Reagan Consulting

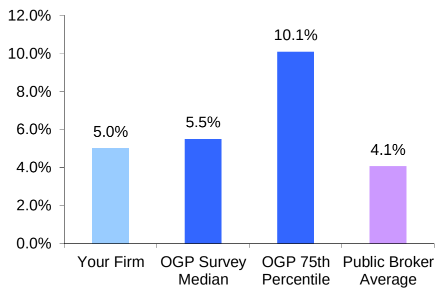
Q2 2012
OGP ID: 9999

Organic Growth & Profitability Survey (OGP) - Q2 2012

- Median annualized revenue for surveyed firms is approximately $16 million, average is over $25 million. All U.S. geographies represented.
- Public broker averages include AJG, AON, BRO, MMC and WSH and are taken from the most recent public filings and press releases.

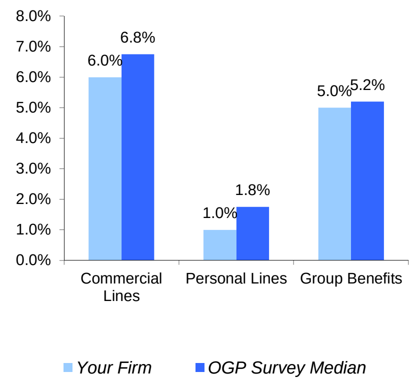
Organic Growth

Total Agency Organic Growth



Your organic growth rank:	**40th - 50th percentile**

Organic Growth by Product Line

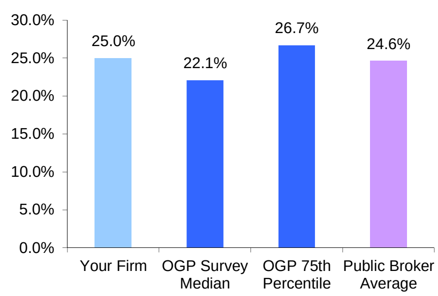


Reagan Consulting Observations

- Industry organic growth continues its climb, reaching 5.5% through the first half of 2012.
- Commercial lines continues to drive the overall results. Commercial lines makes up over 60% of revenues for the typical OGP firm and grew at 6.8% in the first half of 2012.
- Both commercial lines and group benefits growth rates increased in the 2nd quarter, while personal lines growth retreated.
- **OGP Projected 2012 Growth: 5.7%** OGP firms have revised their guidance upward slightly from 5.6% after Q1 2012.

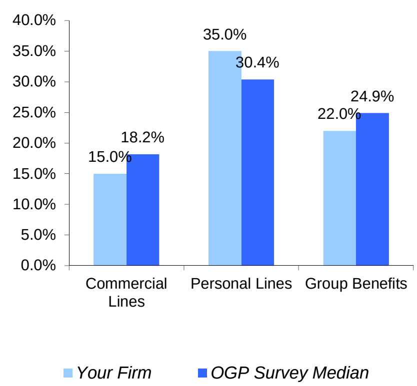
Profitability

Total Agency EBITDA Margin



Your profitability rank:	**60th - 70th percentile**

EBITDA Margin by Product Line

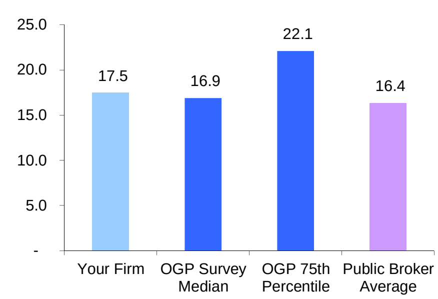


Reagan Consulting Observations

- Median EBITDA margin continues to decline as contingent income is spread across a larger period, finishing at 22.1% after Q2 2012. Reported profitability will continue to decline throughout 2012.
- Personal lines, as usual, leads the margin discussion with a margin through the first half of the year of over 30%.
- **OGP Projected 2012 Margin: 18.0%** OGP firms have bounced between 18% and 19% when projecting full-year profitability. The Q2 forecast represents a reduction of 1% from the Q1 forecast.

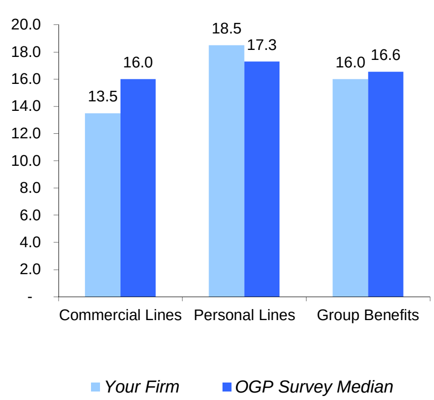
The Rule of 20 (1)

Total Agency Rule of 20



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

Rule of 20 by Product Line



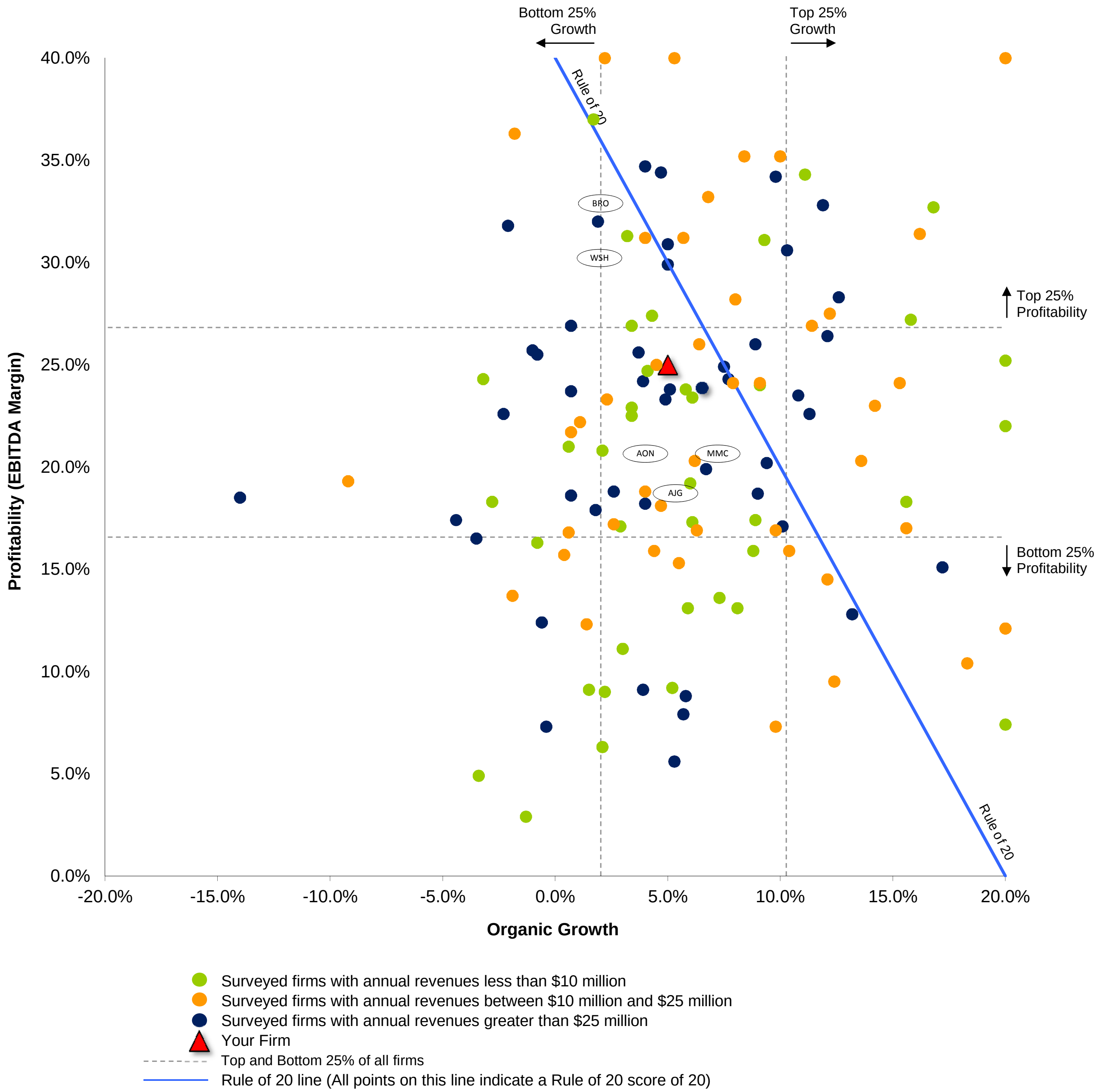
Reagan Consulting Observations

- Rule of 20 scores continue to increase, fueled by stronger growth performance. The median score in Q2 2012 was 16.9, versus 15.4 in Q2 2011.
- Rule of 20 scores in Q2 continue to be inflated by cash-basis recording of contingent income.
- **OGP Projected 2012 Score: 14.7** The median full-year Rule of 20 score is now projected to be 14.7. This is a jump of almost 2 points from the 2011 full-year score of 12.9. The forecast reflects contingent income spread across the entire year's results.

(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.

2012: Organic Growth Continues to Improve - but Will it Last?

by Kevin Stipe & Brian Deitz

Organic growth continues to improve for insurance brokers. For 2012, the industry is growing at a 5.5% clip, which is the highest rate of growth since 2006. All major lines of business grew during the first half of the year, with commercial lines leading the way at 6.8%, benefits close behind at 5.2% and even personal lines pulling its weight at 1.8%. The industry has recovered nicely since the downturn of 2008-2009.

As we head into autumn, which for many is the traditional season for budgeting and strategic planning, questions about the future abound. Will 2013 be another year of improvement, or will recent broker growth level off or go backward?

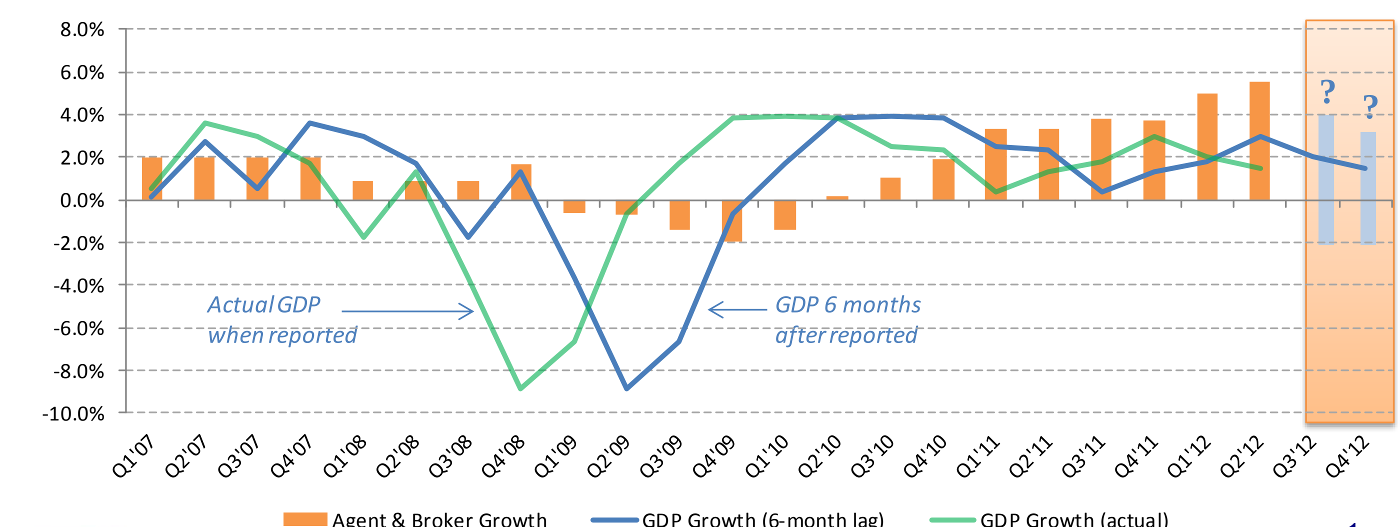
To predict the future for insurance brokers, there are three key external factors that need to be considered: the economy, the direction of P&C pricing, and the impact of healthcare reform.

The Economy and "the 6-9 Month Lag"

The U.S. economy's recovery – already weak by historical standards – seems to be losing steam. Second quarter U.S. GDP growth slowed to just 1.5%, down from an anemic 2% from the prior quarter. With a polarizing Presidential election three months away and the candidates holding widely divergent political views on how the economy should be handled, business leaders are faced with a high level of political uncertainty, which leads to caution, which in turn leads to continued anemic growth. Businesses are sitting on record-high piles of cash while they try to sort out what tax and regulatory policies will look like after the election.

Brokers need to be careful. During the last economic downturn, a "6-9 Month Lag" between U.S. GDP and broker organic growth results was observed. During the early part of the Great Recession, broker organic growth was holding strong – seemingly defying gravity – even while the economy plunged into a deep recession, shrinking by more than 8% in the fourth quarter of 2008. By the 3rd quarter of 2009 the U.S. economy was growing again – but now it was the brokerage industry's turn to shrink. By the 4th quarter of 2009, brokers hit bottom, with an all-time low organic growth of negative 2%. Brokers didn't

The 6-9 Month Lag



begin growing again until the 2nd quarter of 2010 – nine months after the economy had begun its recovery.

The chart on the prior page provides a historical look, comparing the economy to insurance brokers. The green line is actual GDP growth, while the dark blue line shows GDP growth after a 6 month lag. As you can see, the dark blue line correlates tightly with the movement of the orange quarterly growth bars for insurance brokers.

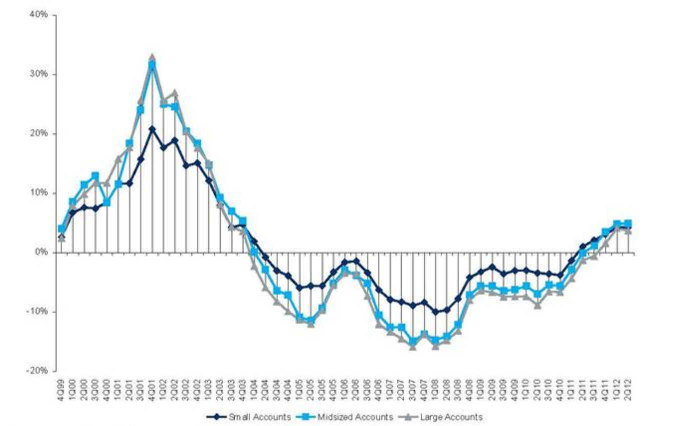
The 6-9 Month Lag occurs because it takes a while for insurance premiums to fall when the economy begins contracting. Declining business activity and staffing reductions for commercial enterprises don't reduce insurance premiums right way, but instead result in lower premiums after the fact via premium audits and lower renewals. And on the benefits side, it is similar – the result of employee downsizing takes months to be fully realized in an insured's group benefits costs. As a result, brokers are slower to feel the effects of a downturn and then slower to recover once the economy turns around.

Somewhat ominously, the past two quarters have shown declining GDP growth, even while broker results have continued to improve. If history is a guide, if slow GDP growth continues, or if we dip into another recession, brokers will begin to feel the pinch 6-9 months later. This suggests that the 3rd and 4th quarters of 2012 could begin to get more difficult. In addition to the economy, there are two other factors which have a major impact on the fortunes of insurance brokers, and for those, the current news is a mixed bag.

P&C Pricing

P&C pricing just finished its best 2nd quarter since 2003 according to the CIAB in its market survey. With a 4%-5% pricing lift affecting the typical account, we are in far better position than during the Great Recession, when P&C pricing was falling by 5%-7%, even while the economy was contracting. If even modest firming can continue, brokers will likely continue to grow, even if the economy dips into another mild recession. The key question is whether or not the firming in P&C pricing will continue.

Average Quarterly Commercial Premium Rate Changes

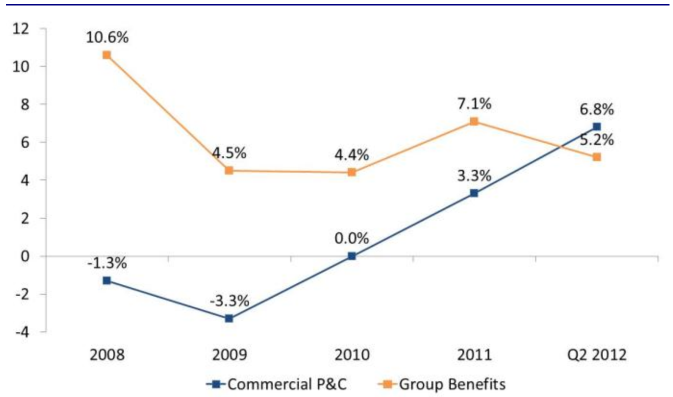


Source: The Council of Insurance Agents & Brokers. Chart prepared by Barclays Research.

Employee Benefits

For most firms in the OGP survey, employee benefits comprises 20%-30% of total revenue, making it the 2nd largest source of revenue. For many firms, it has been the primary engine of growth in recent years, outperforming commercial p&c by several percentage points.

Organic Growth Rate by Line



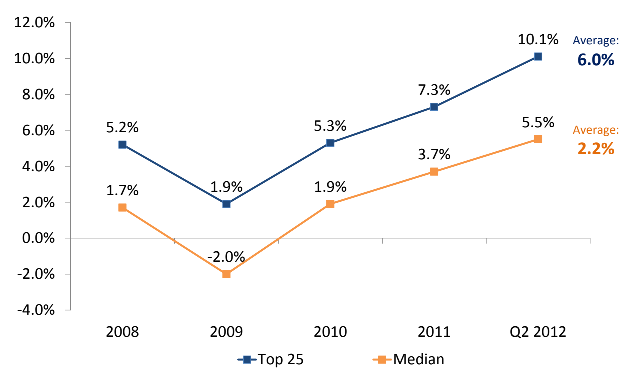
However, it appears that this trend is reversing in 2012. Pressure by employers to trim their own benefits costs, coupled with pressure on broker compensation in recent years has led to a stunning reversal: commercial P&C may outgrow employee benefits this year for the first time since Hilary-care failed back in 1993.

What to do about it

Although brokers are currently enjoying their best performance in years, it is easy to envision a scenario where the P&C market flattens out and the U.S economy slows further, potentially dipping into another recession. Broker results would undoubtedly suffer. How can brokers prepare for this possibility?

The key to long-term success in the brokerage industry never really changes: it's all about sales culture. The top 25% fastest growing firms in the OGP – e.g. the firms with the best sales cultures – never shrank during the Great Recession. Instead, they continued to grow.

Top 25% Fastest Growing Firms vs. Median



In fact, during the past five years, which included several of the toughest consecutive years our industry has experienced, the Top 25% performers have grown at 6% a year, while the median firm has barely exceeded 2%.

What is it that leads to that success? Reagan Consulting is currently conducting a landmark study that we hope will "crack the code" on the industry's top sales cultures. How are they built? How are they managed? What types of activities and behaviors lead to sustained excellence? The study will be released in October, 2012. If you are interested in participating, or in receiving a copy, please contact us by phone at 404.233.5545, or by sending an email to michelle@reaganconsulting.com.