BROWN & BROWN INC
Form 10-Q
August 04, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-13619

BROWN & BROWN, INC.
(Exact name of Registrant as specified in its charter)

Florida	59-0864469
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
220 South Ridgewood Avenue, Daytona Beach, FL	32114
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (386) 252-9601

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

The number of shares of the Registrant's common stock, $0.10 par value, outstanding as of August 1, 2017 was 139,920,874.

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Disclosure Regarding Forward-Looking Statements

Brown & Brown, Inc., together with its subsidiaries (collectively, “we,” “Brown & Brown” or the “Company”), makes “forward-looking statements” within the “safe harbor” provision of the Private Securities Litigation Reform Act of 1995, as amended, throughout this report and in the documents we incorporate by reference into this report. You can identify these statements by forward-looking words such as “may,” “will,” “should,” “expect,” “anticipate,” “believe,” “intend,” “estim “plan” and “continue” or similar words. We have based these statements on our current expectations about potential future events. Although we believe the expectations expressed in the forward-looking statements included in this Quarterly Report on Form 10-Q and the reports, statements, information and announcements incorporated by reference into this report are based upon reasonable assumptions within the bounds of our knowledge of our business, a number of factors could cause actual results to differ materially from those expressed in any forward-looking statements, whether oral or written, made by us or on our behalf. Many of these factors have previously been identified in filings or statements made by us or on our behalf. Important factors which could cause our actual results to differ materially from the forward-looking statements in this report include but are not limited to the following items, in addition to those matters described in Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations”:

- Future prospects;
- Material adverse changes in economic conditions in the markets we serve and in the general economy;
- Premium rates set by insurance companies and insurable exposure units, which have traditionally varied and are difficult to predict;
- Future regulatory actions and conditions in the states in which we conduct our business;
- The occurrence of adverse economic conditions, an adverse regulatory climate, or a disaster in California, Florida, Georgia, Illinois, Massachusetts, Michigan, New Jersey, New York, Oregon, Pennsylvania, Texas, Virginia and Washington, because a significant portion of business written by us is for customers located in these states;
- Our ability to attract, retain and enhance qualified personnel;
- Competition from others in or entering into the insurance agency, wholesale brokerage, insurance programs and related service business;
- The integration of our operations with those of businesses or assets we have acquired or may acquire in the future and the failure to realize the expected benefits of such integration;
- Risks that could negatively affect our acquisition strategy, including continuing consolidation among insurance intermediaries and the increasing presence of private equity investors driving up valuations;
- Our ability to forecast liquidity needs through at least the end of 2017;
- Our ability to renew or replace expiring leases;
- Outcomes of existing or future legal proceedings and governmental investigations;
- Policy cancellations and renewal terms, which can be unpredictable;
- Potential changes to the tax rate that would affect the value of deferred tax assets and liabilities and the impact on income available for investment or distributable to shareholders;
- The inherent uncertainty in making estimates, judgments, and assumptions in the preparation of financial statements in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”);
- Our ability to effectively utilize technology to provide improved value for our customers or carrier partners as well as applying effective internal controls and efficiencies in operations; and
- Other risks and uncertainties as may be detailed from time to time in our public announcements and Securities and Exchange Commission (“SEC”) filings.

Assumptions as to any of the foregoing and all statements are not based upon historical fact, but rather reflect our current expectations concerning future results and events. Forward-looking statements that we make or that are made by others on our behalf are based upon a knowledge of our business and the environment in which we operate, but because of the factors listed above, among others, actual results may differ from those in the forward-looking statements. Consequently, these cautionary statements qualify all of the forward-looking statements we make herein. We cannot assure you that the results or developments anticipated by us will be realized or, even if substantially realized, that those results or developments will result in the expected consequences for us or affect us, our business or our operations in the way we expect. We caution readers not to place undue reliance on these forward-looking statements, which speak only as of their dates. We assume no obligation to update any of the forward-looking statements.

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PART I — FINANCIAL INFORMATION
ITEM 1 — Financial Statements (Unaudited)
BROWN & BROWN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share data)	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
REVENUES				
Commissions and fees	$464,724	$445,662	$909,290	$867,997
Investment income	351	502	594	920
Other income, net	1,230	354	21,501	1,774
Total revenues	466,305	446,518	931,385	870,691
EXPENSES				
Employee compensation and benefits	244,517	231,102	490,383	455,161
Other operating expenses	71,312	66,291	138,231	129,896
Loss/(gain) on disposal	9	(810)	(91)	(2,854)
Amortization	21,347	21,610	42,967	43,220
Depreciation	5,655	5,354	11,753	10,672
Interest	9,874	9,837	19,556	19,734
Change in estimated acquisition earn-out payables	5,589	4,057	9,617	3,236
Total expenses	358,303	337,441	712,416	659,065
Income before income taxes	108,002	109,077	218,969	211,626
Income taxes	41,900	42,827	82,757	83,306
Net income	$66,102	$66,250	$136,212	$128,320
Net income per share:				
Basic	$0.47	$0.47	$0.97	$0.92
Diluted	$0.46	$0.47	$0.96	$0.91
Dividends declared per share	$0.14	$0.12	$0.27	$0.25

See accompanying Notes to Condensed Consolidated Financial Statements.

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BROWN & BROWN, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except per share data)	June 30, 2017	December 31, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$600,296	$515,646
Restricted cash and investments	276,634	265,637
Short-term investments	30,164	15,048
Premiums, commissions and fees receivable	499,670	502,482
Reinsurance recoverable	22,479	78,083
Prepaid reinsurance premiums	297,736	308,661
Other current assets	51,953	50,571
Total current assets	1,778,932	1,736,128
Fixed assets, net	72,747	75,807
Goodwill	2,692,104	2,675,402
Amortizable intangible assets, net	671,874	707,454
Investments	10,876	23,048
Other assets	52,476	44,895
Total assets	$5,279,009	$5,262,734
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Premiums payable to insurance companies	$706,923	$647,564
Losses and loss adjustment reserve	22,479	78,083
Unearned premiums	297,736	308,661
Premium deposits and credits due customers	92,217	83,765
Accounts payable	103,211	69,595
Accrued expenses and other liabilities	176,971	201,989
Current portion of long-term debt	20,000	55,500
Total current liabilities	1,419,537	1,445,157
Long-term debt less unamortized discount and debt issuance costs	965,391	1,018,372
Deferred income taxes, net	373,089	357,686
Other liabilities	62,759	81,308
Shareholders' Equity:		
Common stock, par value $0.10 per share; authorized 280,000 shares; issued 148,264 shares and outstanding 139,999 shares at 2017, issued 148,107 shares and outstanding 140,104 shares at 2016	14,826	14,811
Additional paid-in capital	479,193	468,443
Treasury stock, at cost at 8,265 shares at 2017 and 8,003 shares at 2016, respectively	(268,842)	(257,683)
Retained earnings	2,233,056	2,134,640
Total shareholders' equity	2,458,233	2,360,211
Total liabilities and shareholders' equity	$5,279,009	$5,262,734

See accompanying Notes to Condensed Consolidated Financial Statements.

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BROWN & BROWN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS(UNAUDITED)

	For the six months ended June 30,	
(in thousands)	2017	2016
Cash flows from operating activities:		
Net income	$ 136,212	$ 128,320
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	42,967	43,220
Depreciation	11,753	10,672
Non-cash stock-based compensation	15,326	6,674
Change in estimated acquisition earn-out payables	9,617	3,236
Deferred income taxes	14,793	15,907
Amortization of debt discount	79	79
Amortization and disposal of deferred financing costs	943	807
Accretion of discounts and premiums, investment	13	47
Income tax benefit from exercise of shares from the stock benefit plans	—	(6,816)
Net loss/(gain) on sales of investments, fixed assets and customer accounts	136	(2,700)
Payments on acquisition earn-outs in excess of original estimated payables	(7,109)	(3,550)
Changes in operating assets and liabilities, net of effect from acquisitions and divestitures:		
Premiums, commissions and fees receivable decrease (increase)	2,918	(34,099)
Reinsurance recoverables decrease	55,604	(28,844)

(increase)				
Prepaid reinsurance premiums decrease	10,925		10,736	
Other assets (increase)	(9,326	)	(11,272	)
Premiums payable to insurance companies decrease	59,219		90,068	
Premium deposits and credits due customers increase	8,500		12,049	
Losses and loss adjustment reserve (decrease) increase	(55,604	)	28,844	
Unearned premiums (decrease)	(10,925	)	(10,736	)
Accounts payable increase	38,510		34,156	
Accrued expenses and other liabilities (decrease)	(26,021	)	(29,765	)
Other liabilities (decrease)	(28,449	)	(18,346	)
Net cash provided by operating activities	270,081		238,687	
Cash flows from investing activities:				
Additions to fixed assets	(8,848	)	(8,944	)
Payments for businesses acquired, net of cash acquired	(11,526	)	(107,290	)
Proceeds from sales of fixed assets and customer accounts	669		3,291	
Purchases of investments	(5,916	)	(16,405	)
Proceeds from sales of investments	2,911		9,379	
Net cash used in investing activities	(22,710	)	(119,969	)
Cash flows from financing activities:				
Payments on acquisition earn-outs	(8,668	)	(7,012	)
Payments on long-term debt	(86,750	)	(20,625	)
Deferred debt issuance costs	(2,753	)	—	
Income tax benefit from exercise of shares from the stock benefit plans	—		6,816	

Issuances of common stock for employee stock benefit plans	500	916
Repurchase shares to fund tax withholdings for non-cash stock-based compensation	(5,054)	(6,273)
Purchase of treasury stock	(11,159)	(11,250)
Settlement of accelerated share repurchase program	—	11,250
Cash dividends paid	(37,840)	(34,128)
Net cash used in financing activities	(151,724)	(60,306)
Net increase in cash and cash equivalents inclusive of restricted cash	95,647	58,412
Cash and cash equivalents inclusive of restricted cash at beginning of period	781,283	673,173
Cash and cash equivalents inclusive of restricted cash at end of period	$ 876,930	$ 731,585

See accompanying Notes to Condensed Consolidated Financial Statements. Refer to Note 8 for reconciliation of cash and cash equivalents inclusive of restricted cash.

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BROWN & BROWN, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1· Nature of Operations

Brown & Brown, Inc., a Florida corporation, and its subsidiaries (collectively, "Brown & Brown" or the "Company") is a diversified insurance agency, wholesale brokerage, insurance programs and services organization that markets and sells to its customers, insurance products and services, primarily in the property, casualty and employee benefits areas. Brown & Brown's business is divided into four reportable segments: the Retail Segment provides a broad range of insurance products and services to commercial, public and quasi-public entities, professional and individual customers; the National Programs Segment, acting as a managing general agent ("MGA"), provides professional liability and related package products for certain professionals, a range of insurance products for individuals, flood coverage, and targeted products and services designated for specific industries, trade groups, governmental entities and market niches, all of which are delivered through nationwide networks of independent agents, including Brown & Brown retail agents; the Wholesale Brokerage Segment markets and sells excess and surplus commercial insurance, primarily through independent agents and brokers, as well as Brown & Brown Retail offices; and the Services Segment provides insurance-related services, including third-party claims administration and comprehensive medical utilization management services in both the workers' compensation and all-lines liability arenas, as well as Medicare Set-aside services, Social Security disability and Medicare benefits advocacy services, and claims adjusting services.

NOTE 2· Basis of Financial Reporting

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and the Notes thereto set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

The preparation of these financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosures of contingent assets and liabilities, at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Recently Issued Accounting Pronouncements

In November 2016, the Financial Accountings Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-18, "Statement of Cash Flows (Topic 230)": Restricted Cash ("ASU 2016-18"), which requires that the Statement of Cash Flows explain the changes during the period of cash and cash equivalents inclusive of amounts categorized as restricted cash. ASU 2016-18 is effective for periods beginning after December 15, 2017; however, the Company elected to early adopt for the reporting period ended March 31, 2017 under the full retrospective approach for all periods presented. With the adoption of ASU 2016-18, the change in restricted cash is no longer reflected as a change in operating assets and liabilities, and the Statement of Cash Flows details the changes in the balance of cash and cash equivalents inclusive of restricted cash. Net cash provided by operating activities for the six months ended June 30, 2016 were previously reported as $190.8 million. With the retrospective adoption, the net cash provided by operating activities for the six months ended June 30, 2016 is now reported as $238.7 million. The Company reflects cash collected from customers that is payable to insurance companies as restricted cash if segregation of this cash is required by the state of domicile for the office conducting this transaction or if required by contract with the relevant insurance company providing coverage. Cash collected from customers that is payable to insurance companies is reported in cash and cash equivalents if no such restriction is required.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)": Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force) ("ASU 2016-15"), which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified and applies to all entities, including both business entities and not-for-profit entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 and early adoption is permitted. The Company has evaluated the impact of ASU 2016-15 and has determined there is no impact on the Company's Statement of Cash Flows. The Company already presents cash paid on contingent consideration in business combination as prescribed by ASU 2016-15 and does not, at this time, engage in the other activities being addressed.

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share Based Payment Accounting” (“ASU 2016-09”), which amends guidance issued in Accounting Standards Codification (“ASC”) Topic 718, Compensation - Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of

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awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years and early adoption is permitted. The Company adopted the guidance on January 1, 2017, as required. Prior periods have not been adjusted, as the guidance was adopted prospectively. The principal impact is that the tax benefit or expense from stock compensation is now presented in the income tax line of the Statement of Income whereas the prior treatment was to present this as a component of equity on the Balance Sheet. Also the tax benefit or expense is now presented as activity in Cash Flow from Operating Activity rather than the prior presentation as Cash Flow from Financing Activity in the Statement of Cash Flows. The Company also continues to estimate forfeitures of stock grants as allowed by ASU 2016-09.

In March 2016, the FASB issued ASU 2016-08, “Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)” (“ASU 2016-08”) to clarify certain aspects of the principal-versus-agent guidance included in the new revenue standard ASU 2014-09 “Revenue from Contracts with Customers” (“ASU 2014-09”). The FASB issued the ASU in response to concerns identified by stakeholders, including those related to (1) determining the appropriate unit of account under the revenue standard’s principal-versus-agent guidance and (2) applying the indicators of whether an entity is a principal or an agent in accordance with the revenue standard’s control principle. ASU 2016-08 is effective contemporaneous with ASU 2014-09 beginning January 1, 2018. The impact of ASU 2016-08 is currently being evaluated along with ASU 2014-09. At this point in our evaluation the potential impact would primarily be limited to the claims administering activities within our Services Segment and therefore not material to the Company.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which provides guidance for accounting for leases. Under ASU 2016-02, the Company will be required to recognize the assets and liabilities for the rights and obligations created by leased assets. ASU 2016-02 will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company continues to evaluate the impact of this pronouncement with the principal impact being that the present value of the remaining lease payments be presented as a liability on the Balance Sheet as well as an asset of similar value representing the “Right of Use” for those leased properties. As detailed in Note 13 of the 2016 10-K, the undiscounted contractual cash payments remaining on leased properties is $204.2 million as of June 30, 2017.

In November 2015, FASB issued ASU No. 2015-17, “Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes” (“ASU 2015-17”), which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as a single non-current item on the balance sheet. ASU 2015-17 is effective for fiscal years beginning after December 15, 2016 with early adoption permitted as of the beginning of any interim or annual reporting period. The Company adopted the guidance on January 1, 2017, as required. As a result, the Company retrospectively applied the guidance to the 2016 balance sheet by reclassifying $24.6 million from deferred income taxes (asset) to deferred income taxes, net (liability) on the Condensed Consolidated Balance Sheet.

In May 2014, FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which provides guidance for revenue recognition. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets, and supersedes the revenue recognition requirements in Topic 605, “Revenue Recognition,” and most industry-specific guidance. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under the current guidance. Specifically, in situations where multiple performance obligations exist within the contract, the use of estimates is required to allocate the transaction price to each separate performance obligation. Historically, approximately 70% of the Company’s commissions and fees revenue is in the form of commissions paid by insurance carriers. These commissions are earned upon the effective date of bound coverage, and no significant performance obligation remains after coverage is bound. Approximately 20% of the commissions and fees revenue is in the form of fees, which the Company has evaluated and determined that only a small portion will be affected. The remaining revenue streams are currently being evaluated, and this evaluation will be concluded in the third quarter. Fees are predominantly in our National Programs and Services Segments, and to a lesser extent in the large accounts business within our Retail Segment. At the conclusion of this evaluation, it may be determined that fee revenue from certain agreements will be recognized in earlier periods under the new guidance in comparison to our current accounting policies and others will be recognized in later periods. Based upon the work completed to date, management does not expect the overall impact to be material on a full-year basis, but m