09-Jun-2022

Ryan Specialty Holdings, Inc. (RYAN)

William Blair Growth Stock Conference

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MANAGEMENT DISCUSSION SECTION

Adam Klauber
Analyst, William Blair & Co. LLC

Good morning, everyone. Thanks for joining on the Thursday of the conference. In case you don't know me, Adam Klauber, William Blair. We are lucky enough to have Ryan Specialty, which we think is a really unique company. We have the leadership team, Pat Ryan, Tim Turner, and Jeremiah Bickham.

And I'll just say two words about the company, and then turn it over to Pat, but we think Ryan is really unique. It's so tough to find a true, long-term growth company in the insurance industry. And the reason, it's obvious, insurance is very commodity-oriented, so it's tough to find a company that really has really significant moats that are really differentiated, number one. And then two, what is relatively mature, slow growth industry, a company that not only has a growth – not only has the moats, but has really the long-term growth potential and Ryan really has both. And that's why since they came public almost a year ago now, been almost a year ago, we've been really excited and we've seen the results just be very, very strong.

So, on that, I'll let Pat who founded the company tell us more about it.

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

Sure. Well, in order to understand Ryan Specialty, I think you have to look at why after spending over 40 years founding and building a great team and that I started Ryan Specialty. And it's really instructive to know that, actually, Aon's foundation was as a specialty insurance broker. For the first 13 years, that's what we did, and then we diversified geographically and in terms of broader specialties.

So as I retired, I saw the real need at the specialty insurance space was going to be challenged greatly, but with tremendous opportunity because the world was getting so much riskier. So there were four principles in the founding thesis. The world was getting so much more riskier after the financial crisis, but also because of climate, new products like cyber, a lot of social inflation, a lot of pressure on settlements and litigation settlements [indiscernible] (00:02:38), every reason to believe that all these new risks were going to really – needed a new home.

They needed a home called the US E&S market, because the new US E&S market, you have the freedom of rate and form, and so many of these risks were in the admitted market or in London where you don't have the freedom of rate and form. It's all regulated by the states. And so with these dynamic changing risks, you couldn't keep ahead of the form requirements, because you have to get that approved by the states, 50 states, 50 different regulators, and then secondly, the rates.

So it was a very important move made by the US Congress to open up the E&S market for freedom of rate and form for risks that just could not be met by the admitted market. I saw that that was going to really be a catalyst for change in the specialty lines and that that was going to be important to retail brokers, the agents and the capital providers, the carriers.

And we also saw in addition to the risk profile changing, with my experience at Aon, we realized that retailers like Aon and Marsh and others were using far too many wholesalers. It was very costly, it was inefficient, but most importantly, it wasn't taking the book of business that they have, which is very large, as you know, and intelligently placing it in the marketplace in markets that really understood these risks and had the appetite for them. So we knew that there was going to be a consolidation of the use of wholesalers, so that if we were able to get into a position of being a large wholesaler, we'd be a beneficiary.

So my wife and I agreed we'd invest $425 million to build this distribution and concurrently build a delegated authority, which I'll get into in a minute. So it was the consolidation of the use of wholesalers and then concurrent with that, and Gallagher and Brown & Brown had been rolling up smaller retailers, mid-market, very effectively and Marsh had rolled up the larger retail brokers very effectively, but there was a lot more to do. And then PE discovered insurance brokers business or its free cash flow characteristics, its renewal premium characteristics. So building this consistent free cash flow was really attractive.

But the question was to really how to take advantage of that. And I knew from my experience at Aon that the way to do that was from differentiating talent, differentiating intellectual capital, who would understand the specialty lines and understand the insurance market's appetite and where to place that business and that's a dynamic, changing activity. We only get, at that time, 17% goes into the EMS market of the brokerage community. Now it's 20% and growing and every reason to believe it will continue to grow. So, that the retailers really couldn't afford to – for that percentage of their business to attract the talent. But very importantly, retailers have a conflict in terms of owning a wholesale broker because they're trying to do business with our competitors.

So I had the good fortune of meeting Tim Turner, who had built a very fledgling wholesale broker and do the largest – and that had the largest and sold it because of these conflicts and the need for independence. And I met Tim and we were just aligned on culture. We were aligned on strategy. And I'll explain what that means. We knew that the differentiating talent was critical to set up practice groups, which Tim will get into. We have specialists.

We also knew that if we could get these consolidators as clients, they would be building our client base, because they were buying up the retailers. So we're able to do that. And very quickly, we were appointed preferred by 97 out of the top 100 retail brokers. What does that mean? It's not exclusive, but it means you're one of the three, so – but less than a year after I retired and started Ryan Specialty, my successor, Greg Case, went from 10 down to 3. And then Marsh followed going from 20 down to 3, and Willis went to 4, and it's rippled through, well, that was another dynamic force, that's force number three.

The fourth one was delegated authority. Delegated authority is where capital providers delegate the underwriting, the admin and the distribution, so it's an outsourced service. And you have to have the talent to be able to be providing those underwriting skills. You have to have the infrastructure to administer it, but you have to have access to the retail brokers who distribute it, so we had all of that. So Tim and I were aligned on the independence so that we didn't have conflicts. We were aligned on also the fundamental of all of this was recruiting exceptional talent and then recruiting large numbers of young people right out of college university and training them in the specialty lines. Well, that's been a continuous talent infusion into our enterprise that we believe is really differentiating.

Concurrent with all of this, we knew that expand specialties would expand our moat, would expand with these specialties differentiating talent that would be hard for people to compete with us. Now, we have competition, obviously, but it'd be more difficult. So we were building this moat and concurrently building what at that time, I just called expanding the marketplace. But now, I know from investors, it's called TAM. But we were building TAM by constantly expanding our market into additional specialties, but also geographically.

So we started on the large cities and then we went to, not small towns, but smaller cities [indiscernible] (00:10:03) and that became what was called our Binding Authority business. But all along, Tim and I were aligned on this differentiating talent, continuing to infuse fresh, new talent and minting young producers and underwriters. So when people say, what's your secret sauce? It's just that. It's having these experts' expertise and it's actually having the ability to just keep regenerating them so that as we grow, we can handle the volume of these large brokers.

So I will turn it over to Tim now, who's going to talk about how this all gets executed and why it's working to get us what has been for our 11-plus years in business double-digit rates of organic growth, all supplemented [indiscernible] (00:10:58) acquisition strategy to acquire talent, to acquire – expanding the moat and expanding the total addressable market.

So, Tim, why don't you pick it up?

Timothy W. Turner

President & Director; Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Group Holdings, Inc.

Thank you, Pat. Good morning, everyone. It's a pleasure to be here with you. Many of you have asked why retail brokers and agents across the country use a wholesale broker or an MGU or a delegated underwriting authority specialist. It's a great question and the reason is simple. The specialty market is so technical and it requires a high degree of competency in these very difficult risks to place. And so, many retail brokers don't have the depth and the breadth to handle the volume of business that goes through construction channels, catastrophic property channels, cyber, healthcare, many of these specialty areas require a real focus on that one niche. And retail brokers, to their credit, have to be generalists. And so that's the start in the creation of the wholesale market.

And as Pat mentioned, the dynamic of the freedom of rate and form is a big driver of the non-admitted marketplace in the US today, the flexibility to handcraft these solutions and respond to the ever-growing risk that we have here in the United States. So today, property coverage driven by this unpredictability of catastrophic wind, wildfire out west, flooding, even the greatest modelers and actuaries have been wrong and the losses have been horrific. And so that brings in all this non-admitted capacity from the risk-bearing side. Lloyds, big leader in that, and lots of other new capital coming into the non-admitted space to take advantage of the freedom of rate and form, so you have two sets of dynamics happening here that are driving this sector.

Retail brokers and agents buying differently. They need more specialty broking talent to handle these risks. And on the capital side, the risk-bearing side, more new capital coming in and choosing the non-admitted P&C channel for the freedom of rate and form. So today, we have 105 companies that only provide P&C solutions to wholesalers and delegated underwriting authorities, a huge increase in the capital solution side of it. And on the broking side of it, a higher percentage of P&C business that flows through the retail brokers and agents that needs a specialty broker or a non-admitted form, terms and conditions to solve their problem.

So we saw that coming, we knew that it would be a game of talent. As Pat said, this is superstar talent that's hard to come by, to have the best cyber broker in the world, to have the best construction team in the world. It's not easy to do, but harder to do would be to build the depth and breadth around those practice group verticals to handle the volume that comes through the channel. And that's really what we've done. That's differentiating, quite frankly.

We win a high percentage of the RFPs, starting with the global brokers, as Pat mentioned, the regional brokers, what we call Tier 1, the top 100 retail brokers in America, the most coveted clients are the most selective buyers from the wholesale and underwriting space. So we immediately set the company up in a practice group vertical orientation so that we can RFP and win these preferred positions with the most coveted clients. And that's worked out really well for us, but there's a much longer runway ahead for us, and that's Tier two and Tier 3 retailers, thousands, tens of thousands of retail brokers out there that we are getting to and we need to get to more frequently and deeper.

So that requires a deep bench of talent in all these specialty areas, and it requires the ability to have a small commercial solution. So that's where the underwriting and the electronic trading platform and the binding authorities come in. We have to weave all that together and have a one-stop approach to all of our retailers' needs and we've been doing that.

All the while, this – these two phenomenons that we talked – talk about so much, global warming and social inflation have caused more business to be dumped into our channel. Most recently, a great illustration of that would be this, what I call a miss on the reinsurance side. They missed, everyone missed the Texas freeze and the second half of the Ida Hurricane that hit the Northeast. There wasn't a reinsurance company in the world that got that right.

As a result, the reinsurance companies behind the scenes had to derisk their portfolios, essentially tightening up the capacity that they could give standard insurance companies and non-admitted companies. So the entire catastrophic property world contracted yet again over the last 12 months and that causes a dumping and a shedding phenomenon of business that those standard companies can't handle. And it pours an entire channel and we have to create these shared and layered approaches to huge limit requirements.

These companies need hundreds of millions of dollars of limits on the cat property side, and so they need experts to layer these programs and share them with dozens of insurance companies and that's our specialty. So that's an example. One example, an illustration on the casualty side, again, we're seeing a huge demand on areas like construction, habitational risks that are loss leaders in the reinsurance world and continue to drive the non-admitted marketplace.

And last but not least, we love to share with you our training and development approach to the business. As Pat mentioned, we've both been very, very aggressive recruiters of talent, superstar talent, high-caliber talent to lead these practice groups. But you really have to have the ability to manufacture them, to manufacture talent, to be able to create young brokers and underwriters in a training program, a formal training program. So we took All

Risks university program that they did exceptionally well. They recruited from universities across the country with insurance and risk management undergraduate programs and then augmented that with just talented 22-year-olds that were coming out of school and tried to create a diverse university class twice a year.

And they were much more formalized about that than we were. We had a very successful mentoring program ourselves, and we were heavy recruiters, as I mentioned. But bringing that together in a much more formalized way and creating an intern program has really allowed us to bring in hundreds of young kids across the country now and train them and get them into an accretive position very quickly in our organization.

And if there was a secret sauce that separates us from our competitors today, I would tell you that's part of it, our ability to get these kids into the system, get them highly specialized very quickly, and add value within a couple of years. Many of our superstars today came through that program 10 years ago. So it's really working well for us, and we intend to invest more time and energy into training and manufacturing our own, which is a direct driver of our organic growth.

So, with that, I'd like to turn it over to Jeremiah Bickham, our CFO. Thank you.

Jeremiah R. Bickham

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

Thank you, Tim. Afternoon, everyone. It's my pleasure to speak with you today and I get the very, very exciting privilege of talking to you – I'll talk to you about our financial profile because I'm the CFO and I have to. But I also get to talk to you about our organic growth engine. It's very exciting to speak to, and it's one of the most important pieces to understand, to really understand our story.

The last couple of years, we've put up exceptional organic growth, so 20% in 2020 and then a little over 22% last year. And a lot of people say, well, there's a lot of things going on in the market right now, everyone is growing exceptionally and that's true. But we've, as Pat and Tim, I think have both touched on, put up double-digit organic growth every year since we've been in business and we're actually quite confident that we can keep doing that into the foreseeable future.

And the reason that we have conviction around that is because there's actual secular forces or intentional structural elements that underpin – market fundamentals really that underpin our growth. And so I'm going to try to break those down. And there's actually a really nice visual representation of this. I think it's slide 8 on our deck that's on the Blair website.

But first and foremost, we benefit from the growth of retail brokers. We truly have the best clients on earth. They're natural GDP-plus growers on their own, but many of them are highly acquisitive. So as a cohort, they invest billions in M&A every year. Well, we inherently capture much of that growth on the organic and inorganic side, because remember, we're preferred with 97 of the top 100 retail brokers, so those billions of dollars of investments every year are fueling our growth as well.

Furthermore, sticking with the retail brokers, as Pat mentioned, a little over 10 years ago, they started employing a panel strategy. So that's just where they're working with fewer and fewer preferred wholesale brokers. We've had a huge benefit of that – benefit from that strategy up to this point and there's still more to come, because it takes years to actually optimize that strategy. And especially as the acquisitive brokers are buying new firms, it takes time for that business to migrate over.

So just pausing there and taking a step back, just as a function of who our clients are and then the strategies they're pursuing like M&A and the panel strategy, we have a really nice built-in foundation of organic growth right there. But it gets even better for us because that baseline of growth that the retailers exist in is on an admitted lines basis because that's where they specialize.

As Pat said, we are excess and surplus line specialists. So, over 70% of the business that we broker or underwrite goes into the E&S market. And historically, the E&S market has outgrown the admitted market. So over the last decade, I think the admitted market has grown at a little under 4% CAGR. Over that same time period, the E&S market has grown almost double that.

So we've got the benefit from growth of our clients and we exist in a growing market. And then the cherry on top is really all of the RSG – or I'm sorry, Ryan Specialty specific strategies and attributes that make us special that protect our moat, things like our comprehensive product offering, leading with talent and innovation, that's truly our brand, and then our disciplined go-to-market strategy, the practice groups that Pat and Tim have both talked about. Those are all things that we can control and that we faithfully execute on every day to help us gain and then retain market share.

So I hope you can see that these building blocks were all very intentional and strategic. And if you think back to the middle three and the four elements that Pat outlined when he founded the company, they're the same, retail broker roll ups, the panel strategy, et cetera. But I'll actually take it one step further and argue to you all that there's more secular elements than cyclicality to these underpinning elements of our growth. So no doubt, there's a little bit of cyclicality to E&S pricing. But it's our belief that the world is still getting riskier. And then over time, there are going to be more and more risks, more and more companies that seek a solution in the E&S market, so it's going to continue to grow.

Retail broker roll ups, we don't think that's going away any time soon and their panel strategy that was spurred by data and analytics. That wasn't our idea. That was their idea. So we think that's an enduring trend as well. So that's our growth engine.

Let me talk a little bit about our financial profile. So I'm a huge fan of our business model as well and I would consider it both strong and resilient, and that's paired with a really robust free cash flow profile as well. So we've got high amounts of recurring revenue and really, I mean, everyone realizes their insurance has to renew every year. But in the commercial insurance market, which is where we specialize, most of these products are compulsory, right? And then a lot of that revenue actually and then those earnings turn into cash because we've got extremely low CapEx needs and working capital requirements.

Our CapEx is at any given time less than 2% of revenue. It's generally closer to 1%. And then last but not least, we have – we benefit significantly from really what's a variable cost structure. The biggest line item of expense on our P&L is comp, and the majority of our comp is variable. It's either a producer formula or it's a variable bonus structure based on performance of the company.

Let's talk about capital allocation for a moment. So, it's our belief that the highest and best use of capital today, and let's call it for the foreseeable future is M&A, right? So we're not a roll up. We're not buying growth, but through strategic and accretive deals, we can fortify our competitive position and we can actually add features and fine tune our organic growth engine, which has been our strategy to-date in the 40-plus acquisitions that we've done.

On the leverage side, so we are a 3 to 4 times net leverage operator and we were that way even when we were a private company. And you all know that the private markets, there's ample available leverage to folks in our space. And quite frankly, because of the cash flow properties we've talked about, these businesses can support them. But even as a private company and still true today, we've had what we consider a more prudent and long-term view of financial risk management. And because we throw off so much cash, we're confident that we cannot miss out on any of the great M&A opportunities we see ahead of us and stay in the 3 to 4 times leverage corridor.

Let's talk about margin. So it's our philosophy that pairing very healthy margins, so call it around 30%, with exceptional organic growth is a winning combination for shareholders and what's best for our long-term growth prospects. That's not to say that we aren't margin-focused. It's just that at this moment, solving for the last dollar of margin, trying to get to an optimized margin today at the expense of investments in talent and infrastructure is not the right move, right?

So – and we actually think that you don't have to choose. And most years that on – even on a reported basis, we'll be able to show operating leverage. But from time to time, like in 2022, when we have the opportunity to make outsized investments in infrastructure and talent, that we should do that because over the long term, those investments actually lead to higher margin. And more importantly, they keep the double digit organic train going even longer, which is what we think you all want.

The last piece on capital structure, it's important for you all to know that we are owned nearly 20% by employees not named Pat Ryan. And so the percentage may change over time and certainly the names will. But we think that that's been a critical element in aligning employees with shareholders and attracting and retaining talent. So we're a big believer. We're mindful of dilution where we use equity sparingly in M&A. It's only when it's a true difference maker, but it's an important piece of maintaining the – what we consider one of the best in industry producer retention statistics, which as of today and for the last several years, it's been 97%.

That's all I have. So I'll turn it back to you, Adam.

QUESTION AND ANSWER SECTION

Adam Klauber
Analyst, William Blair & Co. LLC

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Great. Great. With two minutes, I'll just probably ask one or two questions, then we'll have time in the breakout to ask more questions. So you've been public since last July and arguably probably one of the more successful IPOs in the last year. So, what do you think investors are missing? What aren't they getting about the story?

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

A

I think the key thing is they're looking for this point in time where the growth of the E&S market is going to slow down and actually retract. It can slow down in certain areas and it has. But there are so many new risks, like healthcare, like cyber that are replacing that. And so, there's a lot more [indiscernible] (00:29:36) secular growth opportunities. So I think it's just holding their breath to when it's all going to change. Historically, it has changed. But we've never been in history in such a risky world. Forget the fact that we've got the war. But there's just a lot of risk and it just keeps multiplying. And that gets solved in the E&S market. So we have great confidence in the sustainability of that.

Adam Klauber
Analyst, William Blair & Co. LLC

Okay. Well, at this point, we have 45 seconds, so I think we'll just end it here. So thank you. Thank you very much. We appreciate the time.