Reagan Consulting

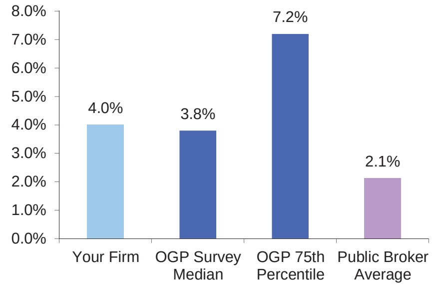
Q3 2011
OGP ID: 9999

Organic Growth & Profitability Survey (OGP) - Q3 2011

- Median annualized revenue for surveyed firms is approximately $15 million. All U.S. geographies represented.
- Public broker averages include AJG, AON, BRO, MMC and WSH and are taken from public filings and press releases.

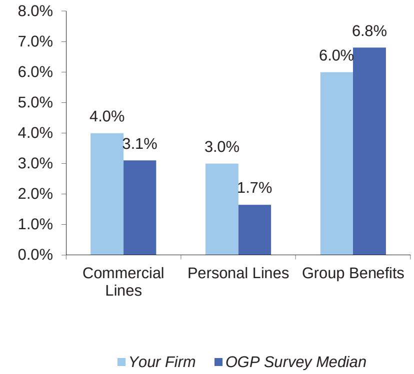
Organic Growth

Total Agency Organic Growth



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

Organic Growth by Product Line

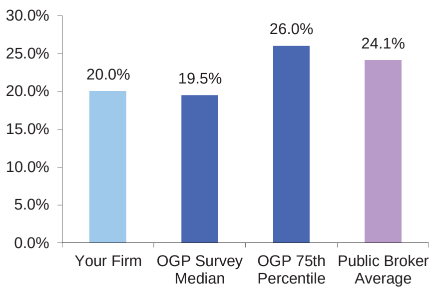


Reagan Consulting Observations

- Median organic growth resumed its climb in the third quarter, finishing at 3.8% through September of 2011
- All lines of business continue to grow, with group benefits leading the way at 6.8% through the first half of the year
- Commercial lines has grown at 3.1% so far in 2011, boosted in the third quarter by the first increase in property & casualty pricing in over 7 years (per CIAB data)
- **OGP Projected 2011 Growth: 4.2%** OGP firms have slightly dialed back their forecasts - earlier projections were at 4.5% for the 2011 year

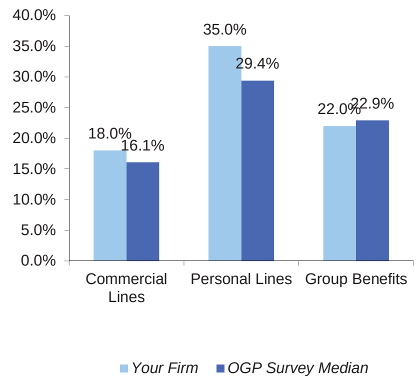
Profitability

Total Agency EBITDA Margin



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

EBITDA Margin by Product Line

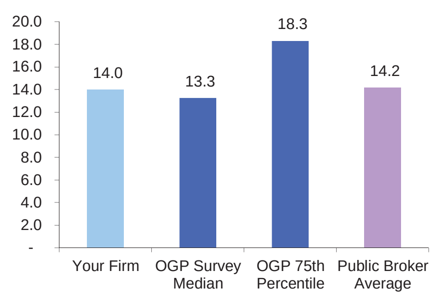


Reagan Consulting Observations

- As is typical due to contingent income reporting, EBITDA margins decline as the year progresses - the median margin is 19.5% through Q3 vs. 22.9% through Q2
- At 19.5%, Q3 2011 EBITDA margins are now 90 basis points below margins in the same period in 2010
- Commercial remains the lowest-margin line of business, trailing group benefits by almost 7% and personal lines by over 13%
- **OGP Projected 2011 Margin: 18.0%** OGP firms have reduced their projected EBITDA margins sharply - from 20% at the end of Q2 to 18% at the end of Q3

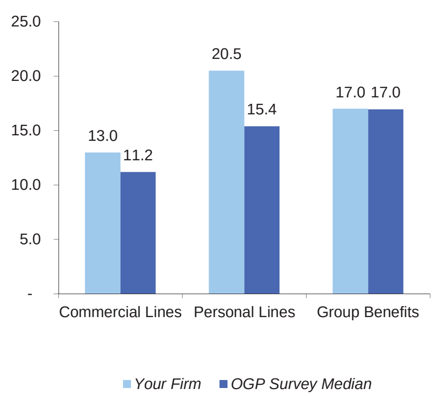
The Rule of 20 (1)

Total Agency Rule of 20



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

Rule of 20 by Product Line



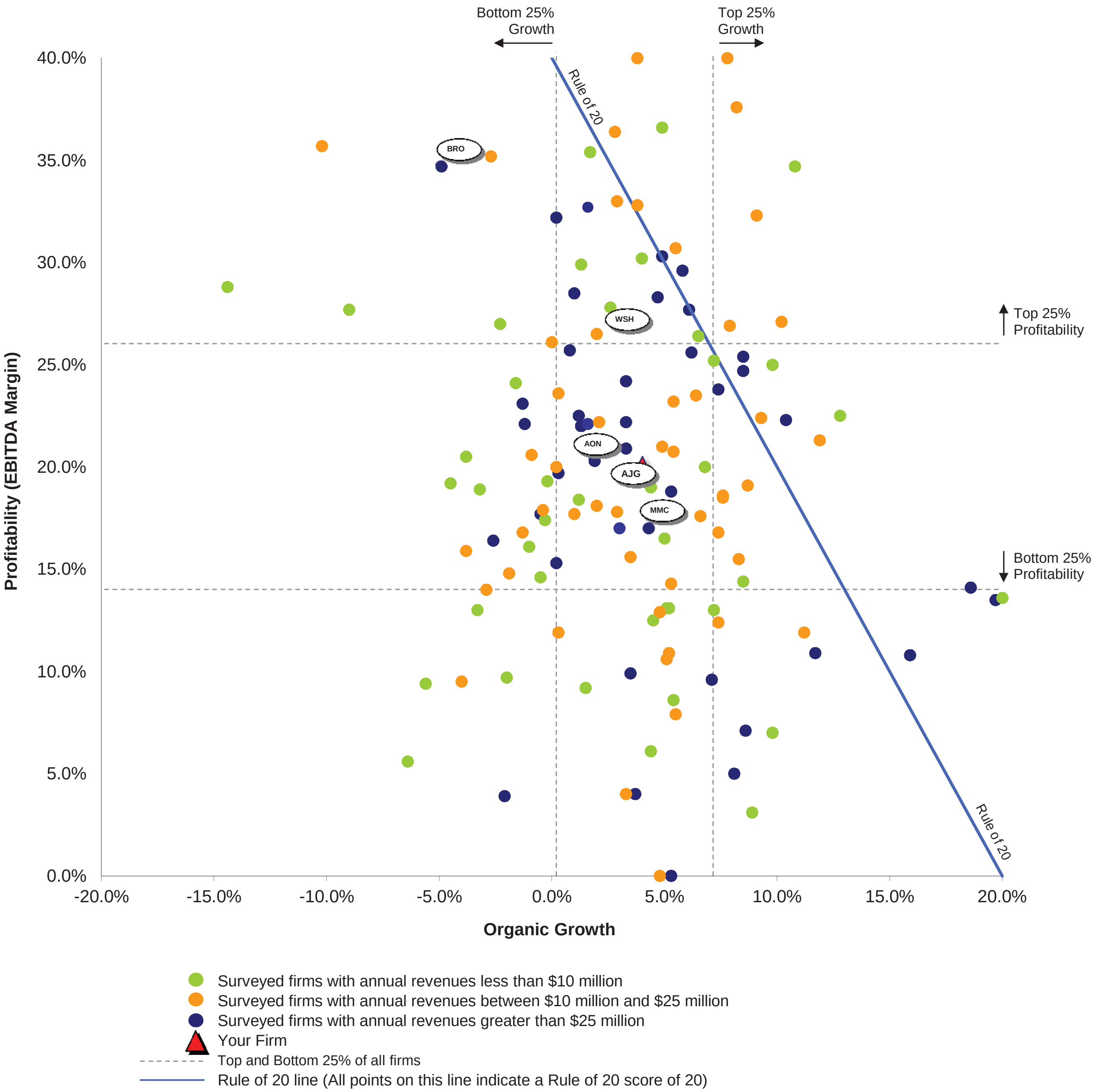
Reagan Consulting Observations

- Rule of 20 scores are trending lower as the year ends and as profit margins come back to annual levels. The median Rule of 20 score is 13.0 through Q3.
- Due to stronger organic growth, Q3 2011 Rule of 20 is 190 bps higher than Q3 2010
- 18% of firms recorded a Rule of 20 score above 20 through the first three quarters
- **OGP Projected 2011 Score: 13.2** The median full-year Rule of 20 score is now projected to be 13.2, a decrease from the Q2 projection of 14.5. Even with the decrease, 2011 should significantly exceed 2010's Rule of 20 of 10.6.

(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

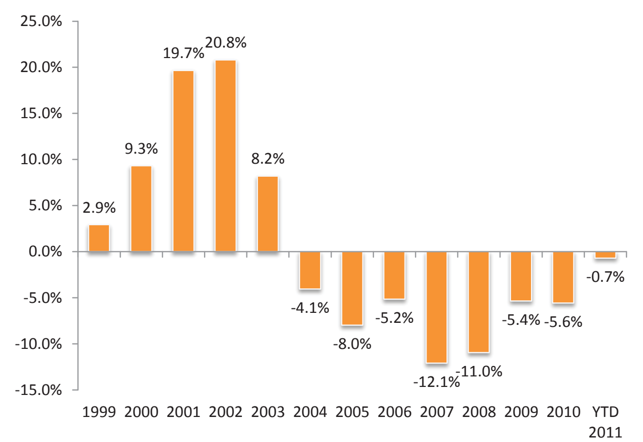
In the chart above, we've plotted every firm in the survey that completed both the total agency organic growth section and the total agency profitability section. Each firm's organic growth is plotted along the x-axis, and each firm's profitability is plotted along the y-axis. We've included a couple 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.

Equity Returns for Brokers Rising As Organic Growth Continues to Climb

Kevin Stipe & Brian Deitz

Insurance brokerage equity returns continued to rise during the 3rd quarter, fueled by the best organic growth environment since the OGP Survey was launched in 2008. Organic growth was 3.8% through the first three quarters of 2011, fueled by a combination of continued growth in the U.S. economy and the first quarterly increase in commercial P&C pricing in nearly eight years. While P&C pricing is still down 0.7% for the year, the CIAB reported that in the third quarter, average commercial P&C pricing *rose* by 0.9%.

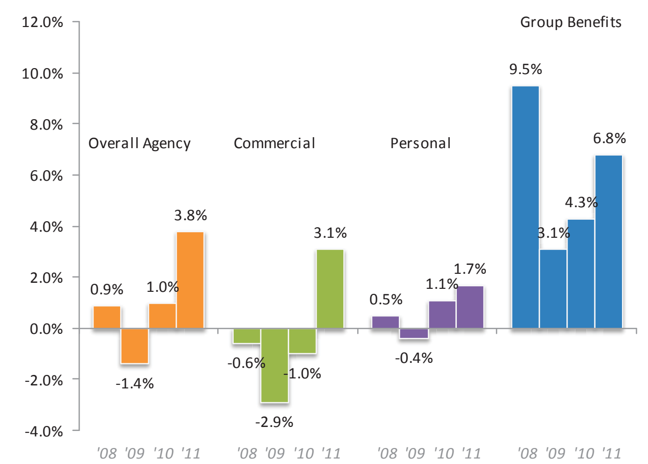
Commercial P&C Pricing Changes (1999 – YTD 2011)



Source: The Council of Insurance Agents and Brokers

Not surprisingly, commercial lines organic growth rates have jumped, and are now positive through three quarters for the first time since the OGP survey was launched. But it wasn't only commercial lines departments that jumped: personal lines growth of 1.7% is also an OGP record for three quarters and group benefits growth of 6.8% is over 50% higher than last year's growth. The improving economic environment is pushing growth – and equity returns – higher across the board.

Organic Growth Over the Last Four Years



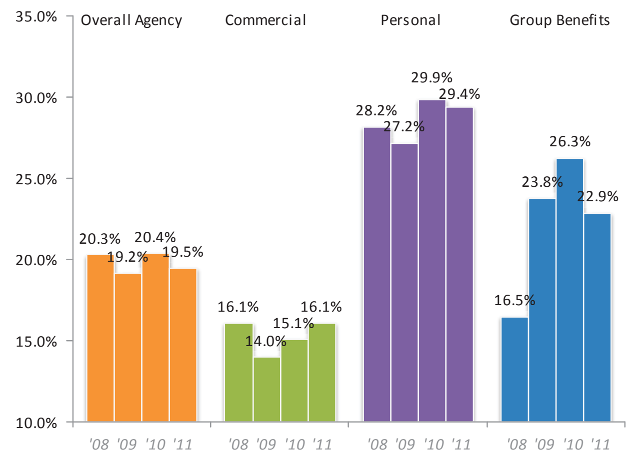
Source: Reagan Consulting Organic Growth & Profitability Survey

In a bit of a surprise, however, EBITDA margins actually declined slightly to 19.5%, from 20.4% a year ago. This decrease hit participants like a whiff of smelling salts, as they re-forecast their full-year 2011 profit margins down 200 basis points from levels they projected just three months ago (18% versus 20%). This swing in profitability is not insignificant: for the typical OGP participant, 200 basis points of EBITDA equates to over $300,000 in profit.

This decrease seems mostly fueled by a decline in employee benefits profitability – which may be the result of a resource-driven market-share battle being waged in the 100+ life group space. Helping to offset some of the profit margin decline, commercial P&C and personal lines margins both increased slightly.

If organic growth increased, but EBITDA margins decreased, how can we be so sure that broker equity returns increased? Isn't profitability what drives returns?

EBITDA Margins Over the Last Four Years



Source: Reagan Consulting Organic Growth & Profitability Survey

Our answer: The Rule of 20 provides compelling evidence that equity returns are increasing. If you are new to the OGP Survey, a bit of background on the Rule of 20 might be useful. Agency investors recognize that organic growth and profitability are the twin pillars of value creation. Unfortunately, agency leaders frequently find these objectives are at odds. To stimulate growth, agencies often reinvest in producers and resources. But to drive profitability, agencies often forego the spending that drives growth. How agencies balance this tension between growth and profitability is a key factor in shareholder returns.

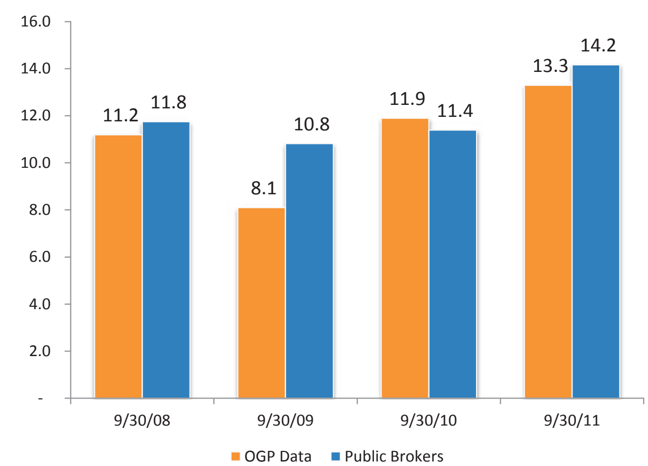
In observing the performance of thousands of brokerage operations over the years, we've developed a tool to help agencies think more strategically about how to set growth and profitability targets, and also to help them better understand the trade-offs between the two. This tool is called the "Rule of 20."

Under the Rule of 20 an agency generates "industry target" shareholder returns when a) its organic growth rate plus b) ½ of its EBITDA margin equals or exceeds 20. What are "industry target" shareholder returns? By examining the cost of capital, we've estimated that over the long-run, the industry target return for privately-held insurance brokers is approximately 15% - 17%. In other words, agency investors expect to earn 15% - 17% per year through a combination of stock price appreciation and shareholder distributions or dividends.

Certainly, these returns seem difficult to achieve in today's environment: Only about 15% of the OGP participants achieved a Rule of 20 score of 20 or more in 2010 - and we expect only a slightly higher percentage will do so in 2011. Nevertheless, our research indicates that over the past 20 years, approximately half of our valuation clients have achieved this target return level. These high returns are a key reason so many agency principals plan to remain privately-held: even when offered significant premiums for their agency, they don't see an alternative investment that can match the shareholder returns they've been receiving.

Below is a look at overall Q3 Rule of 20 scores dating back to 2008. For comparison purposes, we've also provided the score for the major public brokers.

Rule of 20 Performance: Public and Private Brokers



Source: Reagan Consulting OGP Survey, Public Filings and Press Releases (Brokers include AON, MMC, AJG, WSH and BRO)

OGP Survey participants are forecasting they will end the year with a median Rule of 20 score of 13.2. This would be a welcome development after two years of intense struggles to recapture value that was lost during the Great Recession of 2008-2009.