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Ryan Specialty Group Holdings, Inc.

(RYAN)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to the Ryan Specialty Group's Second Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to your host, Noah Angeletti, Treasurer of Ryan Specialty Group. Thank you. You may begin.

Noah S. Angeletti
Senior Vice President & Treasurer, Ryan Specialty Group Holdings, Inc.

Thank you, operator. Good afternoon and welcome to Ryan Specialty Group Holdings second quarter 2021 earnings call. This afternoon, the company released its financial results for the quarter ended June 30, 2021. The earnings release is available on the Investors section of the company's website at ryansg.com.

I would like to remind everyone that certain statements made in the course of this call are not based on historical information and may constitute forward-looking statements. Any statements that refer to projections, forecasts or other characterizations of future plans, events or circumstances, including any underlying assumptions, are forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of trends and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. I'll refer you to the company's filings made with the SEC for a more detailed discussion of the risks and factors that could cause actual results, levels of activity, performance or achievements to differ materially from those expressed or implied in any forward-looking statements made today.

The company undertakes no duty to update any forward looking statement that may be made during the course of this call except as required by law.

Additionally, certain non-GAAP financial measures will be discussed on this call. Our presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. Reconciliations of these non-GAAP financial measures to the most closely comparable measures prepared in accordance with GAAP is included in our earnings release, which is available on the Investor Section of the company's website at ryansg.com.

With that, I'd now like to turn the call over to the Founder, Chairman and Chief Executive Officer of Ryan Specialty Group, Pat Ryan.

Patrick G. Ryan

Founder, Chairman & Chief Executive Officer, Ryan Specialty Group Holdings, Inc.

Thank you. Good afternoon, everyone. Thank you for joining us on our second quarter 2021 earnings conference call and our first call as a public company. I'd also like to thank you for your interest and in support of Ryan Specialty Group.

On today's call, I'll provide an overview of the strengths of our business model and our competitive advantages and our President, Tim Turner, will give an update what is happening at each of our three specialties. And finally, our Chief Financial Officer, Jeremiah Bickham, will walk you through the quarter in more detail, absent for share details since were not yet a publicly traded company in the second quarter, and then we'll open it up for Q&A.

Given that we're newly public, I want to take a moment to speak to those of you who may be new to the Ryan Specialty Group story, to provide some color on [ph] why a part of the company of (03:19) what we've built and how we provide meaningful differentiated value to our clients and how we expect to continue to win in the future.

As the name suggests, Ryan Specialty Group is a specialty insurance solutions company and generally are not involved with placing more standardized insurance, like typical auto or homeowner's insurance, we facilitate hard-to-place risks that require a different type of expertise in the specialized area of insurance.

In typical insurance transaction, the consumer will purchase insurance directly from an insurance company or will engage a retail broker, and will go direct to the insurer. But for more complex and hard-to-place risks, Ryan Specialty Group [indiscernible] (04:11) as an intermediary between the retail broker and the insurer. We facilitate the placement of these specialty risks by assisting the insurer and the broker in various ways.

In 2010, it became clear to me that there was a growing and unmet need for specialty insurance solutions. The world was rapidly changing and risks were becoming much larger and far more complex. In my view, there was no scaled specialty insurance platform that could assist retail brokers and carriers in fully addressing this growing universe of complex risks, and also provide a place where the best and brightest talent in an industry that self-optimize.

As a lifetime sports fan, I'm partial to sport metaphors. The one that has always resonated with me is a quote from the greatest hockey player of all time, Wayne Gretzky. When asked how he was such a prolific goal scorer, his response was simple, I skate to where the puck is going to be, not to where it is. That's the perfect way in my mind to describe our thought process, because I always believe in anticipating change, [ph] and been (05:35) encouraged to take the necessary action to implement that change and staying ahead of the curve with the change. This philosophy enables us to be a first mover and I believe we're real disrupter in our industry.

When we started, we observed four clear trends in specialty insurance, trends that continue to this day and in many cases are accelerating, risks still coming larger and more complex, [indiscernible] (06:04) excess and surplus, or the E&S market, was poised to significantly expand over time. Also retail brokers were looking to use fewer wholesaler than they had been doing historically and to amplify the opportunity for a full-service counterparty that have the necessary breadth and depth, and specialty expertise. Same time, retail brokers were becoming larger through organic growth and the massive wave of consolidation. This was going to fuel the growth of well-positioned wholesalers with the expertise to serve on their preferred wholesale broker panels. And importantly, delegated authority that was accelerating quickly. Carriers were outsourcing underwriting, administrative functions, and distribution. This delegated authority allows carriers to be more agile and significantly reduce their overall investment needs, as well as to replace fixed costs with very little expenses.

On the other hand, individual underwriters, many of whom have been dislocated by the consolidation of carriers, often were seeking to join entrepreneurial firms like Ryan Specialty so they could be empowered to innovate. With a clear long-term opportunity in front of us, Ryan Specialty Group was founded to fill that important need and build a platform that both empowers our producers and our underwriters to innovate, as well as to take calculated risks on behalf of their client that ultimately best position them to succeed.

I think, we've absolutely risen to the moment with regard to these opportunities. Since the founding Ryan Specialty, we've grown rapidly, both organically and inorganically. We are now the second largest property and casualty insurance wholesale broker in the US and the third largest property and casualty managing underwriter, also in the US. [ph] I'm now (08:13) very proud each and every one of our nearly 3,400 teammates who joined us on this journey and have collectively worked together to bring us to where we are today. We grew our revenue 20% organically in 2020. We've continued with our strong momentum in 2021, recording over 28% year-over-year organic revenue growth in the second quarter, while generating [indiscernible] (08:44) adjusted EBITDAC margins.

If we think about our company, the qualities that clearly set us apart from our peers and first of all, are our diverse areas of specialty. Secondly, our independence. We have no tattle conflicts with our retail insurance brokers and most importantly, our expertise in specialty insurance. Taking a step back, we focus primarily on the rapidly growing E&S market, which was $55 billion in direct written premium at year-end 2019 with a focus on complex policies. Also requires specialized expertise to provide innovative solutions and procure the best available coverage options on behalf of insurers. There are number of reasons for the rise in complexity. Among them, climate change, recent larger catastrophic events, growing cyber threats, [ph] or just jury verdicts (09:53), we call that social inflation, novel health risks and many others. Moreover, Admitted carriers are declining certain areas of coverage due to past generation of elevated losses. Result of that was more complex coverages have shifted into the E&S market and the traditional market no longer provides a viable solution.

To that end, independent full service model, scaled distribution platform and expertise allow us to clearly differentiate our business closer to our peers and to take advantage of the strong and evolving secular trends. We offer our clients, insurance brokers and carriers, tailored and creative solutions to address those unique and complex risk profile from our platform to support and collaborate with both insurance brokers and carriers, the broadest product access, underwriting knowledge and a comprehensive distribution network. This has enabled us to become a preferred and trusted partner for 97 of the top 100 retail insurance brokers in the US.

As retail brokers continued to expand and have larger needs for the assistance in specialty insurance services and products, Ryan Specialty remains well-positioned to provide them with a one-stop holistic solution. Briefly, as I mentioned before, we have no retail insurance brokerage operations, ensuring we remain free of channel conflicts with our client. We are firmly committed to never competing with our retail broker clients. We cannot over-emphasize how important we believe this is to our business. Our success is driven by our proven ability to make Ryan Specialty a destination of choice for producers and underwriters. And we believe that they will attract and retain the best talent in the industry.

We believe we've created a unique environment where our producers and underwriters are empowered to succeed. Innovation and empowerment are two of our defining attributes fundamental to our culture. We want our professionals to take calculated risks when appropriate and to think like entrepreneurs and owners. We've provided them with the tools and freedom to establish themselves, think outside the box to create new ways of delivering best-in-class results for our clients.

They also seek multiple perspectives to enable us to find the best solutions. As a result, in 2020, we retained 97% of our producers. We believe producers join Ryan Specialty for an incredible opportunity and culture that we foster. And they stay, because they're rewarded an incentive to succeed in the way that aligns them with each other and the company.

As we think about our path forward, we believe we're in a prime position to grow and prosper. We will continue to invest in our growth and ensure Ryan Specialty remain a destination of choice for the industry's top-tier talent. We will continue to lead with innovation and meet the ever changing needs of the market. We'll expand and deepen our relationships with our current clients and continue to win new clients. And we'll continue to expand our organic growth capabilities into the future, executing on strategic M&A. [ph] We're fond of saying, (13:59) that today's acquisitions are tomorrow's organic growth. Since inception, we have partnered with over 40 firms through acquisitions.

In summary, I am tremendously proud of what we created and developed at Ryan Specialty over the past decade. We have built a winning culture that emphasizes successful outcomes through our expertise, our skill and our unrelenting and passionate work ethics to deliver a value proposition, is clearly resonating in the market, mostly by our talent and our trading partners in the insurance industry, without whom none of this would be possible. I'm truly excited for our future and our ability to continue to deliver long-term value for our shareholders.

Now, I'd like to turn it over to our very capable President, Tim Turner, to get into more detail. Tim?

Timothy W. Turner

President & Director, Ryan Specialty Group Holdings, Inc.

Thank you, very much, Pat, and good afternoon, everyone. As Pat highlighted, at Ryan Specialty Group, we focus on partnering with our retail insurance brokers and agents to assist them with complex policies and hard-to-place risks. These complex risks are often placed in the E&S market, which represents approximately 17% of the US commercial insurance market where there is significantly more freedom to underwrite, bespoke, complex, larger, or higher hazard risks. Importantly, our trading partners know they will see no drop-off in quality when they work with us, as we act and execute as a seamless extension of their practice group specialties.

Notably, the flexibility of the E&S market is perfectly aligned with today's global challenges and offers Ryan Specialty a tremendous opportunity for growth. For example, the COVID-19 pandemic has forced the entire insurance industry to reconsider how it deals with contagious disease and the risk associated with it. Additionally, there is significant opportunity for us to grow our business in newer emerging sectors such as shared economy [indiscernible] (16:22), renewable energy, healthcare, cyber risks, where carriers may have less of an appetite given a myriad of legal and regulatory complexities. We have the ability to facilitate coverage in many cases that would otherwise be unattainable.

To that end, we believe all great businesses have a clear value proposition to their key constituents and ours is no exception. For retail brokers, we help them become more efficient and our force multiplier for seamless execution on behalf of their clients. We also provide access to insurance markets that might not otherwise be available to them, because of the insurance companies' chosen distribution model of utilizing a specialist, be it a wholesale broker, finding authority, or managing general underwriter. We specialize in this small area of their business to enable them to bring the same level of excellent service for every risk that comes across their desks, while maintaining the quality that their clients. the insurers, are accustomed to.

For our employees, we attract and retain the best talent in the industry, in part by giving them access to over 15,000 retail agent and brokerage firms and their large platforms across the country. This broad reach is an enormous competitive advantage. Talent thrives on having a myriad of opportunities to succeed. Our independence, scale and entrepreneurial culture, ensures that we have the most opportunities to prosper. Importantly, carriers rely on us for product expertise as well as distribution and administrative capabilities. We are a source of innovation and a critical filter in the underwriting process.

To provide a little more context, we offer retail brokers a comprehensive, full service solution through our three specialties. At our Wholesale Brokerage specialty, we distribute a wide range of diversified mix of specialty insurance products and solutions from insurance carriers to retail brokerage firms, such as specialty, P&C, professional lines and workers' compensation. These typically involve the retail agents' most challenging risks. These policies are submitted on a brokerage basis and it is up to the insurers to make the underwriting decision.

Our Binding Authority specialty provides timely and secure access to our carrier trading partners and has delegated underwriting authority as well as critical, administrative and distribution responsibilities to us through our in-house binding agreements. These policies are submitted on a bound basis and are generally more uniform in design, for example, builders' risk and coastal properties.

Our Underwriting Management specialty offers insurance carriers variable costs, specialty expertise, in distinct and complex market niches underserved in today's marketplace through 21 underwriting managers and 29 national programs. These carriers have provided us with the authority to design, underwrite, and bind coverage and administer policies for specific risks. These policies are submitted on a bound basis, and generally have a higher level of underwriting complexity, for example, reps and warranties, coverage for M&A, cyber coverage, and renewable energy.

Looking ahead, we see multiple avenues for sustainable growth. We will continue to innovate and organically grow our top line, driven by broadening and deepening our retail brokerage firm relationships. It's worth highlighting that we have historically grown faster with our largest trading partners. In 2020, our growth with the top 100, the most coveted clients, we have the most E&S business as ranked by Business Insurance, exceeded our organic revenue growth of 20% for the same year.

Talent development and recruitment is also essential. We will continue to recruit the best talent in the industry, as well as onboard new professionals into the industry through our heralded RSG University, our world-class training and development program for the next generation.

We also plan to continue our core competency of making select acquisitions where we see clear opportunities to partner with successful specialty firms that are aligned with our goals, our culture and our values. As you know, we've acquired over 40 firms since our founding. Most notably, last year, with All Risks, our largest acquisition to-date. With respect to All Risks, the integration is proceeding very smoothly. Producers at both companies are working together as one team out in the field. The acquisition of All Risks, the number four largest wholesale distributor in the United States at the time of acquisition, gave us further scale in insurance markets where we previously had less reach, provided us a deeper and significant market segmentation, expanded our domestic footprint in a meaningful way and accelerated our vision with respect to the Binding Authority platform. It is rewarding to see that the combination is already yielding very positive results, and we expect it will be a major contributor to our long-term success.

We will also seek to expand into natural adjacencies. We recently hired an industry expert and proven leader, John Zern, who is the former CEO of Global Health Solutions at Aon. He brings to us over 30 years of health and risk strategy experience and will be developing our new employment benefits specialty, which will focus on wholesale benefits, brokerage and managing general underwriting capabilities, to serve the needs of our retail brokers.

In addition, we see a tremendous opportunity to comprehensively address the fragmented delegated authority market, which represented over 40% of the E&S premiums in 2019 and where both M&A and panel consolidation are in their very early stages. With All Risks, we have the size and capabilities to build the first truly 50 state Binding Authority operation. We expect to provide updates on these initiatives and our continued progress at our specialties in the quarters ahead.

With that, I would now like to turn the call over to our Chief Financial Officer, Jeremiah Bickham, who will give you more detail on our second quarter financials. Thank you.

Jeremiah R. Bickham

Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

Thank you, Tim, and hello, everyone. Let's go right into our second quarter results. So for the second quarter, we generated $390 million of total revenue, which represents a 58% increase over the $246 million in Q2 of last year. Our strong revenue growth for the quarter was attributable to both the acquisition of All Risks, which we completed in September of 2020, and organic revenue growth of 28.5%.

This exceptional organic revenue growth was driven through a combination of new client wins, expanding relationships with existing clients, and a higher rate of growth in our total addressable market, as risk continue to flow out of the Admitted market and into the E&S market, which is where we place the majority of our business. Further, multiple classes of risks realized year-over-year premium rate increases, which drives commission revenue growth which is typically calculated as a percentage of total premium.

At each of our three specialties, revenue growth was strong across the board, marked by solid organic revenue growth and contributions from the All Risks acquisition. So breaking down total revenue by specialty, our Wholesale Brokerage business posted very solid results with net commission and fee revenue of $256 million, which is a 49% increase relative to the $172 million in the same period last year.

Net commission and fees at Binding Authority were also very strong as they grew 70% to $54 million compared to the $32 million in the prior period last year. Finally, Underwriting Management grew net commission and fees revenue to $80 million this quarter, which is an 89% increase compared to the $42 million in Q2 of last year.

Moving down to P&L, total operating expenses for the second quarter were $298 million, or a 58% increase compared to the same quarter last year. This was primarily due to compensation and benefits expense of $237 million, which is an increase of 51% from the prior year period. It's important to note that compensation and benefits expense is heavily correlated with revenue growth, as many of our producers are compensated based on a percentage of the revenue that they generate for the company. We also saw an increase in both acquisition-related long-term compensation, which is primarily due to the All Risks acquisition and non-cash equity-based compensation in the second quarter as well.

Now, I'm proud to report that our compensation and benefits expense ratio improved 300 basis points year-over-year to 60.7% and our adjusted compensation and benefits expense ratio improved 460 basis points to 56.5%. General and administrative expenses were up $9 million, or 40%, period over period. This increase was driven by cost to support revenue growth and the All Risks business flowing into the P&L as well as an uptick in travel and entertainment spending during the quarter as we saw COVID-19 restrictions begin to relax. This increase was partially offset though by a decrease in our acquisition-related expenses compared to the prior year period.

Now our G&A expense ratio improved 100 basis points year-over-year to 7.9%. Our adjusted G&A expense ratio was 7.4% in Q2 this year compared to 7.1% in the same quarter last year. The increase in this ratio was primarily due to increased travel and entertainment spend, as pandemic restrictions began to relax. However, given the lingering and ongoing impact of the pandemic, we still have not yet returned to our pre-COVID levels of quarterly T&E spending.

Finally, amortization expense increased $18 million period-over-period, primarily due to the amortization of acquired intangibles from the All Risks acquisition. Adjusted EBITDAC for the second quarter grew 79% year-over-year to $140 million compared to $78 million in the prior year period. Our adjusted EBITDAC margin increased 420 basis points to 36.0% compared to 31.8% in the prior year quarter. Now, primary drivers included, one, our revenue growth driving scale in compensation and benefits expense and G&A, and two, the continued execution of the company's restructuring plan which we initiated in 2020. When this plan is complete, we expect to achieve $25 million in cumulative annualized saving and we anticipate that the remaining actions of this plan will be executed by June 30 next year.

Now, regarding our adjusted EBITDAC margin. Historically, on a seasonal basis, the second and fourth quarters are the strongest in terms of margin, while the first and third quarters are typically lower. Additionally, we continue to invest in the long-term growth of our business, including our previously mentioned wholesale employee benefit specialty as well as investments in our platform, so we can continue working towards long-term growth opportunities. Further, we also expect T&E cost to normalize to pre-pandemic levels in the coming months ahead and we now have additional material costs associated with being a public company. As such, we are looking in the medium term to maintain margins that are relatively consistent with our current annual levels. Over the long term, we do expect that our exceptional growth will yield operating leverage, but we're not quantifying that at this point.

Net income for the second quarter of 2021 was $63 million, which is a 27% increase compared to the $50 million in Q2 of last year. Net income margin was 16.3% this quarter compared to 20.3% in the prior-year period. This change is due to the fact that operating income was partially offset by certain non-operating charges taken in connection with the IPO, amortization of acquired intangible assets related to the All Risks acquisition, and an increase in interest expense from the debt used to fund the All Risks acquisition. As we look ahead to the third quarter, we want to point out that we expect to record a significant equity-based compensation expense related to the IPO which is, of course, one-time in nature.

To provide additional visibility as well, we are providing a full year 2021 outlook for both organic revenue growth and adjusted EBITDAC margin as follows. Organic revenue growth rate for the year 2021, the full year 2021, is expected to be between 18% and 20%. As a reminder, All Risks will become part of the organic revenue growth calculation beginning in September of 2021. Adjusted EBITDAC margin for the full year 2021 is expected to be between 30.0% and 30.5%.

With that, we thank you very much for your time and we'd now like to open up the call for Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question is from Weston Bloomer of UBS. Please state your question.

Weston Bloomer
Analyst, UBS

Q

Hi, good evening. My first question is on organic growth. I believe the outlook implies around 15%, or 13% to 17% in the second half. I was hoping you kind of expand on how we should think about that in the 3Q versus the 4Q and maybe also expand on how you're thinking about the pricing dynamics in E&S shaping out in the second half of the year and then thoughts around new client wins as well? Thank you.

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

Thanks for your question, Weston. We are not giving guidance by quarter. But yes, your math for H2 is roughly correct. Q2 had exceptional organic growth and we certainly don't plan for growth numbers like this every quarter. Our forecast and the way we budget are, of course, prudent and achievable and they don't factor in market dynamics that we're seeing right now, like the current pricing dynamic and the heavy flow into the E&S market. So, we view the overall guidance for 2021 of 18% to 20% as very achievable. And if the opportunity is there, we will, of course, you can see from this quarter and prior quarters that we're capable of exceeding that when the opportunity presents itself.

Tim, did you want to add anything to the pricing dynamic part of the question?

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

Sure. We don't always focus on the rate in our industry. It's more on the flow of business into the channel, the dumping and the shedding of business from the standard market. And that flow is continuing to rise. Our opportunities continue to increase in the E&S space. The percentage in non-admitted business continues to grow. Very, very modest rate deceleration that we see in one or two lines, but overall, continued growth and rate increases.

Weston Bloomer
Analyst, UBS

Q

That's great. Thank you. Just one more on pricing. It sounds like you're expecting a slight deceleration in the second half, is there a way to think about that as we move into 2022? And can you just talk through the different avenues for pricing strength as we move through the second half of the year and into next?

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

There continues to be what we refer to as niche-firming phenomenon. Lines of business like cyber and healthcare and transportation and others that continue to firm and rates continue to increase substantially. So, again, this talk about rate deceleration is very modest. We don't have a lot of data on that. Again, we measure the increase in flow and opportunities that come into our channel. That's really the governing factor for us.

Weston Bloomer
Analyst, UBS

Q

Got it. Thank you. And if I could sneak one more in on M&A. Just curious on what you're seeing in your pipeline, if that's changed at all since you've become a public company, if that's helped more targets come to the table and what are you seeing in terms of multiples and size of deals in your pipeline currently?

Patrick G. Ryan
Founder, Chairman & Chief Executive Officer, Ryan Specialty Group Holdings, Inc.

A

Well, this is Pat. I'll answer the first part. There's been a strong flow across the board and transactional wholesale, finding opportunities, program opportunities and benefits. Lots of different reasons why people are selling, some of them are probably tax motivated. But there's a lot of consolidation going on in the industry. So, we have to hold back, obviously, during the IPO. But we've had discussions with people and that we're very confident that the pipeline is strong, high quality and we're expecting to be on our plan or as we've outlined in the S-1.

Weston Bloomer
Analyst, UBS

Q

Great. Thank you. Appreciate all the color.

Operator: Our next question is from Elyse Greenspan of Wells Fargo. Please state your question.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good evening. My first question, starting off on the organic side, so recognizing that you don't want to give guidance by quarter, but just as you think about the first half was 24% and you are expecting somewhat of a slowdown in the second half. Can you just give us the components, whether it's you expect perhaps a little bit less business to come to the E&S market or just lower level of new business? I'm just trying to understand what might lead to that type of slowdown.

And then if we look at the quarters of last year, the Q3 actually should represent your easiest comp, so if there is just some level of conservatism embedded within this – within your organic growth guidance?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

It's – we wouldn't call it conservatism, but definitely, prudence and we don't want to bake in, like I said, favorable market dynamics. You are right that in terms of comps, Q3 should – Q3 is traditionally our smallest quarter, but the comp for Q3 is the easiest of the four, Q4 is certainly our hardest. And I'm glad you asked, because the outlook for H2 is not meant to signal anything that we're seeing in the market in terms of a reversal of flow out of the E&S or a major whipsaw on the pricing side. It's more a function of just how we forecast.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

And have you seen – recognizing obviously we're into September at this point, have you guys seen any slowdown in the third quarter to-date, just given that we are two months into the quarter or just say, slowdown in terms of revenue growth?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

No. We are tracking to our plan. I want to stop short of giving color on the quarter or going past Q2, but we are on track for Q3.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. And then in terms of your margin, can you just give us a sense, like also, like you guys will have the public company cost, you mentioned T&E normalizing, and investing internally. Can you give us a sense which represents the larger pieces to the kind of margin in the second half, like [ph] is there (39:57) going to be some deceleration in the second half from where the margin was comping in the first half of the year?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

Yeah. Well, so Elyse, I think, you correctly hit on all of three buckets. So, how we get from our, call it, H1 margin to the year-end guidance is those three things, so seasonality, T&E, and public company costs. So, as a reminder, Q1 and Q3 are our weakest quarters in terms of revenue and margin, it's highly correlated with Q2 and Q4 being the strongest. In fact, often Q2 is our strongest margin quarter. So, even under normal circumstances, we would expect Q2 to be well above our forecasted annual margin. And this year is no exception, although it has the boost of exceptional revenue growth.

So, seasonality, number one. Q2, likely our highest margin quarter, the offset to that is Q3, it's historically well below the annual margin, with Q4 typically coming closer to our annual margin.

Now, additional context is, COVID restrictions began to relax in Q2, but we're expecting that to continue increasing and for us to not be at a full run rate by the end of the year, but perhaps by November or December be closer to pre-COVID levels of spending. So that's going to be a drag on margin as well. And then, of course, we went public in July, so there were no ongoing public costs represented in the P&L through Q2. That is going to be a material impact on margins for H2. And then of course, looking into next year, we'll have the full-year, not only of public costs, but T&E. So, keep that in mind as you're tweaking your model.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. Thanks for the color.

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

Of course.

Operator: Our next question is from Tracy Benguigui of Barclays. Please state your question.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thank you. Not to rehash it too much, but is it fair to say in your outlook expectation that you're basically neutralizing any rate increases, [ph] or agnostic (42:30) to where rate is in those figures?

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

No, we believe rates will continue to increase in most lines and specialty segments that we're in. Again, we really measure flow into the channel, the dumping and the shedding of business in the standard market. And that continues to increase measurably based on the surplus lines stamping offices that flow through our national organization, WSIA. So, we see no slowdown in that at all.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. So, the variability is on slowdown, basically?

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

It's a stronger metric measurement for us than rate, and again we see no slowdown in flow into our channel, whatsoever.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay.

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

But Tracy – okay, go ahead.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Go ahead.

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

No, no. Go ahead. We're fine.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. And out of your three segments, how would you – which ones would you characterize to have the largest organic revenue growth and margin potential?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

So we, Tracy, manage the business as a single operating segment. So, that's how we budget. We think of organic on a consolidated blended basis, so that's how we report. We do show revenue disaggregation by specialty in the financials, so hopefully that's helpful. But the important thing to remember is two things. One, all three specialties are capable of double-digit organic growth. They all benefit from the fundamental building blocks of our organic growth engine that allow us to capture double-digit organic growth agnostic of pricing cycles. And the other thing is, is that they're all firing on all cylinders right now and all benefiting from current market conditions.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thank you.

Operator: [Operator Instructions] Our next question is from Meyer Shields of KBW. Please state your question.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yeah. Great. Thanks. I'm going to take advantage of the fact that it's September also, how is the Delta variant impacting clients' assessment of exposed units?

Timothy W. Turner
President & Director, Ryan Specialty Group Holdings, Inc.

A

At this point, we saw a direct impact on small commercial in our Binding Authorities. But that's recovered now. So, there really, it hasn't [ph] been (45:45) any material or measurable impact from the Delta variant surge. It's affected some of our meetings and our industry gatherings have slowed back down and we have some cancellations. But actually, we're more efficient, we're more productive. We're converting more opportunities. So, while it's a distraction and a minor setback at the moment, we're really making the best of it working remote. And we see small commercial recovering. Small businesses are opening. There's much more construction going on and even in the small area. So, things are moving along uninterrupted really in the E&S channel.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Perfect, that's helpful. And I know we've talked about this a lot on the call, I apologize for bringing it up again. But is the implicit organic growth guidance for the second half of the year, is that assuming no rate changes, no changes in the pace of rate increases? How should we think about that?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

Think of it as very little impact from additional rate increases. Again, we want to separate that from what we're seeing in the market. It's – we just don't factor in to our budget the impact of, like current market dynamics. They're really hard to predict, they can change unexpectedly. But again, it's not meant to be a signal of what we're seeing in the market. As Tim said, the vital signs of the E&S market are very healthy.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. That's helpful. Is there any way of keeping out maybe what you think the market impact was in the first half of the year?

Operator: I'm sorry? Hello.

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

Would you like to repeat that question? I'm sorry.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yeah. I'm sorry. I was asking like when we look at the first half of the year organic growth, is there any way of saying, okay, this was the market impact from rate increases, again, obviously not budgeted in. But just to give us a sense of how much of a contributor that was in the first half of the year?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

So, Meyer, I – we are not going to break out the impact of rate specifically. It's hard to measure and even harder to interpret meaningfully. As Tim said, the more meaningful metrics that we track is flow into the E&S market. So, let's think of those as a bundle. Historically, we've been able to grow at least low-double digits with no impact of heavy flow or rate increase, in fact, in several years where rates were going the opposite direction. So, it's not a perfect walk but you can see the difference that current market dynamics are at least contributing to when you go from low-teens to high-teens or 20s. I mean, the important thing to remember is, Meyer, that our growth, even double-digit organic growth, is not dependent on market dynamics like we're seeing now, because these are not meant to last forever. But when the opportunities are there, we are market-plus growers as this quarter and this whole year demonstrates.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Perfect. Thank you. That was very helpful.

Operator: Our next question is from Mike Zaremski of Wolfe Research. Please state your question.

Mike Zaremski
Analyst, Wolfe Research LLC

Q

Hey, good afternoon. Thanks. Maybe switching gears for a second to the M&A environment, kind of curious, is there a kind of a broad flavor of size of transactions we should – you guys are looking at? Is it kind of mostly, like smaller tuck-ins or is it going to be a mix of kind of larger transactions and tuck-ins? Any color would be helpful.

Patrick G. Ryan
Founder, Chairman & Chief Executive Officer, Ryan Specialty Group Holdings, Inc.

A

Well, we always look at acquisitions to improve our offering to our clients. Parallel to that, we look at acquisitions that are beneficial to our shareholders. And so, it can be tuck-in and have generally been tuck-ins. But I would tell you that, because yes, the current status, there is more activity in larger, not tuck-in, but different specialty lines expertise that can be managing underwriting, often are managing underwriting. There's a robust interest in delegated authority growth and so buyers are out there and that's attracted sellers. And so, right now, I would say that the average deal that we're being exposed to is larger than the norm.

Mike Zaremski
Analyst, Wolfe Research LLC

Q

Okay. That's helpful, Pat. Maybe moving back to organic growth and I'm just going to focus on this quarter. I'm not trying to focus on the forward looking like lot of the the previous questions, but is there any flavor or context around some of the acceleration in growth that we should be thinking about? Perhaps, maybe there were some larger, chunkier account placements that kind of came through? Anything kind of more, might be kind of not one-off but just a more near term trend or is it just really what you guys have been saying, just everything is – all the segments are hitting all cylinders?

Patrick G. Ryan
Founder, Chairman & Chief Executive Officer, Ryan Specialty Group Holdings, Inc.

A

It's more of the latter. It's a real measurable increase in flow into the channel and we're capturing a large share of that. So, it's again very difficult to pull out rate, new versus renewal. It's much more accurate for us to look at the percentage of non-admitted business overall and how much of that flows into our world and how much we can capture. So, it's all very specialized by discipline, but as an example, construction, construction is picking up again, we read about it every day. So, infrastructure projects, residential construction, all of that is starting to really pick up and boom and that's one of our top specialties. So – and lots of other segments that we can see this increase in flow.

Mike Zaremski
Analyst, Wolfe Research LLC

Q

Okay. Got it. And maybe I just sneak one last one in. Is there going to be a potential difference between the cash tax rate and the GAAP tax rate going forward? And I guess, for thinking about the Class A shareholders?

Jeremiah R. Bickham
Chief Financial Officer & Executive Vice President, Ryan Specialty Group Holdings, Inc.

A

So, Mike, the best way – the best guidance I can give you, I won't go through the details of how taxes at a LLC show up or don't show up on the P&L versus the C-corps, I know you understand that. The most comparable view of taxes for us is going to be in our adjusted net income walk, where we show what's called adjusted tax expense. And that basically assumes that the C-corp owns all of Ryan Specialty Group LLC. And so, you see a consistent tax rate for the entire company, when in reality, right now, the PubCo or the C-corp only owns 42%, 43% of the LLC.

So, as that changes over time and in thinking about us relative to other C-corps, I think that adjusted income tax expense which is basically a pro forma 25%, is the best calculation to use for your model. Because in reality, the cash taxes that the C-corp – that the PubCo holding company, C corp pays to the government will be one piece of it. The cash tax is paid directly to the government on behalf of the C-corps that the LLC owns are going to be the small piece. And then, there is tax distributions that go to all holders of the LLC, including the PubCo C-corp. So, the simplest, most comparable fair view is that adjusted income tax expense in the adjusted net income walk.

Mike Zaremski
Analyst, Wolfe Research LLC

Q

Thank you.

Operator: There are no more questions at this time. We have reached the end of the question-and-answer session. I will now turn the call back over to Pat Ryan for closing remarks.

Patrick G. Ryan

Founder, Chairman & Chief Executive Officer, Ryan Specialty Group Holdings, Inc.

Thank you, operator, and thank you, ladies and gentlemen. In closing, I'd like to thank our entire team here at Ryan Specialty for their tremendous work and dedication to get us to this point and for always delivering the highest quality service to our clients. I really believe that our exceptional talent has us in a position to continue delivering well into the future. Thanks, everyone, for joining our inaugural quarterly earnings call and we look forward to speaking with you all next quarter.

Thanks, very much. Have a good evening.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.