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Ryan Specialty Holdings, Inc. (RYAN)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Ryan Specialty Group Fourth Quarter 2022 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] As a reminder, this conference is being recorded.

I would now like turn the conference over to your host, Noah Angeletti, Head of Investor Relations and Treasurer. Please go ahead.

Noah Angeletti

Treasurer & Head-Investor Relations, Ryan Specialty Holdings, Inc.

Good afternoon and thank you for joining us today for Ryan Specialty Holdings fourth quarter and full-year 2022 earnings conference call. In addition to this call, we filed a press release with the SEC earlier this afternoon, which has been posted to our website at ryanspecialty.com.

On today's call, management's prepared remarks and answers to your questions may contain forward-looking statements. Investors should not place undue reliance on any forward-looking statements. These statements are based on management's current expectations and beliefs, and are subject to risks and uncertainties that could cause actual results to differ materially from those discussed today. We encourage listeners to review the more detailed discussion of these risk factors contained in the company's filings with the SEC. We assume no duty to update such forward-looking statements in the future, except as required by law.

Additionally, certain non-GAAP financial measures will be discussed on this call and should not 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 are included in our earnings release, which is filed with the SEC and available on the company's website.

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

Patrick G. Ryan

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

Good afternoon. Thank you for joining us to discuss our fourth quarter results. Joining us on today's call is our President, Tim Turner; our CFO, Jeremiah Bickham; and our CEO of Underwriting Managers, Miles Wuller.

Before we discuss Ryan Specialty's 2022 performance, I'd like to take a moment to reflect on the passing of Andrew J. McKenna. Andy was an invaluable member of our board since its inception in 2012, serving on the Compensation and Governance Committee and as our Lead Director. Andy was a national voice on the topic of corporate governance, Chicago Institution, business icon, humanitarian philanthropist, husband, father, brother, and a dear friend. He will be missed by all who knew him.

2022 was an outstanding year for Ryan Specialty. The tireless efforts and dedication of our brokers, underwriters, and the entire Ryan Specialty team is evident in our results. For the full-year, we generated record revenue of over $1.7 billion, driven by organic growth of 16.4% on top of 22.4% in 2021, and produced a strong adjusted EBITDAC margin of 30%.

I want to take a few minutes to highlight some noteworthy achievements in 2022, which were significant for our firm. We invested in exceptional talent while onboarding the largest production class in our history. We enhanced our capabilities through new product offerings and integrated our 2021 acquisitions of Keystone and Crouse, both of which exceeded our growth goals for the first year as a part of the Ryan Specialty team.

We are pleased to announce a highly strategic acquisition, Griffin Underwriting Services, which closed on January 3 of this year. With approximately 23 million in revenue, Griffin deepens our offerings in the Pacific Northwest, broadening our geographic scope and our capabilities in Binding Authority and Brokerage Specialty. Importantly, Griffin's consistent underwriting results, deep bench of talent, and focus on training and development is a clear cultural match with Ryan Specialty. It further enhances Ryan Specialty's essential role as a trading partner to our retailers.

Continuing our winning culture, I'm pleased to report another year of 97% retention of our producers consistent with 2021. For the fourth quarter, total revenue grew 14.9%, led by 10.3% organic growth. We also grew our adjusted EBITDAC and generated another quarter of solid adjusted net income. In the fourth quarter, the specific headwinds we noted on our prior call were in line with our expectations. We anticipate that these headwinds will persist into at least the first half of 2023. Outside, we were very pleased to see the strength in property manifest itself late in Q4, which drove the modest outperformance versus our expectations for the quarter.

As we progress through 2023, there are three things we believe you can expect from Ryan Specialty. First, we see continued solid growth in the business. Although there is heightened macro uncertainty, the complexity of risks continues to increase. And as a result, we believe the E&S market will continue to be a standout within the insurance industry. We expect our growth will be balanced across our diverse portfolio of products and solutions, enabling us to capture the broader the E&S tailwinds, while capitalizing on specific areas of accelerated growth.

We expect to grow our business through M&A. Our pipeline remains robust both in tuck-ins and some larger platform opportunities. We continue to focus on M&A opportunities with the highest quality specialty distributors, including wholesale, delegated authority and benefits. We will also look to grow our business through our alternative risk strategy, arranging alternative capital to support our clients, expanding our addressable market, and building on our culture of innovation.

Second, we will continue to invest in our business. We expect another year of targeted hiring, adding industry top talent in both underwriting and broking, where they're needed most, as well as continuing to build our internship program at Ryan Specialty University. We will also make disciplined additional investment in our delegated authorities specialties, including the systems and technology, to further enhance our actuarial, risk management and loss control teams.

And third, we will execute on strategic initiatives to increase the scalability of our operating platform. Today, we are announcing the launch of ACCELERATE 2025, a two-year restructuring program effective in Q1. Through this program, we're making changes and investments that will enable continued growth, drive innovation, and deliver sustainable productivity improvements over the long term. ACCELERATE 2025 is a natural progression of our strategy that brings together our people and assets in a way that allows us to continue to rapidly innovate and more efficiently provide new and improved solutions to the most complex challenges that our clients face.

Jeremiah will provide more details in his remarks, but we anticipate a cumulative special charge of approximately $65 million through 2024. We expect the program will deliver approximately $35 million of annual savings in 2025 and further enhance our ability to scale our platform in the years beyond. ACCELERATE 2025 is designed in concert with our growth strategy, and we will continue to make investment decisions, including hiring and M&A, based on a disciplined return on capital basis both now and in the future.

Looking forward, I'm confident that 2023 will be another strong year for our firm. We expect sustained growth, have a flexible business model that allows us to quickly adapt and pivot to changing market conditions. As we've noted previously, risks across industries are only becoming more complex, and the E&S market has continued to outpace the overall P&C insurance market. Our products are largely compulsory and our clients and trading partners value the unparalleled expertise we bring as we anticipate their needs and work tirelessly to provide the right solutions for our insurance. This, along with our other secular growth drivers should allow us to continue generating double-digit organic growth over the long term.

In summary, I'm very proud of our entire team for delivering outstanding results for our clients, trading partners, and shareholders in a challenging insurance market and macroenvironment. Through innovation and exceptional customer service, we have once again validated our differentiated business model and continue to be a trusted partner to substantially all of the top 100 retailers.

Now, I'll turn it over to Tim. Tim?

Timothy W. Turner

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

Thank you very much, Pat. It was another solid quarter and year across our specialties. These results are a testament to the teamwork across the firm, from our producers to our underwriters and their teams. As Pat noted, the E&S market continued to grow in importance to the insurance industry, and we capitalized on these industry trends.

Diving into our specialties, our Wholesale Brokerage specialty achieved another quarter of solid growth, spread across many lines of business. Property continues to experience a historically hard market as rates rose significantly and capacity tightened. We are seeing a large volume of new business flow into the non-admitted market, and we remain very encouraged by property's potential, looking ahead.

As we've noted previously, major events such as Hurricane Ian, winter storms, and other climate events, as well as a tougher reinsurance renewal process have led to less capacity, as well as even higher rates. This is producing increasing demand for insurance solutions and a recurring opportunity for our experience and expertise to fill that need.

Cyber performed well in the fourth quarter and for the year. While we continue to see a moderation in rate increases, we believe there's ample runway for us to pursue regardless of short-term pricing trends. Our technical expertise in areas like cyber is playing a significant role in our ability to build large towers of capacity for our clients.

Our transportation practice, particularly in trucking, continues to see substantial flow, fueled by social inflation and ensure need for continued rate increases. We continue to win new business and remain well-positioned for 2023 to capitalize on additional growth opportunities.

In our Binding Authority specialty, we saw another quarter of solid growth in traditional binding, which includes small commercial business that has historically been economically sensitive. This growth was partially offset by our Personal Lines Binding Authority, which was still experiencing capacity constraints prior to renewals. We continue to see the potential for panel consolidation as a long and steady growth opportunity, and we are well-positioned to execute.

Our Underwriting Management specialty posted another strong quarter led by property and casualty, healthcare, and our reinsurance MGU, Ryan Re, despite headwinds in our transactional liability lines driven by lower M&A volume.

As Pat noted, in the fourth quarter, the specific headwinds in certain lines we raised on our prior call, a rapid rate decline in public company D&O, lower external M&A and IPO volumes and transactional liability and delayed project-based starts in construction were in line with our expectations. We anticipate that these headwinds will persist into at least the first half of 2023. We remain confident that we have the right teams in place to grow these lines over the long term.

In terms of the E&S market, our observation is that pricing has remained firm in January and into February in most classes of business with public company D&O being the ongoing exception. In addition the standard market carrier competition, we observed on the periphery and which we flagged on prior earnings calls, has yet to meaningfully impact rate or flow in the aggregate. As we've said previously, we expect the flow of business into the non-admitted market to continue to be a significant driver of Ryan Specialty's growth, more so than rate.

With that, I will now turn the call over to our Chief Financial Officer, Jeremiah Bickham, who will give you more detail on the financial results of our fourth quarter. Thank you.

Jeremiah R. Bickham

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

Thank you, Tim. In Q4, we grew total revenue, 14.9% period-over-period to $435 million, fueled by another solid quarter of organic revenue growth at 10.3%, reflecting ongoing tailwinds in much of the E&S market and continuing to win a substantial amount of new business. We were pleased to see the strength in property late in Q4, specifically in the last two weeks of December, which drove the modest outperformance versus our expectations for the quarter.

Net income for Q4 of 2022 was $46 million or $0.14 per diluted share. Adjusted net income for the quarter, which excludes IPO-related and other unusual items, was $74 million or $0.27 per diluted share. Adjusted EBITDAC for the fourth quarter grew 6% period-over-period to $127 million, while adjusted EBITDAC margin declined 250 basis points to 29.3%. Our adjusted EBITDAC margin was impacted by continued investments in the business and T&E continuing to return to normalized level, which was partially offset by higher fiduciary investment income.

As Pat noted, in 2023, we expect to continue bringing aboard top underwriting and broking talent wherever we see clear opportunities to grow lines of business. We also expect to recruit a significant class of new talent at Ryan Specialty in the months ahead. In addition, as we noted in our release earlier today and in Pat's earlier remarks, we are embarking on our ACCELERATE 2025 program, which will strengthen how Ryan Specialty operates and further improves our efficiency and unlocks additional value for our clients and shareholders.

Over the last four years alone, our revenue has more than doubled, head count is up 50%, and all while the US E&S market has grown by over 80%. We believe this is the right time to continue building on our success and have thoughtfully designed a program that will prepare Ryan Specialty for the next cycle of growth. ACCELERATE 2025 will result in approximately $65 million of cumulative charges through 2024. In turn, we expect it to generate annual savings of approximately $35 million in 2025 and facilitate even greater operating leverage thereafter.

Based on our current forecast, we expect to record GAAP interest expense, which is net of interest income on our operating funds, of approximately $120 million in 2023. As Pat and Tim mentioned, we remain very excited about our long-term growth opportunities and value proposition. As a result, we are guiding full-year 2023 organic revenue growth to be between 10% to 13%. We believe the first half of 2023 will see continued headwinds in certain areas, but we expect that pressure to ease in the back half of the year. In addition, we are guiding adjusted EBITDAC margin for the full-year 2023 to be between 29.0% and 30.0%. We will continue investing in talent during the year as well as the annualization of our 2022 head count growth, which from a margin perspective will be partially offset by increases in fiduciary investment income during 2023. These investments, particularly in the recruitment of new colleagues, offer the highest returns for our shareholders, and we continue to aggressively recruit and build out our teams to meet the challenges, demands and opportunities of the marketplace.

In summary, we were very pleased with our overall performance in 2022, and we remain very excited for the path ahead. The current economic and insurance cycles present both challenges and opportunities, and our flexible and diversified business model positions us well to best serve our clients in a time where we are more relevant than ever before.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] The first question today is from Elyse Greenspan of Wells Fargo. Please proceed with your question.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good evening. My first question, the Q4 organic was 10.3% and you saw the headwinds that you guys spoke about last quarter. And it sounds like you expect them to persist in the first half, right, and then get better? But property rates, right, sounded like you only saw the benefit of that for two weeks and perhaps you get the benefit right throughout 2023. So wouldn't the baseline expectation be that all quarters of 2023, I guess, should show growth, that's a better level than the fourth quarter?

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

A

Hi, Elyse. So we think that our guide range for the year and again, we want to remind everyone, it is best to look at organic growth on an annual basis, not quarter to quarter, because you often can't infer a trend. You are correct, the headwinds we referenced that affected us in Q3 and Q4 played out just about as we expected. And then as Tim said in his prepared remarks, they'll continue, it's our belief they'll continue through at least H1. We did get a pick up from property in late Q4 and we expect that to be a net benefit to us in all of 2023. But it's still too early to tell how much of a lift it will provide on an annual basis, given that there's just so many variables in play, along with general macro uncertainty. And don't forget, we've got extremely tough comps in Q1 and Q2.

I mean, Tim can provide more color on the property market specifically. But taking a step back, what we do know is that the net of all the headwinds and tailwinds should be positive for us, and the E&S market overall and that our value proposition to our clients is very much intact at the moment.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

And then with your property book is – do you have a greater concentration in one quarter versus another or would the revenue from property be even throughout the four quarters with some slight variation?

Timothy W. Turner
President & Director, Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Holdings, Inc.

A

We do. It's well recorded that the second quarter is the strongest win-buying season, and we expect the flow of business that has increased month to month, quarter to quarter, to continue to increase, and we'll capitalize on that. We're very well-positioned on the broking and the underwriting side for that.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

And then lastly, you guys pointed to an active – it sounded like an active M&A pipeline. Can you just provide a little bit of color just as it looks today, what types of deals you're looking at and just do you think we might see some deals sooner than later, or do you have a sense of timing on transactions?

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

A

We did mention that – as I mentioned, this is a robust pipeline, and it is. And it's an interesting pipeline in that there are many companies coming to market. There are companies that we are trying to convince to come to market. As you know, Elyse, we look for really good companies to make them better, to make them great companies. And we've had, I think, a successful track record at that. So, this pipeline that I'm referencing, are people that we've been speaking with over the – at least the last 12 months in many cases, and they weren't ready. Some are still not ready, but they're getting closer. Others seem to be getting pretty close. We're having quite good discussions.

So, to sum it up, I would say that we're at a point in time here starting in 2023 where the prospects for bringing in really high-quality companies that fit our overall strategy in the broadest of ways that we have good confidence that we'll be able to be closing these. We can't tell you when during the year, but we're certainly in deep discussions with a few of them.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thank you.

Operator: The next question is from Mike Zaremski of BMO Capital Markets. Please proceed with your question.

Mike Zaremski
Analyst, BMO Capital Markets Corp.

Q

Hi. Great. Good afternoon. On the cost efficiency initiative, I was hoping you can just give some more color whether the program's weighted towards distinct buckets. Some of your peers have talked about collapsing back offices and outsourcing and less real estate. Is there anything you'd like to call out? And just on the cost program as well, just some clarification. Just the margin guidance, is that inclusive or exclusive of the charges over the coming two years?

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

Thanks, Mike. I'll just start off and turn it over to Jeremiah. These are proactive, strategic initiatives. We're always challenging ourselves to improve our ability to serve our clients. So we believe we're taking a great platform to the next level of operating excellence so we can better serve those clients, and frankly, prepare for the next wave of what we believe is exceptional growth ahead of us.

Jeremiah, you want to pick up on that?

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

Yeah. Thank you, Pat. So, Mike, I know it's hot off the press, but in the 8-K we filed today, we do list out the buckets of all the action areas. And you'll see that the vast majority of the charge and the savings are going to come from ops and technology optimization, which we're really excited about. We think that those actions, those investments will lead to sustainable productivity improvements and savings over time. And just to give you some examples of where we expect efficiencies to come from, streamlining our mid and back office processes, consolidating and upgrading technology platforms that should drive automation, consolidating vendors, and then expanding our shared service model.

And I'll also note that the investments that we're accelerating in our data and analytics, we think will help us innovate faster, serve clients with more distinction, and help us further differentiate ourselves from our competitors. So we're very excited to kick this program off.

Mike Zaremski
Analyst, BMO Capital Markets Corp.
Q

And, just a clarification, the margin guidance for next year is exclusive of the charges, correct?

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

Correct. Correct.

Mike Zaremski
Analyst, BMO Capital Markets Corp.
Q

Okay. And as a follow-up, in the prepared remarks, Tim, and I think you touched on it in Elyse's question or mentioned property was very strong in the latter half of the 4Q. And just given – is that continuing into 2023 and you are very clear about some of the headwinds into the first half of the year. Just curious if that better-than-expected property tailwind is persisted a bit into the first part of the year?

Timothy W. Turner
President & Director, Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Holdings, Inc.
A

It certainly has. It continues to increase in submission flow rate. The entire channel is growing and expanding rapidly. We're seeing the start of the conversion rates picking up and we expect that to continue. Reinsurance treaty renewals are expected to be very difficult for 4/1 and 7/1, and we see more dumping and shedding of cat property business in the standard market flowing into our channel.

Mike Zaremski
Analyst, BMO Capital Markets Corp.

Q

But just as a follow-up, just to be clear, you're saying that you're not seeing much price acceleration in the E&S marketplace inclusive of property, which may be seeing some pricing hardening.

Timothy W. Turner
President & Director, Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Holdings, Inc.

A

Well, we're definitely seeing the increases in cat property, but the entire flow of business in property and casualty and E&S ebbs and flows. So we have some moderating, some price deceleration, but we see prices going up in certain classes like transportation, habitational, healthcare, sports and entertainment, higher education, rates continue to climb and terms are continue to be difficult in those long tail casualty classes.

Mike Zaremski
Analyst, BMO Capital Markets Corp.

Q

Thank you for the color.

Operator: The next question is from Rob Cox of Goldman Sachs. Please proceed with your question.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Thanks for taking my question. So, it looks like just on the margin guide that the midpoint is lower than where you were at for 2022 and double-digit organic growth, the tailwind of a fiduciary investment income. So I'm just wondering what the offset there as you talked about talent investments. Is that the only thing that's really offsetting the margins here? Is there – are there other investments you're making?

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

A

Hey, Rob. Great question. And just to set the table, we've demonstrated that our platform can scale. So we're up 500 basis points since year-end 2019. And if you were to ask any of us in this room a couple of years ago, we would tell you that where we are today, where we finished 2022 is actually a little bit ahead of schedule in terms of a margin basis. And what we've said since then is that, most years, not all years, but most years, we can show you scaling on a reported basis. And last year, one thing we were very upfront about and very happy to follow through on is that we were targeting to onboard the biggest production class ever, and we did that. And with that comes a run rate impact in 2023. We're also, as Tim said in his remarks, going to continue making strategic production hires this year. And these investments have the highest ROI of any investment we can make. So we know that it's the right decision for our long-term growth prospects and so, we feel really good about sticking to this game plan.

Further, ACCELERATE 2025, the program that Pat and I have both touched on now, will bring a step change to our margin by 2025, and it will also unlock enhanced annual scaling thereafter. So taking another step back, we feel really good about where we are today in terms of margin, and we believe that we're making the right investments that will continue to enable top line growth and margin growth for the long term.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Appreciate that. Thank you. And just next, on the organic guide and the different businesses you have, maybe you could talk about how you think the three businesses could perform relative to the consolidated guide. And how you feel about the capital backing you have on the Underwriting Management side of the business.

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

A

Miles, why don't you take the capital?

Miles Wuller
President & Chief Executive Officer, Ryan Specialty Underwriting Managers

A

Yeah, I think we've shared in past meetings that our growth is not constrained by capital. We're well-supported by our carrier partners. We've got a great string of delivering underwriting profit to the community and that's allowing them to help support new products and grow incremental capacity to current lines. And then maybe to the heart of your question, what is going to prompt some continued growth as you know, we're pleased to share we're coming into the year with incremental property capacity and capability, again, reflective of our great results across the platform. So we believe that we continue to build new facilities and add capacity to existing as a source of ongoing growth.

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

A

I'll take the first part of the question. Following up on what Miles said, we have experienced and we expect to continue to experience significant organic growth in Delegated Authority underwriting and managing underwriting. I have every reason to believe that the open market Wholesale Brokerage will have very good, strong growth. As we've said, we started our alternative risk vertical and we've had good organic growth and we look forward to significant organic growth there. And as you know, we've been working on the launching of the benefits strategy. These numbers are not in the forecast because we haven't executed yet. But when we execute on the benefits strategy, it will be a higher growth rate than the normal of the industry with higher margins than the normal in the industry.

Robert Cox
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: The next question is from Weston Bloomer of UBS. Please proceed with your question.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Hi. Thank you. My first question on $35 million in saves in 2025, should we expect any of the saves to come in 2023 or 2024, or when should we kind of start to see that ramp up? Is it after you've kind of taken the charges, or how should we think about that?

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

A

Yeah. So I'll take you through the – a high-level path on the charges and the saves. So you'll see charges trickle in in Q1 and Q2 of this year, but they really ramp up in H2. So by the end of this year or let's call it end of Q1 2024 at the latest, we'll be through more than half of the $65 million charge and then take the remainder through the end of 2024. No savings in 2023, some savings in 2024, which we'll report on as we go, and then the full $35 million will be realized in fiscal year 2025.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Great. Thank you. And then my second question is a follow-up around the uplift that you're seeing in property. Just rough math, it seems like it was around 200 basis point to 300 basis point positive impact in the 4Q. Is it fair to say that that's roughly the uplift that you're expecting in 2023 as well? I know you're not – it could be – it could change or – but I'm curious how you're thinking about that or what's baked into your guidance.

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

A

There's a lot of variables baked into our guidance. And if you're – I don't want to imply false precision on any of the math you just threw out. So our guide range for Q4 was 3% to 9%, and we barely beat it at 10.3%. That was mostly attributable to property. As Tim said, the property market is quite hard right now. It could get harder. We expect that to be a net benefit. But in terms of basis points, how much that contributes to the 10% to 13% this year, it's really difficult to calibrate.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Great. Thank you. And then on the cadence for organic growth throughout the year, is there any way to quantify maybe first half for second half? Like, is the first half of the year going to be in the mid-single-digit range or upper-single-digit range or close to the low end of the guidance? I know you said there's difficult comps in the first half and we should look at it on a full-year basis. But any additional granularity for the 1Q to 2Q would be helpful.

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

A

You've got the key points. The tougher comps are in H1 and then we expect the worst of our headwinds to manifest in H1. So, H1, there's going to be a lot of challenges on an annual basis. We think that we're going to come through quite well, but there's a reason that we only guide on an annual basis. The quarters can be difficult to predict or to read into. So let's just stay focused on the 2023 number, which we think will ultimately be a really solid year of organic growth.

Weston Bloomer
Analyst, UBS Securities LLC

Q

Great. Thank you for taking my questions.

Operator: The next question is from Tracy Benguigui of Barclays. Please proceed with your question.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thank you. A quick clarification question. You mentioned in the third quarter call that no single product line, including public D&O represents 10% of your overall book and property is multiples ahead of D&O. But then when I think about the proportion of property to the overall E&S market, it's something like a quarter or a third. Can you clarify the proportion of property placements more broadly to your overall book, and if that's becoming a larger piece?

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

A

Okay. So, Tracy, we've actually said publicly that we're representative – our portfolio is representative of the broader E&S market, and 25% to 30% is the right range.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. So it's a more narrow view when you previously discussed 10% of a particular product?

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

A

When we were talking about products on the Q3 call, Tracy, we were giving public D&O as an example of a product and trying to compare that to an entire category of our portfolio in the insurance world overall, right. Property and casualty. And since our portfolio is representative of the broader market, we were just drawing attention to the difference in scale between our exposure in property versus a single product line like public D&O.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. So that's what I thought. I just wanted to bridge those two comments together. Thank you for that.

And this one may be a bit of a wild card question. Can you discuss your process of placing business on behalf of an MGU? What due diligence do you do to ensure that the risk is backed by a rated insurer? And also on the back of higher financial line rates, I'm wondering as a corporate buyer of insurance if you're expecting higher E&O insurance costs and if that's meaningful in any way.

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

A

Hi, Tracy. We've got industry standard procedures. Whenever we're onboarding a new MGU, we make sure that they're licensed. We make sure that the quality of their security meets our standards for counterparties and things like that. So very much in line with industry standards there.

What was the other part of your question?

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Oh, I mean, the back of just higher financial lines rates, in general. I mean, a lot of brokers buy E&O insurance. So as a corporate buyer, are you seeing higher costs and if that's meaningful in any way?

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

A

Our – well, certainly, our D&O insurance went up significantly when we went public. It's been pretty stable since then. It's too early to talk about any of the renewals for our professional lines which come up later in the year. So right now, everything looks stable.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Got it. Thank you.

Operator: The next question is from Derek Han of KBW. Please proceed with your question.

Derek Han
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you. My first question is on fiduciary investment income. It looks like you stepped up $3 million quarter-over-quarter. Is that kind of the sequential step-up that we should think about for 1Q 2023?

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

A

For modeling purposes or what we would recommend, what we always recommend, is to take 30-day term SOFR minus 50 basis points and multiply that by our fiduciary income balance, which is broken out in the cash flow statement. At year end, it was around $770 million. That's what we earn investment income on.

Derek Han
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Got it. Thank you. And then my second question is on the compensation costs for next year. It looks like you're hiring pretty significantly, but are you anticipating any upward pressure on comp expenses? I know this is just in context of one of your competitors sold the stake to a private equity firm to create equity incentives for their producers, and I'm wondering if that has an impact on your comp costs.

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

A

So we are expecting increased comp costs like I think probably every other company now. But fortunately, the majority of our comp cost is production related. And so it's variable to revenue. So wage inflation doesn't affect a wholesale broker, for example, the same way it does a salaried employee. So we're dealing with it like everyone else. But it hasn't gotten out of control for us yet just because of the attribution of our comp that is production related and paid out as a percentage of revenue.

Derek Han
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And just follow up on that, do you anticipate that impacting your retention of producers, I know Ryan's obviously great home for talent, but just kind of curious about the impact maybe throughout 2023?

Timothy W. Turner
President & Director, Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Holdings, Inc.

A

We expect to continue to have a very high industry-leading retention level for brokers and underwriters, and all of our staff, no change at all.

Derek Han
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thank you.

Operator: The next question is from Jimmy Bhullar of JPMorgan. Please proceed with your question.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hi. So most of my questions were answered, I just had one on margins. If we think about the midpoint of your guidance in 2023, it's suggesting lower margins than in 2022, despite the fact that your growth has been fairly healthy, even with the slowdown. And then on top of that, you've got a restructuring charge where the costs are going below the line, the benefits are going to go above the line. So I'm wondering if, like, is this because of a lot of your expenses being variable in nature where there's less leverage in the business to growth in revenues or any sort of fee pressure, commission pressure or any that sort of and I do recognize the comments about wanting to grow the business, but it is somewhat surprising that margins are not improving with the strong growth that you've had and fairly strong growth that you're projecting.

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

A

Hi, Jimmy. As I said, the business model is proven to scale. We were at 25% margin at the end of 2019. We're at 30% at the end of 2022. What we've tried to be upfront and consistent about is making long-term investments in talent is the right thing to do to keep up our differentiated growth. We saw a big opportunity last year. We made it. There's a run rate impact for this year. There's an opportunity this year that we want to capitalize on, like that's the right playbook. And we're planning to stick to it.

It won't be the case every year that we have an outsized opportunity like we saw in 2022. And so I'll go back to my prior statements. Many years – not all but many years, you will see scaling. And what we're really excited – one thing we're excited about for ACCELERATE 2025 is that we're going to get a step change in margin once the program is fully built out. And the capabilities, the efficiencies that we're going to gain are going to make our continual annual scaling that much more rapid. So, the model the model scale, Jimmy, it's just when we have the opportunity, we think it makes sense to reinvest in our talent.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. And then on the uptick in sort of activity that you saw in your business in late December, are you able to comment if that's continued through January and February as well, recognizing that certain business has booked more a certain quarter and less in another quarter, but has that uptick in activity continued through the first half of this quarter?

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

A

Sorry, Jimmy. When you say uptick in activity, what are you referring to?

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Oh, are you just saying you saw stronger activity in the last two weeks of December which caused you to do better on growth than you had previously indicated?

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

A

Oh, right. Okay. Yeah. The comments on the late surge in property that benefited the quarterly organic, yes, we're – and Tim touched on the ongoing state of play with regards to property, we're still seeing a benefit from that as we sit here today.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

And despite that, your assumption for growth in the first half being less than in 4Q, is that a function of just booking less property revenues in the first half of the year or in the first quarter early on, or is it something else that's gotten worse since?

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

A

Oh, we actually haven't made any statement about the growth of H1 relative to Q4, just that we've got tough comps. There's headwinds we know about. So we know that it's going to be a challenging H1. But the important thing to do is to focus on the annual growth rate, which we think is going to be a very healthy 10% to 13%.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: The next question is from Ryan Tunis of Autonomous Research. Please proceed with your question.

Ryan Tunis
Analyst, Autonomous Research US LP

Q

Hey. Thanks. Good evening. I guess just thinking about the 2023 organic growth guide, it sounds like what's being explicitly contemplated are some comp issues in project-related business like D&O and construction, and also a net benefit from property. But I was just curious if – what other assumptions you might be making on how market conditions might evolve through the year and coming up to the 10% to 13%.

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

A

So, in any given year, there's going to be pluses and minuses. Tim referenced ebbs and flows with related to business that moves between the E&S market and the admitted market. There's lines that are still firming and there is lines that are going the other direction rapidly. We've talked extensively about public D&O as an example of that. So we're factoring all of that in. And what we do on an annual basis is we person-by-person, MGU-by-MGU, broker-by-broker, do a bottom up build of their book. And we put that all together. We improve it with any other market-based intelligence we have, but it is what it is. And fortunately, the sum of all the opportunities and challenges for 2023 is what we anticipate to be a really positive result.

Ryan Tunis
Analyst, Autonomous Research US LP

Q

Got it. And then I guess another question I had was – I guess with plenty brokers, we tend to think about a lot of the businesses being recurring. But I was curious like is there an outsized amount of your annual commissions that come from the project-based world, whether it's construction or D&O tied to an M&A transaction like that type of thing. I was wondering maybe you could quantify like how much usually of your book is project based.

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

A

So we don't disclose the specific percentage, but most of it is recurring type business. In fact, nearly all of it is commercial. We publicly disclose that we're over 70% E&S, and most importantly, the majority of the products that we work, we place or underwrite on behalf of our clients is compulsory.

Ryan Tunis
Analyst, Autonomous Research US LP

Q

Got it. And then – sorry, my last question is just on the – you said property performed well in the last couple of weeks of the year. Just from a timing standpoint in the fourth quarter, are there an outsized percentage of property renewals that take place at the end of that quarter? Or are they pretty uniformly distributed through 4Q?

Timothy W. Turner
President & Director, Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Holdings, Inc.

A

No, they continue to increase as we go into the new year. The winter buying season is well known to peak in the in the second quarter, actually. But as I said earlier, that the reinsurance treaty renewals of 4/1 and 7/1 will have a further hardening impact on the flow of cat property business into our channel. So, we expect it to continue to grow and expand and we're set up perfectly to absorb it and convert it, so the market definitely going to get harder in property.

Ryan Tunis
Analyst, Autonomous Research US LP

Q

Sorry. Let me clarify my question. I wasn't sure if maybe there were some renewals in the fourth quarter that were just standard property that got pushed to late in December just because of the market was becoming more challenging. I just didn't know if there were an outsized percentage of renewals that ended up taking place in those last couple of weeks?

Timothy W. Turner
President & Director, Chairman & Chief Executive Officer-RT Specialty, Ryan Specialty Holdings, Inc.

A

No, nothing to measure, but definitely rate increases and premium increases.

Ryan Tunis
Analyst, Autonomous Research US LP

Q

Thank you.

Operator: There are no additional questions at this time. I'd like to turn the call back to Pat Ryan for closing remarks.

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

Thank you, all, for your participation, and your interest in our company. As I look to the year ahead, we're really filled with optimism. We've got great team, the impact in the marketplace is strong, very strong drive, unwavering drive. We think world-class expertise and deep commitment to serving our clients. So we're confident that will continue to drive growth and success in this year of 2023. So thanks for your participation and your very good questions. Have a good evening.

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