, in fact, looking at the more of deals and building our infrastructure to go visit and talk with more people, because I think one of the safest place we have for our shareholders is to continue to look at the small deals, they are very accretive. They really fit well. They blend well with our culture. So, we will continue to focus on that, not exclusivity away from margins. So, I think we were encouraged by the activity flow. The history? our? turning to history is about one-third organic and two-thirds by acquisitions, and we don't really see that long-term changing. Near-terms when organic is certainly a challenge by the market and by government, we are, frankly, very pleased with that. We have another option to go create growth.

Michael Grasher - Piper Jaffray

Okay. Thank you. And then just a final question or follow-up on that. How much of the smaller activity or acquisition-wise is being driven by the potential for change in change in capital gains.

Jim W. Henderson - Vice Chairman and Chief Operating Officer

Well, it definitely comes often in discussions with the sellers, when they are looking for 15% rate and allow the national press and Canada indicate that basically all that? that rate is unfair. So, there is a? it's coming up in conversation and timing matters that? is it a component by self? No, but it certainly the factor that's encouraging now versus later.

Michael Grasher - Piper Jaffray

Thanks again.

J. Hyatt Brown - Chairman and Chief Executive Officer

Thank You.

Operator

We will go next to Meyer Shields from Stifel Nicolaus.

Meyer Shields - -Stifel Nicolaus & Company

Thanks. Good morning. If we look at recent acquisition by folks by hilb and by hub, there has been a fair number of banks that have been divesting their insurance operations. Is that a trend or those are just a number of one off issues?

J. Hyatt Brown - Chairman and Chief Executive Officer

Well, I think, it's a trend. What's happening is banks are starting to vomit up their insurance agency operations. And there are a couple of banks who are doing a very good job. But for the most parts, there is a substantial difference in culture, and there is always the Board of Directors being concerned about the specter of tide house evil. And if a bank ever gets nailed on time, credit is selling insurance the client's action impact to that would be they will be saying more money than they make from insurance agency operation in a thousand years. So, all of that does have an impact, and of course, what's happening right now is there are number of banks who are divesting that are? in the marketplace as we speak. And we have actually acquired the JP Morgan one as you know. We have acquired a small amount in Kentucky about a year ago or so. And we made an offer on another one in the Southeast and it was sold internally. And then, of course, HRH bought Bank of America, and then, there is a whole bunch of things going on. So, as time goes on, I think, we are going to continue to see more of that. I think, there is another situation that's occurring where a bank is just bought another bank in the Southeast and apparently there is some of divesture concern. So, those are opportunities for us and they are opportunities for other people too.

Meyer Shields - -Stifel Nicolaus & Company

That's very helpful. Switching gears a little bit. Have there been an issue with employee turnover? Is that getting worse over the past couple of years for you folks?

J. Hyatt Brown - Chairman and Chief Executive Officer

No. The one thing about having a market like, this it does separate the good people sometimes from the people that are not quite as good because you have to be on your toes. Every account have to be very, very carefully handled. And so, that's not just at producer the level, it has to do with marking level, has to do with a customer service representative, is the whole team. And so, what we are constantly doing is one of the reason that we have? the kind of margins we have is that we try to have a very best people and try to give them additional training. Now, we have something called Brown & Brown University, which has been going now for about three years? four years. And it has been very beneficial and helping to upgrade our people and the retail P&C area and now we are ready to look to see how we ca do this in the brokerage or wholesaler area. As we go forward, the ability to run our model is very similar to the ability of a very well couched athletic team, take in look like a football team, where they have a fairly sophisticated game plan, offensive game plan, ours is really kind of like that and very good people can scroll up the touchdowns in their model, but they got to be willing to follow the model itself and to follow the leadership that has gone before them, that has shown the way. So, in the case of turnover, I don't think we have greater turnover today than we normally have.

Meyer Shields - -Stifel Nicolaus & Company

And I guess one last question. In terms of the office leadership, are you comfortable with the people you have in force now?

J. Hyatt Brown - Chairman and Chief Executive Officer

Well, we always have turnover and leadership, and that has to do with several reasons. We have 163 or 164 offices, and so the 163, 164? how many people are considering retiring, let's say, in one or two years, or three years? Well, there are several. And so, we have to then go forward and find someone. They have to start bringing on someone who will take over their positions. And we have to help them grow that individual. And then, there are just people who all of a sudden one day, say, gosh, I am going to just going to walk out, go to the beach. So, we do have some turnover. But generally speaking, our people? our leadership capital, it's the strongest today than it's ever been.

Meyer Shields - -Stifel Nicolaus & Company

Thank you very much.

Operator

We'll go next to Doug Mewhirter from Ferris, Baker Watts.

Douglas Mewhirter - Ferris, Baker Watts

Hi, good morning. I've two questions. The first is, obviously, a sort of retailers are very disappointing and also? Hyatt, you mentioned that FIU was also? was still very soft through for obviously reasons.

But given the FIU's within special programs, and correct me if I'm wrong, but special programs showed very positive overall organic growth. What seemed to be picking up the slack?

J. Hyatt Brown - Chairman and Chief Executive Officer

It's a combination of one profitable financial that we talked about, and we had some nice growth in public entity.

Douglas Mewhirter - Ferris, Baker Watts

Okay. Thanks. And the second question. Because of the contingents commissions have seemed to be, I guess restructuring and the nature of them were restructuring. Do you think, Cory, that continuance maybe less front loaded, as they have in the past? And we have seen more quarters with unusually large amounts in the second, third, and fourth quarter as opposed to just getting it all in the first quarter?

Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

The short answer is, no. And first of all, there is really only three maybe four carriers with Harford [ph] are the only one that I'm aware of that are restructuring. It is all parts of the previous settlement. I don't see? I heard of any other insurance carriers of the other 900 that we deal with that they would go to the guarantee supplemental commission. So, that takes care of that. The rest of the contingents should fall in the normal period of time. Now, the reason why we had such a larger number of contingents in the third quarter, relates primarily to the wholesale or marketplace where a lot of those carriers have? June, 30th type year-end. And so, it would just? they had good year, this past year and so the contingents were up. And so, they are really overall being much of a change in the normal flow in those contingents commission.

J. Hyatt Brown - Chairman and Chief Executive Officer

Doug, I think I pull you back on that, there is another issue here and that is when insurance carriers are making lots of money, our contingent commissions go up as a percentage of our revenue. When prices start to rise as they do when losses amount for risk bearers generally our contingents are flat or down, but we grow the other hand of this spectrum which is the organic growth. So, it's kind of balancing act.

Douglas Mewhirter - Ferris, Baker Watts

Okay. Thank you very much.

Operator

We go next to Matthew Heimermann with JP Morgan Sectors? Securities.

Keith Alexander - JP Morgan

Hi. This is actually Keith Alexander calling on Matt's behalf.

J. Hyatt Brown - Chairman and Chief Executive Officer

Okay

Keith Alexander - JP Morgan

Just one follow-up question. I was wondering if you guys could discuss how changes in price and exposure have possibly led to any changes in compensation or commission ratios or how these three factors are moving on relative basis?

Jim W. Henderson - Vice Chairman and Chief Operating Officer

Well, first of all, relative to our commissions of the company commission of the same. However, we are getting some additional commissions from some companies and it's kind of sporadic and its not across the country, but that's probably going to become a little bit more prevalent as they continued to got the prices. So, that's the top end and in terms of the way we paying people, there is no difference.

Keith Alexander - JP Morgan

Okay. Great. That's all we had.

Operator
[Operator Instructions]. We go next to John Fox with [inaudible] Asset Management.
Unidentified Analyst
Hi, good morning. I have a question from Powell. If you had the dollar amount for FIU this quarter and last year?
J. Powell Brown - President
John, last year FIU had about $4.42 and then this year it was just little over $2 million. So, there was roughly $2.1 million draft in the third quarter.
Unidentified Analyst
Okay. Great. And then for Jim, I can't remember any type of projection I mean about acquisitions before, but are you telling us to expect $100 million or does just the pipeline looks good and what's the message here?
Jim W. Henderson - Vice Chairman and Chief Operating Officer
That's up to run rate, John. And we never have? we never have forecast normally.
Unidentified Analyst
And so, that you are analyzing the current run rate.
Jim W. Henderson - Vice Chairman and Chief Operating Officer
Yes, the current run rate, that's right.
Unidentified Analyst
Thank you.
Jim W. Henderson - Vice Chairman and Chief Operating Officer
They have never done until the one.
Operator
We will go next to Nick Fisken of Stephens Incorporate.
Nikolai Fisken - Stephens Inc
Hey, good morning everybody.
J. Hyatt Brown - Chairman and Chief Executive Officer
Hi, Nick, how are you?
Nikolai Fisken - Stephens Inc
Good. How much of Florida is casually?
J. Hyatt Brown - Chairman and Chief Executive Officer
I don't know
Nikolai Fisken - Stephens Inc
Just kind of goal post, it if you can.
J. Hyatt Brown - Chairman and Chief Executive Officer
Well, it will be a scientific wild guess, yes.
Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer
You got personal lines, you got marine, and so, let's see employee benefit is about $200 million. Casualty, when you talk about Florida, only is that right, Nick?
Nikolai Fisken - Stephens Inc
Correct.
Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer
Maybe 40%, but that's kind of a guess. I have to look at that.
Nikolai Fisken - Stephens Inc
Okay. And Cory, what's your outlook for a contingents for the fourth quarter?
Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer

Right now, it should be well less than $1 million, maybe $0.5 million from what we know right now
Nikolai Fisken - Stephens Inc
And then if you look at the four underwriters that are paying you these guarantied contingent, do you know how much they paid you last year in the form of the regular weight contingent?
Cory T. Walker - Senior Vice President, Treasurer and Chief Financial Officer
Yes, it was about the same amount. We was around $6 million in total contingent, and so, right now, on the run rate, right now, we are running at $6 million and $6.5 million. So, I think it's almost a wash.
Nikolai Fisken - Stephens Inc
Okay. And then last question for Hyatt. If you look at '08, you guys are pretty confident? you guys can hit that B part of the B40 goal, but I am wondering more on the 40%.
J. Hyatt Brown - Chairman and Chief Executive Officer
Well, I will tell you, right now, we have never normalized earnings and so, for instance, whenever we had the numbers last year where we had $5.8 million payment to the folks in [inaudible], we did normalize those in our own thinking. So, this year including the Rock-Tenn sales, we are probably going to be 40% in terms of the margin and I think Wall Street has a falling a little below the B and so is it going to be $15 million below B I don't know, but that's what some of the Wall Street estimates are as I understand it. And what we are in the process of doing as a mater of fact is our leadership meetings start Wednesday and we are going to talk about the next intermediate goal and because of a rolling 12 sometime in the not to far distant future we are going to be at the B. So, we will declare a victory and then go to the next intermediate goal, and we don't know exactly what that's going to be. But I think you can probably figure it out by just thinking about it.
Nikolai Fisken - Stephens Inc
So, if I look at margins year-on-year, you are down about 80 bits just on the comp and other Op expense, is there any reason that should not continue?
J. Hyatt Brown - Chairman and Chief Executive Officer
Well, it depends it might continue it might not. And so if you look back at our history, of course, you cannot look at one quarter or maybe any six months and say, it's up or down. We continuously except for the cases I am talking about pretax now and you are thinking EBITDA, that's sort of cases where there was a change and the amortization from 20 to 15 years our pretax have gone up fairly evenly. And so, we think there is still upward mobility, and we are going to see if we can get there.
Nikolai Fisken - Stephens Inc
Okay. Thanks.
Jim W. Henderson - Vice Chairman and Chief Operating Officer
This is Jim. If you look at the acquisition activity and if that comes in and unless it matches obviously the current rate there is some impact on margins from the acquisitions, and they come in at a very higher rate, some of them are not going to come in at the longest that much to have Brown & Brown rate.
Nikolai Fisken - Stephens Inc
Okay, thank you.
Operator
If there are no further questions at this time, Mr. Brown, I would like to turn the conference back over to you for additional or closing remarks.
J. Hyatt Brown - Chairman and Chief Executive Officer
Okay. That's all we have, and so, good luck everyone and we will see you in January.
Operator
This concludes today's conference. We do appreciate your participation. You may now disconnect.