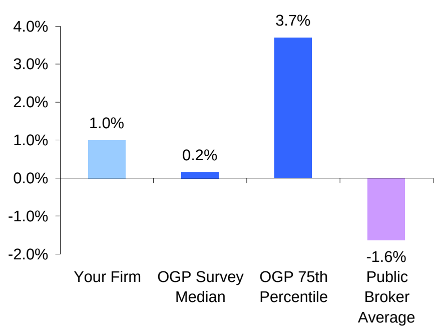
Q2 2010
OGP ID: 9999

Organic Growth & Profitability Survey (OGP) - Q2 2010

- Median annualized revenue for surveyed firms is over $16 million, average is over $40 million. All U.S. geographies represented.
- Public Broker results are from press releases and Reagan Consulting estimates, and include Aon, Gallagher, Marsh, Brown & Brown and Willis.

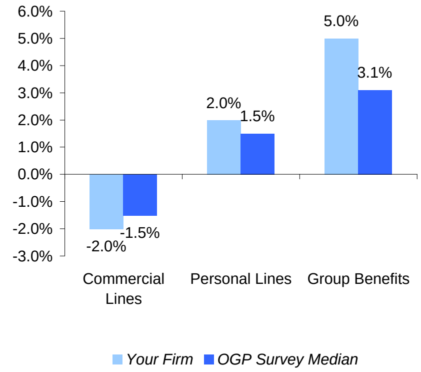
Organic Growth

Total Agency Organic Growth



Your organic growth rank:	**50th - 60th percentile**

Organic Growth by Product Line



Reagan Consulting Observations

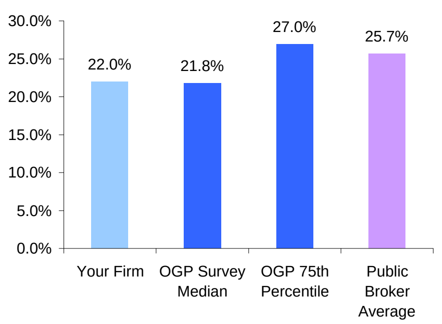
- Median organic growth was positive for the first half of 2010, up 0.2%. Though the increase was slight, it marks the first positive growth result since Q4 2008.
- Perhaps finally seeing some of the effects of recent GDP increases, growth in all lines improved significantly in the second quarter of 2010

Growth	*First Qtr* <u>*2010*</u>	*First Half* <u>*2010*</u>	<u>*Change*</u>
Comm	-2.9%	-1.5%	1.4%
Pers	-0.8%	1.5%	2.3%
Group	2.3%	3.1%	0.8%

- Public broker organic growth remained negative (-1.6%) through June of 2010

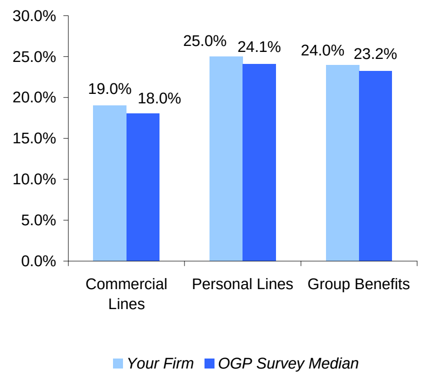
Profitability

Total Agency EBITDA Margin



Your profitability rank:	**50th - 60th percentile**

EBITDA Margin by Product Line

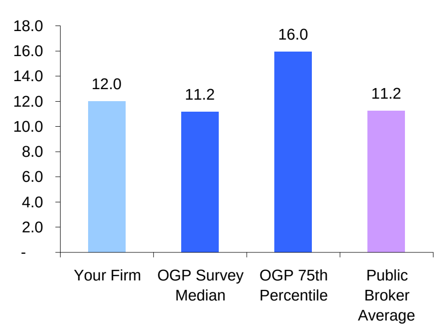


Reagan Consulting Observations

- Median EBITDA margin, boosted by first half contingent income receipts, was 21.8% in the first half of 2010
- Like the growth results, profitability was strong in Q2 2010. First half margins for 2010 now exceed first half margins for 2009 (21.8% versus 21.1%).
- Contingent income, which was down 8% for the median firm after Q1, is now down only 5%, improving profitability
- The public brokers continue to outperform OGP participants in profitability. Public broker EBITDA was almost 400 basis points above the OGP median in 1H 2010.

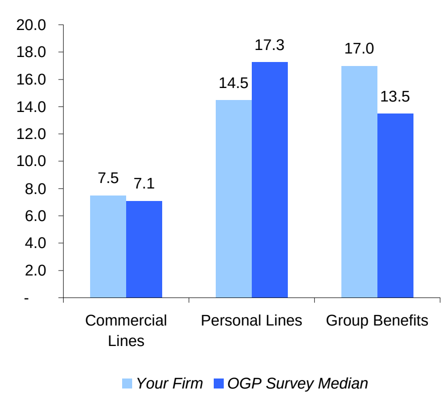
The Rule of 20 (1)

Total Agency Rule of 20



Your Rule of 20 rank:	**50th - 60th percentile**

Rule of 20 by Product Line

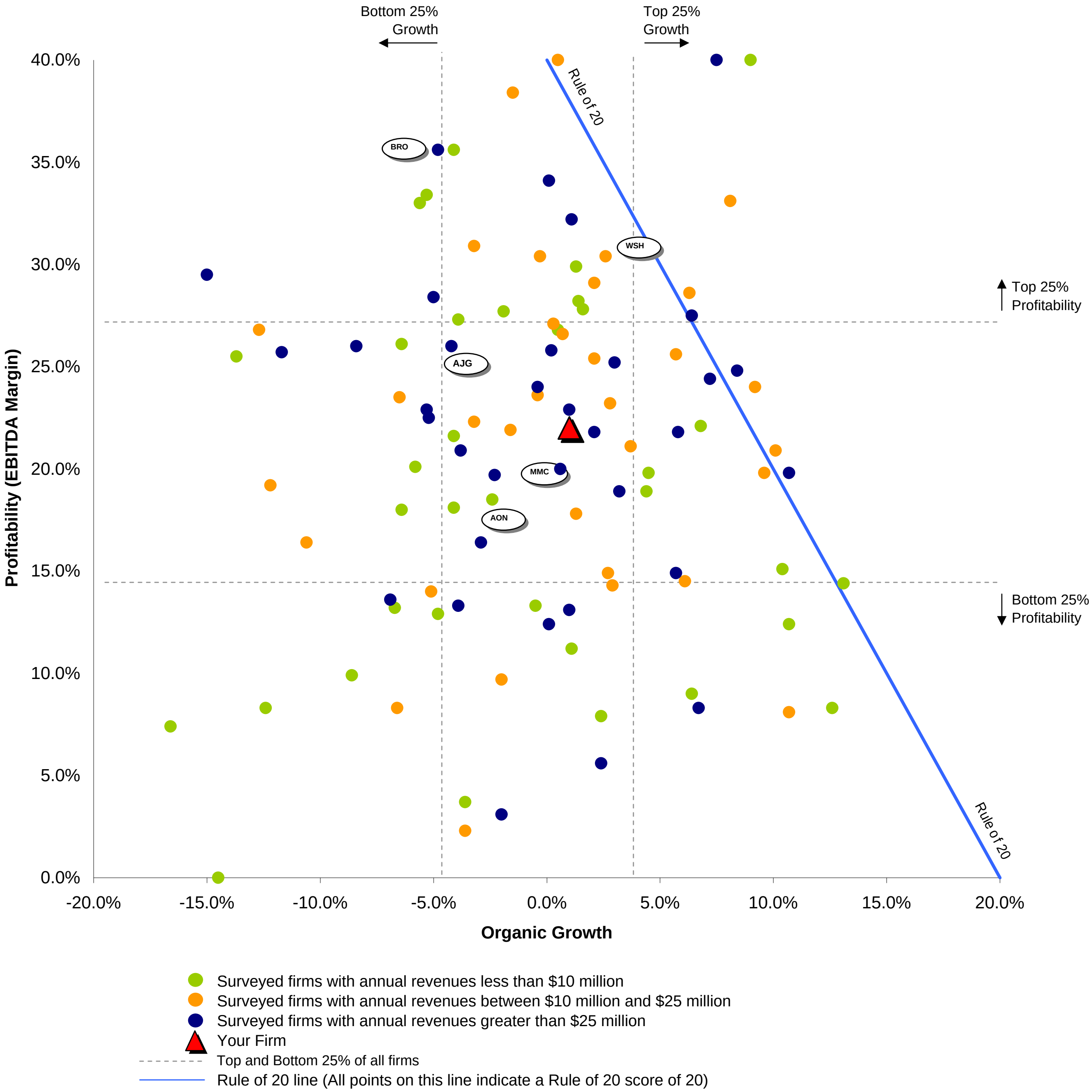


Reagan Consulting Observations

- The shift to positive growth was not enough to make a meaningful impact on Rule of 20 results: just over 10% of all firms recorded a score of 20 or higher
- To be a top 25% performer required an overall Rule of 20 score of 16.0 or higher
- Commercial Lines trails Personal Lines by 10.2 points and trails Group Benefits by 6.4 points in Rule of 20 scoring
- Public broker Rule of 20 scores were equivalent to the OGP median through the first half of 2010

(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.

Winners and Losers of the Obama-Care Era

Kevin Stipe & Brian Deitz

President Obama finally got his way in March, 2010, when he signed comprehensive health reform legislation ("Healthcare Reform") into law. The benefits brokerage community cringed, fearing the impact of this massive bill (over 2,000 pages) on their ability to deliver value to their customers.

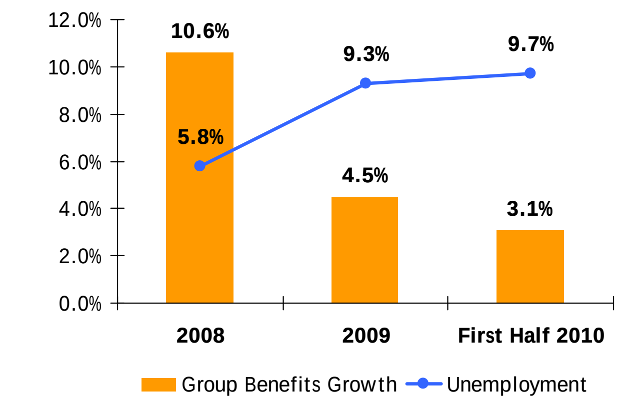
Four months later, much more is known, but confusion still reigns. Predicting the marketplace response to even simple legislation can be difficult. But with many important elements of the bill still to be determined and with the Secretary of Health and Human Services given vast new powers to create, determine or define things in the bill, it is impossible to predict how this legislation will impact the brokerage industry. Some key concerns include:

- What will happen to small groups as healthcare exchanges are established in each state?
- How will mandated medical loss ratios affect broker compensation?
- Will the new taxes being levied to fund healthcare reform impact employers and their ability to provide benefits to their employees?
- How will the broad new powers given to the Secretary of HHS to regulate health insurance impact brokers?

During last decade employee benefits revenue (consisting primarily of commissions and fees from group health insurance brokerage) has been the most consistent growth engine for many brokers. By focusing on growing benefits capabilities, many have grown this segment to a point where it currently represents between 20% and 40% of total revenues.

Double-digit growth in benefits revenue has not been uncommon, which has helped soften the blow of another long, and at times brutally deep, soft Commercial P&C market. Recently, however, recession-driven high unemployment has caused this growth engine to sputter. Since 2008, organic growth rates for employee benefits have plummeted. And while benefits is still growing nearly 5 percentage points faster than commercial P&C (3.1% versus negative 1.5%), it appears that a significant rebound in benefits growth won't likely resume until the U.S. employment picture improves.

Benefits Organic Growth and Unemployment



Source: OGP Surveys, Bureau of Labor Statistics

Unfortunately, in light of the state of the economy, the passage of the Healthcare Reform couldn't have come at a worse time for insurance brokers. Even when the economy improves, now there is concern that the legislation will slow benefits growth – perhaps for years to come.

Impact on M&A Activity

In recent years, many of the industry's most aggressive acquirers have targeted benefits business. It seems logical that with the passage of Healthcare Reform that this enthusiasm would be dampened, with many now steering clear of doing benefits acquisitions.

This does NOT seem to be the case. In fact, the pace of benefits acquisitions has actually appeared to accelerate since Healthcare Reform passed. The most notable example was Marsh Agency's purchase of the Bostonian Group, a large benefits broker in Boston, a few weeks after Healthcare Reform was passed. Why is the pace of acquisition activity accelerating? There are two reasons.

First, a significant number of benefits brokers are now heading for the exits, fearful that they must capitalize now on whatever value they can before the adverse impacts of Healthcare Reform are fully realized. For some brokers, this is probably wise – depending on the composition of their customer base. The real story here is that given the legislation, the distinction between brokers that focus on small groups (under 50 lives) and those that focus on large groups (over 100 lives) has become more pronounced than ever.

The industry's most active acquirers are all pretty clearly articulating a consistent position concerning benefits acquisitions: Their acquisition appetite for brokers that specialize in large groups is strong, albeit cautious. These acquirers see a bright future for a consultative broker that serves as a trusted advisor for large group clients who need help in navigating an increasingly complex world of healthcare choices. These clients will need a variety of value added resources to enable them to attract and retain the best employees in their industry. A key question, however, is whether today's profit margins can be maintained as more and more resources are required to remain competitive.

On the other hand, the major acquirers are generally not interested – at any price - in brokers comprised of small groups, out of concern that a significant number of small employers will exit the traditional private employer-sponsored marketplace.

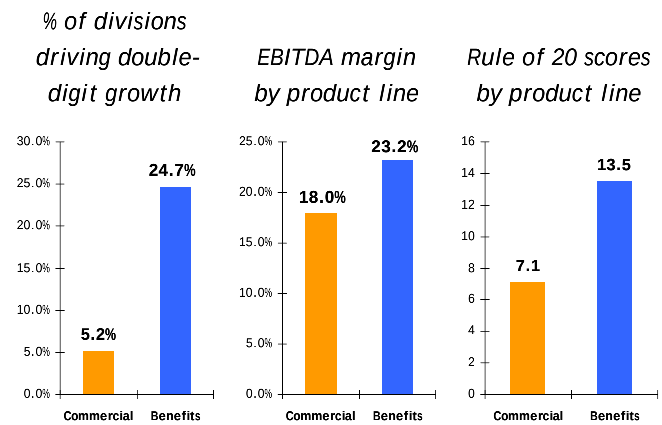
Impact on Valuation

How is all of this impacting the value of benefits agencies and/or benefits divisions within all-lines agencies? Valuation is a function of growth and profitability. Assuming a benefits business is operating profitably, the answer to this question depends on two key variables relating to future growth potential.

What is the composition of the client list, based on group size - is it comprised of the endangered species of groups with less than 50 lives? Reagan Consulting analysis has indicated that for agencies similar to those participating in the OGP Survey, (total benefits revenue typically $2 million or more) the percentage of revenue derived from groups under 50 lives is frequently less than 10%. So despite the fact that an agency might have a high number of these small clients, fortunately it doesn't amount to much revenue. This is good news for many, but for those operating in a community with mostly small groups, the situation might be quite different. The heavier the concentration of small groups, the lower the value.

What are the growth expectations for the broker's larger group segments? Having a book of mostly larger groups is a good starting point, but future growth is the key to commanding a high value. Is the firm investing in the next generation of large account sales people? Is it investing in the value added resources necessary to deliver sophisticated solutions to large groups? Those whose strategy is to simply hold on to their existing clients will soon be hit by a tsunami of competitors who are all scrambling to ensure their own survival by moving up-market. Those who don't have an offensive strategy need to develop one quickly!

Despite Healthcare Reform, Benefits Business is Valuable



Source: OGP Survey

For those agencies that are not heavily concentrated in the small group segment and are continuing to invest in future growth, there is no reason to believe that the future looks bleak. In our view, values for these benefits operations have continued to grow and should do so consistently in the future.