Organic Growth & Profitability Survey

Q3 2008 Results

About the Organic Growth & Profitability (OGP) Survey

The two most important drivers of agency value are organic growth and profitability. In today's difficult economy and soft P&C insurance market, agency leaders need to know how they stack up against their peers. Unfortunately, while growth & profitability metrics are available quarterly from the publicly traded insurance brokers, there is no industry-wide source of quarterly data for privately-held insurance brokers.

Until now.

In late 2008, Reagan Consulting launched a new quarterly survey called the Organic Growth and Profitability Survey. It is designed to provide agency leaders with real-time information on the performance of their industry. The intent is to equip them with critical information necessary to aid strategic decision-making.

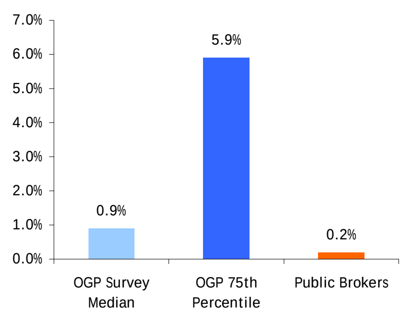
In the first survey, which covered the first nine-months of 2008, a total of 109 insurance brokers participated in the OGP Survey. The median annual revenue of the participants was over $15 million. We have also shown, for comparison purposes, the results of the public brokers, which include Aon, Arthur J. Gallagher, Brown & Brown, Marsh and Willis.

The results of the survey are shown below.

Q3 2008 Survey Results

The results of the first OGP Survey, covering the first nine months of 2008, reflect the continuing influence of the soft market on the performance of independent agencies and brokerages. Median organic revenue growth was almost flat for the period. Profitability was just over 20% for the median independent agency, buoyed by strong contingent income received early in 2008.

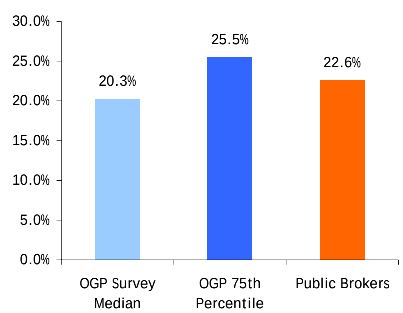
Organic Growth



Reagan Consulting Observations

- The survey indicates that large private broker organic growth exceeded public broker growth
- 42.2% of surveyed firms indicated that organic growth was negative during the first nine months of 2008
- Only 8.3% of firms surveyed reported double-digit organic growth (10% or more)
- Florida firms have faced a difficult market, with average organic growth for Florida firms in the survey of negative 13.7%

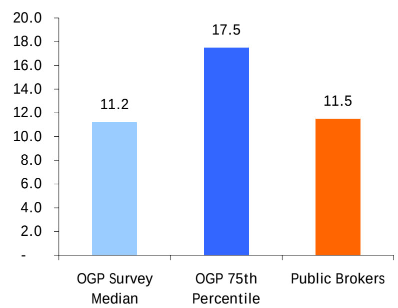
EBITDA Margin



Reagan Consulting Observations

- Only three firms reported negative agency EBITDA margins
- 39.8% of surveyed firms reported EBITDA margins greater than the average public broker margin
- In a divisional analysis not shown, the survey found:
  - Commercial Lines and Group Benefits divisions are currently generating very similar margins
  - Personal Lines EBITDA is approximately 12 points higher than Commercial Lines or Group Benefits

The Rule of 20



Reagan Consulting Observations

- Low organic growth rates in the soft market have hurt Rule of 20 scores
- Only 8.4% of surveyed firms had a Rule of 20 calculation above 20
- The median Rule of 20 score for surveyed firms was very close to the public brokers
- In a divisional analysis not shown, the survey found that the Group Benefits Rule of 20 score of 18.8 indicates that Benefits is currently generating the highest overall return

Balancing Growth & Profitability: Introducing the Rule 20

Growth or profitability? Stock price appreciation or profit distributions? Agency owners frequently find that these objectives are at odds – especially in a soft market. To create growth, agencies must often invest in producers and resources, sacrificing short-term profits. Similarly, to drive profitability, agencies must often forego the spending that drives growth. How agencies balance growth and profitability ultimately determines the returns they create for their shareholders.

At Reagan Consulting, we see various approaches to this balancing act. Many agencies invest heavily in production talent and value-added resources to drive organic revenue growth. Other firms are content to grow at below-average rates in order to reap strong profits. Is one approach preferable? Which drives greater shareholder returns? What is the right balance?

We've performed extensive research to determine exactly what balance of growth and profitability is optimal for independent agencies and brokerages. What we've found is a relatively simple growth and profitability balancing equation that we call "The Rule of 20." The Rule of 20 states that an agency will drive acceptable shareholder returns if the sum of (a) its organic growth rate and (b) ½ of its EBITDA margin equals or exceeds 20. (EBITDA margin is defined as Earnings Before Interest, Taxes, Depreciation and Amortization, divided by Net Revenue.)

What are "acceptable shareholder returns?" By examining the cost of capital, we've estimated that an "acceptable" or "industry-standard" return for privately-held agencies and brokerages is approximately 15% - 17%. In other words, shareholders who are investing in these businesses want to earn 15% - 17% per year through either stock price appreciation and/or shareholder distributions. When we've tested the annual returns generated by different combinations of growth & profitability, we've found that any time The Rule of 20 is met (any time organic growth plus ½ of EBITDA margin equals 20) industry-standard returns are achieved.

Because organic growth is such a key input into the Rule of 20, the persisting soft market and the current depressed economic environment have made it very difficult to hit The Rule of 20. The median Rule of 20 score during the first nine months of 2008 was 11.2, and only 8.4% of the firms in the OGP Survey had a Rule of 20 score of 20 or higher.

For independent agencies and brokerages, there are two applications of The Rule of 20: Benchmarking and Balance. First, an agency can quickly benchmark its shareholder returns by adding ½ its EBITDA margin to its organic growth rate. If this sum equals or exceeds 20, shareholder returns are meeting or exceeding industry-expected returns. If this sum exceeds 11.2, shareholder returns are above current median performance in the industry. Second, an agency can appropriately balance the trade-off between growth and profitability, understanding that two points of EBITDA margin are worth one point of revenue growth.

So, growth or profitability? The Rule of 20 indicates that there isn't one correct combination of the two, but that there are a variety of combinations that can generate similar, adequate returns. Every agency can find its appropriate mix depending on its capabilities, resources and aspirations.