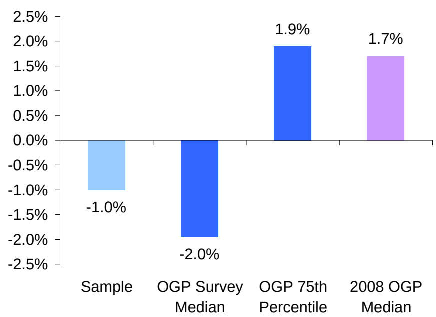
Organic Growth & Profitability Survey (OGP) - Year-End 2009

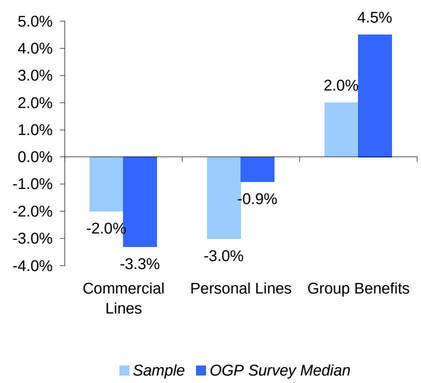
- Median annualized revenue for surveyed firms is over $15 million, average is $37 million. All U.S. geographies represented.
- In this Year-End survey, we have provided a comparison to 2008 OGP results in lieu of public broker results, as public broker results have not been released.

Organic Growth

Total Agency Organic Growth



Organic Growth by Product Line

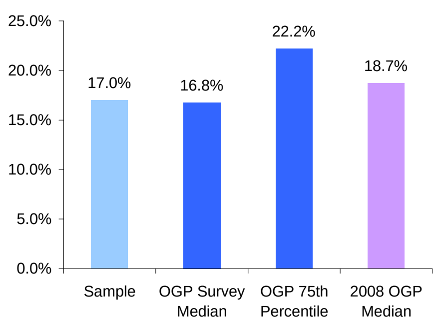


Reagan Consulting Observations

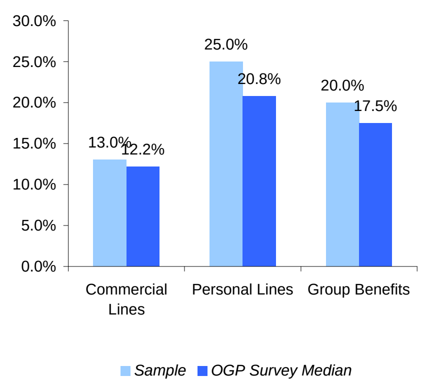
- Median organic growth was negative 2.0% for 2009, and only 35% of firms reported positive organic growth
- At negative 2.0%, organic growth for 2009 was 3.7% lower than the 2008 organic growth rate of positive 1.7%
- Commercial lines continues to be the hardest hit, with median organic growth of negative 3.3% in 2009
- While all product lines were hurt by the recession, (U.S. GDP contracted 2.4% in 2009) Group Benefits seemed affected the most, as Benefits growth of 4.5% was less than half of 2008's 10.6%.

Profitability

Total Agency EBITDA Margin



EBITDA Margin by Product Line

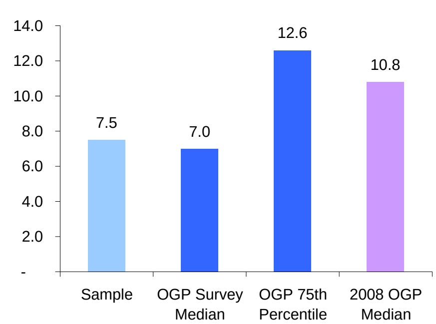


Reagan Consulting Observations

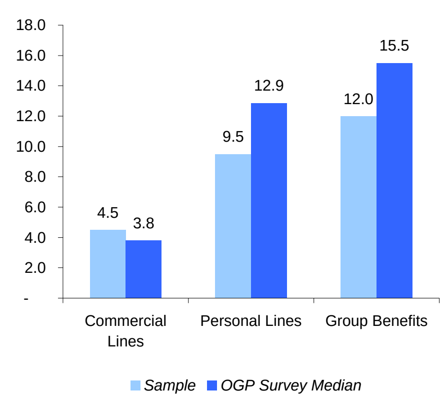
- Median EBITDA margins continued to fall as the year progressed - the median firm's EBITDA in 2009 was 16.8%
- Profitability fell nearly 2 percentage points in 2009, as EBITDA margins were 16.8% this year versus 18.7% last year
- Median contingent income in 2009 was down 13% versus 2008, contributing to the year-over-year decline in profitability
- To be a top 25% performer nationwide required EBITDA of 22.2% or higher

The Rule of 20 [(1)]

Total Agency Rule of 20



Rule of 20 by Product Line



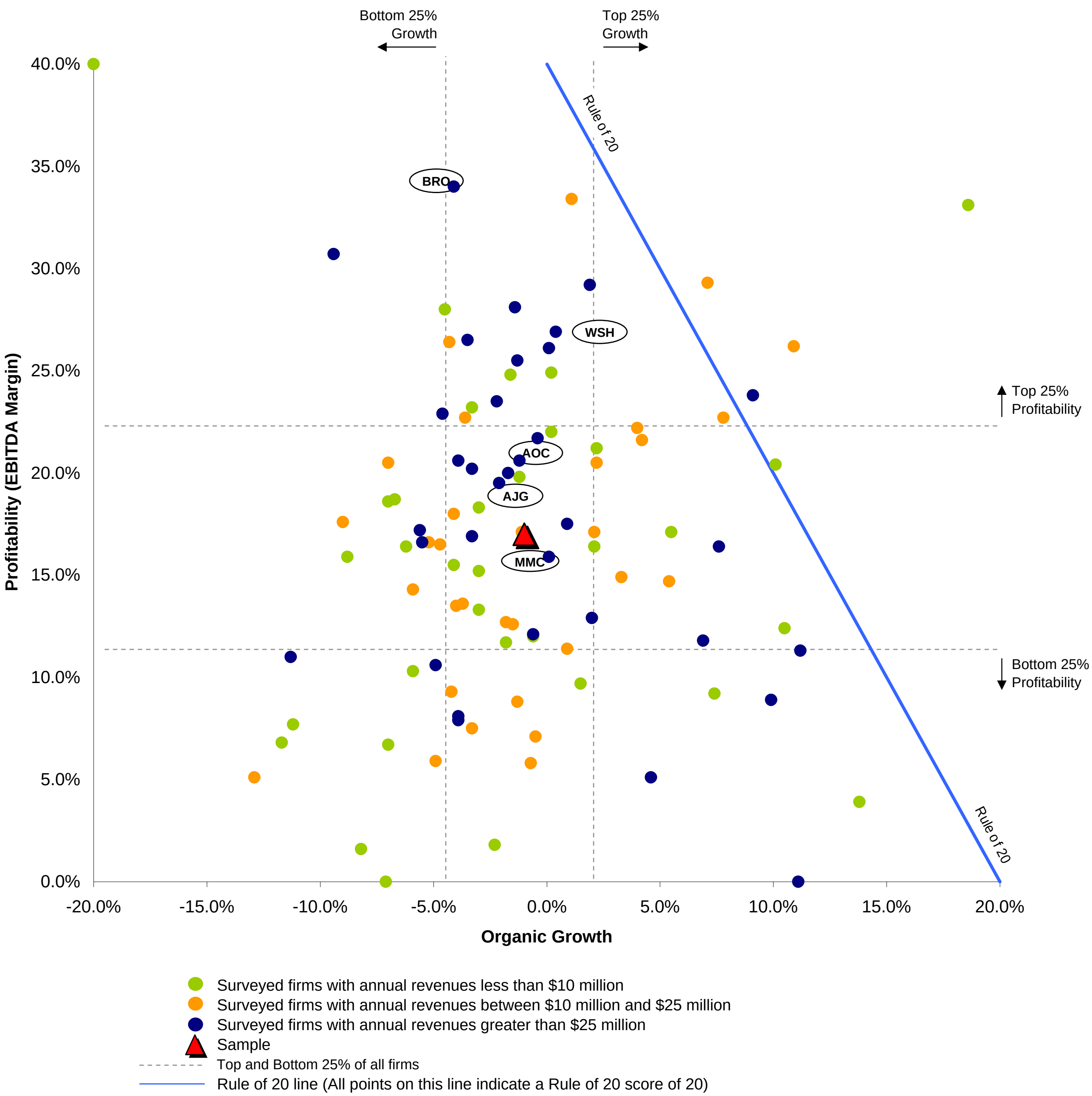
Reagan Consulting Observations

- Year end Rule of 20 numbers, with a median of 7.0, fell dramatically from 2008, when the median was almost 4 points higher (10.8)
- Benefits generated the best shareholder returns with a Rule of 20 score of 15.5
- Commercial Lines trails Personal Lines by over 9 points and trails Group Benefits by almost 12 points in Rule of 20 scoring
- To be a top 25% performer required an overall Rule of 20 score of 12.6 or higher
- Only 5% of firms hit a Rule of 20 score of 20 or higher in 2009

(1) Reagan Consulting has developed a metric called the “Rule of 20” to provide a quick means of benchmarking an agency's shareholder returns. The Rule of 20 is calculated by adding half of an agency's EBITDA margin to its organic revenue growth rate. An outcome of 20 or higher means an agency is likely generating, through distributions and / or share appreciation, a shareholder return of approximately 15% - 17%, which is a typical agency / brokerage return under normal market conditions. Given current market conditions, however, few firms are achieving a score of 20 or better.

NOTE: If data for your firm reads "0.0%" or "0.0" it may mean that no data was submitted for that metric.

Agency Organic Growth & Profitability Scatter Plot



About the Scatter Plot

In the chart above, we've plotted every firm in the survey that completed both the total agency organic growth section and the total agency profitability section. Each firm's organic growth is plotted along the x-axis, and each firm's profitability is plotted along the y-axis. We've included a couple of guidelines on the graph to help in interpreting the data. The grey dotted lines show the top and bottom 25% of firms in organic growth and profitability. The solid blue line represents all combinations of organic growth and EBITDA margin that result in a Rule of 20 score of 20. Finally, we've broken the firms into groups based on revenue size, as distinguished by the different colored dots. The goal of this scatter plot is to show the wide range of organic growth and profitability results in the industry and to benchmark where your firm falls.

2010 is Shaping Up to be Even Tougher for Insurance Agents & Brokers

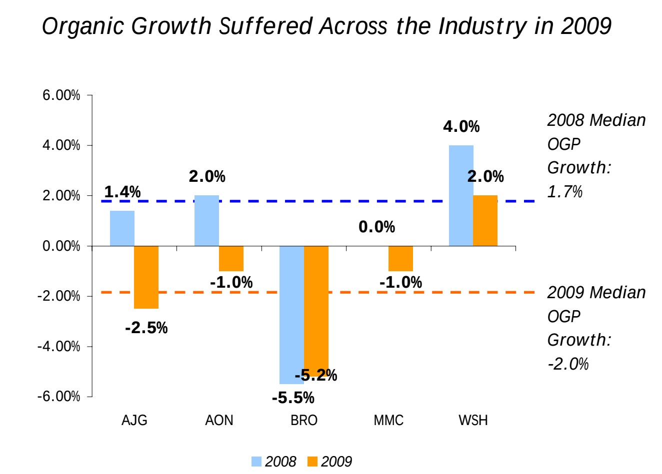
Kevin Stipe and Brian Deitz

The combination of a shrinking economy and soft P&C pricing was toxic to insurance agency performance in 2009. The difficult conditions caused the first ever recorded year-over-year reduction in organic growth and dropped industry profit margins by nearly two percentage points. And it was equal-opportunity pain, affecting agencies of all types and sizes – from industry leader Marsh down to the little personal lines agencies that populate middle-America.

Organic Growth

The table below provides the unfortunate picture of organic revenue growth in 2009 for OGP survey participants and the public brokers. The typical OGP firm saw revenue growth decline from 1.7% in 2008 to negative 2.0% in 2009. Only about one-third of OGP firms grew organically in 2009, and the two-thirds that didn't grow shrank by a stunning 4.0%.

Public Broker and OGP Organic Growth Benchmarks



The story for the public brokers was similar. Four of the five public brokers reported negative organic growth rates (the average of these four being negative 2.4%). Willis was the only public broker that grew organically in 2009, and its 2.0% organic growth was only half of the 4.0% reported in 2008. Brown & Brown, primarily due to poor results in Florida, had the worst organic growth performance of the public brokers: a decline of 5.2%. This mirrors the OGP results for Florida firms, which were down an average of 4.2% in 2009.

Pinpointing the cause of the difficult organic growth environment is not difficult. Declining exposure units, driven by the weak U.S. economy, replaced the soft market as the industry's #1 boogeyman in 2009. But it could have been worse. While still soft in 2009, P&C pricing declined by only 5.4%, which was the smallest reduction since 2006.

Profitability

The difficult revenue growth environment also took a toll on agency profitability in 2009. OGP profit margins dropped almost 200 basis points, from 18.7% in 2008 to 16.8% in 2009. For the typical firm that completed both the year-end 2008 OGP survey and the year-end 2009 OGP survey, pro-forma EBITDA dollars fell by 9.0%.

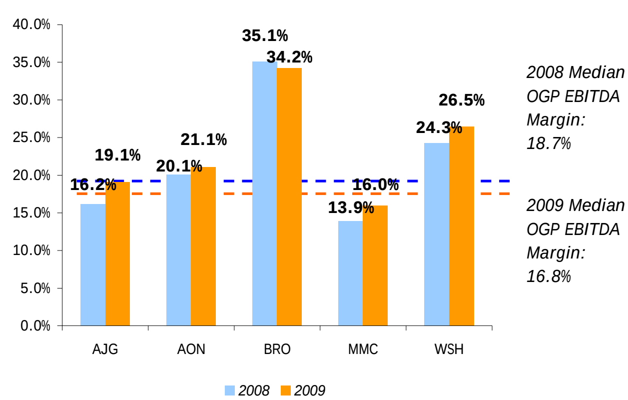
However, the public brokers actually performed quite well from a profitability standpoint in 2009. Four of the five publicly-traded brokers *increased* EBITDA margins despite their declining organic revenue growth. The only public broker to see a margin decrease in 2009 was Brown & Brown, and despite its profitability reduction the company still led the public brokers with a 34.2% EBITDA margin.

What caused the disparity between public broker and private broker EBITDA performance? Both groups fought through the same soft market conditions and struggled versus the declining economy, but private brokers were held back by two factors:

Contingent income dependency. The private brokers in the OGP survey depend heavily on contingent income. For the median firm that completed the OGP survey in 2009, 48.6% of EBITDA was generated by contingent income. And in 2009, contingent income performance was weak. For the median firm, contingent income dropped 13% and one-third of firms lost over 25% of their contingent income. Given this contingent income performance, a drop in profitability was almost unavoidable. The public brokers, however, don't have this large contingent income dependency. Three of the largest publicly-traded brokers (Aon, Marsh and Willis) do not accept contingent income (though they will in 2010) and Gallagher began accepting contingent income again late in 2009. Brown & Brown is the public broker with the largest contingent income exposure, and their contingent income fell by 15.6% in 2009 – likely contributing to their decline in profitability.

Public Broker and OGP Profitability Benchmarks (EBITDA Margin)

Public Brokers Drove Profits While OGP Firms Struggled



Aggressive expense control. The public brokers were more aggressive in 2009 than their private broker counterparts in aggressively reining in expenses. Gallagher, which had the highest EBITDA margin increase among the public brokers, was especially aggressive in terms of headcount reduction. Gallagher reduced its workforce by 4% in early 2009 and then by another 4% in late 2009 and early 2010. Further, Gallagher was able to capitalize on investments in systems and processes that allowed the company to significantly reduce operating costs. Margin improvement at Willis was driven, in part, by the realization of over $200 million in cost savings from the integration of the HRH transaction.

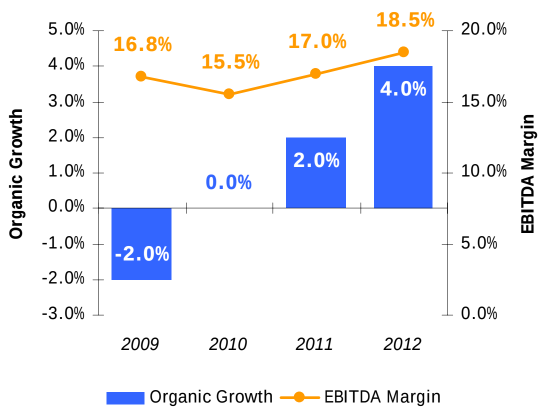
While the contingent income dependency is not likely to dissipate, some private brokers are getting more aggressive in controlling expenses to preserve margin. Often, however, it is easier for public brokers to make these difficult decisions, as they are under pressure from Wall Street and from their shareholders to maintain and grow earnings.

Where is the industry going in 2010 and beyond?

We have truly entered the "grow or die" era in our industry. Ironically, the soft P&C market may have been a blessing in disguise. Experiencing a soft market in 18 out of the last 22 years caused many agency leaders to get serious about transforming their agencies into true sales organizations. Although they may not have foreseen today's crisis any more clearly than others, their efforts to build a sales culture are now paying real dividends. They are the fortunate few who are positioned to not only survive, but also to prosper even while others stumble and are driven from the business.

Forecasting the future is always difficult, but with today's economic uncertainty it is even harder. Nevertheless, below is a Reagan Consulting projection of growth and profitability for OGP survey participants for the coming three years.

Three-Year Private Broker Organic Growth & Profitability Forecast



There are some key assumptions that underpin our forecast:

- Commercial P&C pricing will remain moderately soft (zero to negative 5%) until at least 2011 and perhaps well into 2012.

- The U.S. economy will resume modest growth (1% - 3%), but it will fall far short of the levels seen following other U.S. recessions during the 20th century.

- Exposure unit declines of 2009 will level off in 2010, but any growth will be meager and will move in tandem with the overall economy. Since broker results tend to lag changes in the economy by several months, a significant rebound in broker organic growth is unlikely to occur before 2011.

- Game-changing healthcare reform might have experienced its last-gasp in the Obama-led summit with Congressional leaders on February 25th. Benefits brokers – who were in a state of near-panic in the months after Obama was elected – are feeling a bit more confident that their livelihoods will remain viable for at least a few more years.

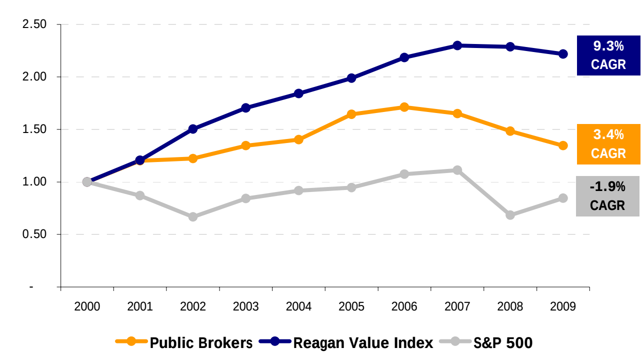
- While employee benefits revenue will continue to contribute to agency growth, political pressure on healthcare costs and on broker compensation will cause it to grow more slowly. The days of automatic 10% - 15% growth in revenue from employee benefits are likely over, replaced with 5%-10% growth rates for most brokers.

- EBITDA margins will bottom out in 2010 in the mid 15% range (the worst level since the early 1990s) and will not reach 20% again until 2013 at the earliest. The industry will return to 20% margins only when organic growth improves to 5% or better and contingent income rebounds.

Conclusion

With the myriad of challenges brokers face, it might be helpful to be reminded what a great business insurance brokerage is. The first decade of the new millennium has been tumultuous. It included: the bursting of the technology bubble, the terrorist attack of 9/11, the mortgage meltdown of 2008, and the Great Recession. During that time, as one might expect, the stock market has lost ground, losing almost 2% per year. The publicly traded brokers have fared better, growing at an annual rate of 3.4%. But privately-held brokers have "lapped the field", growing their value at an annual rate of nearly 10%. The new decade will clearly bring its own set of challenges – but using history as a guide, don't bet against the privately-held insurance broker!

Investment Performance 2000 - 2009



The Reagan Value Index is a group of over 30 privately-held brokers whose valuations are tracked annually by Reagan Consulting.