

Agency Value

Hanging by a Thread

A
MarshBerry
Outlook



Agency Value: Hanging by a Thread

Table of Contents

Health Insurance	4
P&C Insurance	5
Current Premium Valuations.....	7
Disintegrating Organic Growth	8
The Past - Supply and Demand	9
The Future - Supply and Demand	11
Banks.....	13
Private Equity	14
Public Brokers	14
Accounting Rules.....	15
Projected Deal Multiples.....	16
Growing to Maintain Value.....	16
Pipeline Management.....	18
Customer Contact Management.....	18
Producer Reinvestment.....	19
Remaining Independent is a Sound Option.....	19
What Are You Going To Do About It?.....	20
Summary	22
Reference.....	23

©2008 Marsh, Berry & Company, Inc. – No part of this white paper may be reproduced, published, stored or transmitted by any means, electronic or mechanical, without prior written permission of Marsh, Berry & Company, Inc.



For the majority, agency value is hanging by a thread. The string is about to break. For the minority that are willing and able to execute a plan to combat sustained soft market conditions through organic growth and strong core operating profitability, valuations will remain strong and in some cases increase. The widening spread between the many (average value) and the few (high value) will expand and look like the Grand Canyon during the next three years. Unheard of, unforeseen and inconceivable premium valuations have been sustained for so long that most agency owners have long since accepted this utopia as reality. But make no mistake, the confluence of factors that led to sustained high valuations for all agencies is rapidly passing over the industry and the value of the average agency is hanging by a thread. Some will hang on to high value while others will find themselves in a valuation free fall.

Are you surprised? Did you convince yourself that agencies without a business plan, a true sales culture and sustainable profitability are worth 8 times EBITDA (earnings before interest, taxes, depreciation and amortization) and would remain so forever? Certain things in life that are obvious are often ignored when picking money off of trees. Hindsight is always 20/20. The world stood by in shock when dot com start ups with little more than a business plan and valuations of 100 times price to earnings literally disappeared. Today, many stand in horror as the landscape becomes littered with financial institutions that were once heralded as market leaders, who now trade at a fraction of historical value or have been sold. Looking back, maybe it should have been obvious that the bottom would fall out of the residential mortgage industry when loan underwriting embraced 100%+ loan to value, negative amortization and no verification of employment or income. We at Marsh-Berry refuse to idly sit back and allow such a dynamic to occur and go unnoticed within our collective bread and butter; the insurance distribution system.

Within the next three years, the past cycle of real and anecdotal claims of 8-9 times EBITDA deal valuations will be revered as the good old days for most agencies. The short era of 10-14 times EBITDA achieved in a handful of billion dollar private equity transactions during 2007 will become legendary. The silver lining is that the minority that understood that "this can't last" and systematically reinvested to build a

true operating model will emerge as an endangered species capable of reaping the rewards of sustained premium value. For those void of executable plans to drive growth in revenue and earnings, value will spiral downward. Try as we might to come up with a statement that best summarizes the winds of change, nothing better captures the current market than an adage eloquently stated by Warren Buffett, "It's only when the tide goes out that you discover who's been swimming naked."

The tide will move out during the next three years. Given current premium deal pricing, now is the time for agency owners to make the age-old decision: fight to drive long-term agency value or sell at the top. Value is a function of growth and sustainable profitability. To achieve both is difficult, but possible, if an agency can embrace accountability and differentiation and at the same time balance reinvestment with profitability. Too many agency owners indicate that they want to drive growth and profit, but do not proactively execute a plan to make dreams become reality. With so much value at stake, agency owners can no longer procrastinate.

As will be outlined later in this white paper (page 16), agencies that remain independent during the next four years must orchestrate organic growth in the high single digits with controlled reinvestment to preserve current value on an after-tax basis. To advance after-tax value, organic growth must be near double digits. Such a task is difficult. Even the public brokers are having difficulty. The public brokers achieved average organic growth of 0.6% during 2007 and -0.5% organic growth during the fourth quarter of 2007. Agencies that remain independent but do not drive profitable organic growth will see a consistent decline in agency value. Now is the time to be realistic. Now is the time to make a commitment, whether that commitment is to hold or divest. Are you ready to fight? Are you willing and are you able to drive growth and profit? To help answer this question, consider Figure 1 below.

Figure 1
Are You Willing and Able to Drive Growth and Profit?

	Willing	Unwilling
Able	Hold, Execute	Divest
Unable	Hold, Get Help	Divest

Some readers of this white paper will scoff and suggest that it is impossible to remain profitable and grow at high single digits, let alone double digits. To preempt the naysayers, we ran the numbers on the top 25% organic growth agencies in the country. Within this high-performing group, the average performance had organic growth of 12.0%, actual EBITDA of 21.1% and pro forma EBITDA of 25.7% (after the elimination of excess owner bonuses) during 2007. In other words, some have figured it out. It is possible. But, it is not possible without peak-performing levels of new business production.

What was your new business production during 2007 as a percentage of 2006 commission income? The new business production of the Top 25% averaged 23.2% of prior year commission income. The top 5% in the nation had new business production that averaged 29.1% of prior year commission. Figure 2 below illustrates Average and Best 25% for organic growth:

Figure 2 - Organic Growth Composition

	Average	Best 25%
2007 New Business Production as a % of 2006 Commissions/Fees	15.3%	23.3%
Less: Leakage: Retention/Rate	11.6%	11.3%
Equals: Organic Growth	3.7%	12.0%

The best organizations do not use external market conditions as an excuse for non-performance. Instead, they focus squarely on initiatives within their direct control... selling more business. Remember, Economics 101 taught us that there are 3 ways to grow organically and not all are completely under an agency's direct control:

<u>Organic Growth</u>	<u>Agency Control</u>
1. Add a New Product	Limited Control
2. Increase Price	Limited Control
3. Sell More Existing Products/Services	Direct Control

To drive growth, peak-performing organizations start by dissecting the volume of new business production generated by average and high-performing individual producers. Such organizations then implement infrastructure and accountability best practices to drive results. Figure 3 outlines the new business production commission dollars attained for various producer classifications, stratified by percentile.



Figure 3 - New Business Comparables

*New Producer - less than three years
Senior Producer - over three years and <\$500k book
Executive Producer - over three years and >\$500k book*

Percentile Group	All Producers	Executive Producer	Senior Producer	New Producer
80% to 100%	\$264,496	\$311,890	\$127,910	\$218,306
60% to 80%	\$127,315	\$157,462	\$66,791	\$102,215
40% to 60%	\$78,188	\$107,191	\$44,834	\$57,548
20% to 40%	\$44,277	\$57,393	\$30,481	\$28,872
0% to 20%	\$17,567	\$30,958	\$13,750	\$11,556

As can be deciphered from Figure 3 above, the major problem with new business resides within the senior producer category. Why? Because in some agencies, producers getting paid a 30% renewal commission on a stagnant book-of-business of \$400,000 can make \$120,000 in personal income. Executive producers are hunters by nature. New producers must sell to put food on the table. Senior producers either grow to become executive producers or more than likely, become complacent on a renewal stream. While it's easy to blame the individual, quite often the agency infrastructure does not foster continued new business production because the agency does not execute world-class sales practices and can't make the tough calls. In short, senior producers coast because agency owners let them.

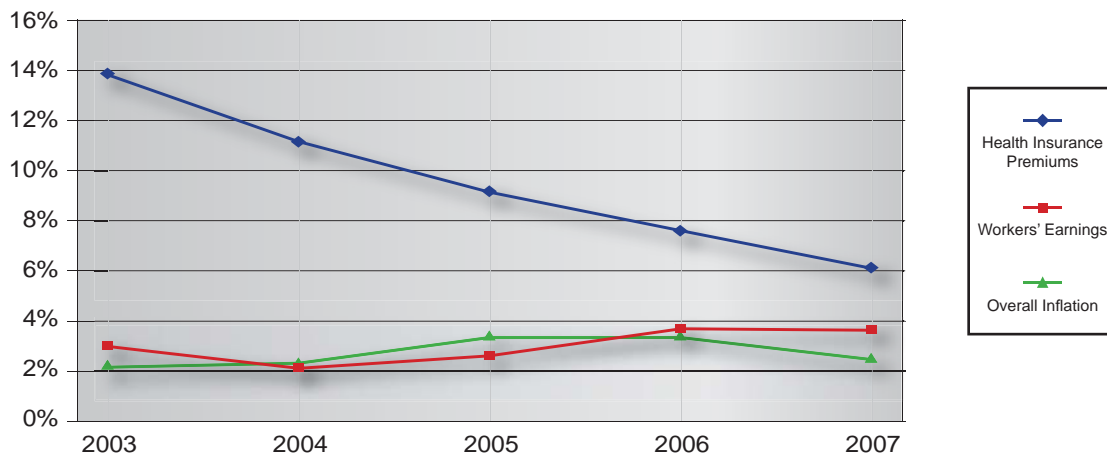
What would it take for the average agency to drive a high performance new business production metric? To highlight the importance of making the hold or divest decision now, following is an overview of the market dynamics that are sawing away at the string of agency value.

Health Insurance

Insurance agencies around the country have fought with sword and shield to reinvest heavily in the health insurance side of the house. Looking back, health insurance commission income in the average agency increased from 11% of total commission income during 1998 to 17% during 2007. Peak-performers have pushed health insurance to as much as 35% of total commission income. This focus has been instrumental to driving value given stronger profit margins in health insurance and a better rate environment. Commission income for those with a health book is now under fire as premiums related to employer sponsored health insurance are facing a trend of sustained softening. The decline in the rate of growth in health insurance premium is a by-product of fewer employers offering insurance and an increase in risk sharing back to covered employees. And this trend has only begun.

According to the 2007 Kaiser/HRET survey, the percentage of private and public companies with less than 199 employees that offer health insurance declined from 65% in 1990 to 59% during 2007. For those businesses that provide employees health insurance, more and more medical expenses are being pushed down to employees, shifting away the claims cost burden at the low level from the carrier to the employee, in turn reducing the need for carrier premium advances. According to the survey, among those companies that offer benefits, 37% plan to increase deductibles, 42% plan to increase office visit sharing

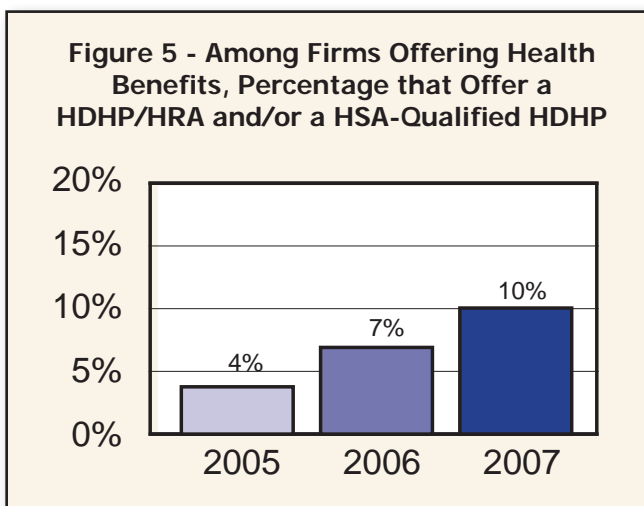
**Figure 4
Average Percentage Increase in Health Insurance Premiums
Compared to Other Indicators, 1999-2007**



costs and 41% plan on increasing the employee share of prescription drugs during 2008. Gross health insurance premium within the distribution system will continue to soften as more expenses are shifted to the insured and less risk at the low level is retained by the underwriters.

The brightest spotlight in the risk sharing movement is in the high deductible health plan (HDHP) segment. The 2007 survey indicates that the percentage of employers that offer a HDHP (with a HSA or HRA) increased from 4% during 2005 to 10% during 2007. Even more startling is that almost 25% of private and public employers report that they are likely to offer a high deductible health plan during 2008. While many insurance producers claim that high-deductible plans are complicated to sell and only appeal to a portion of the market, high-deductible health plans have gained significant momentum. As more and more opt for high-deductible plans, the claims cost covered by insurers declines as the loss experience at the low level is essentially self insured by the employee. This trend will continue as carriers are now demonstrating a clear willingness to trade lower-premium growth for a reduction in the frequency of low-severity claims costs that are insured.

Health insurance premium advances continue to outpace inflation and workers' earnings, but the margin is narrowing. Whether compensation from health carriers is on a capitated basis or a commission basis, over the long term commission income will take a hit as less premium is placed with underwriters. While organic growth over the past five years has been buoyed up by higher growth in health insurance premium, the trend is obvious and the one line of business that had some lift is now softening.



P&C Insurance

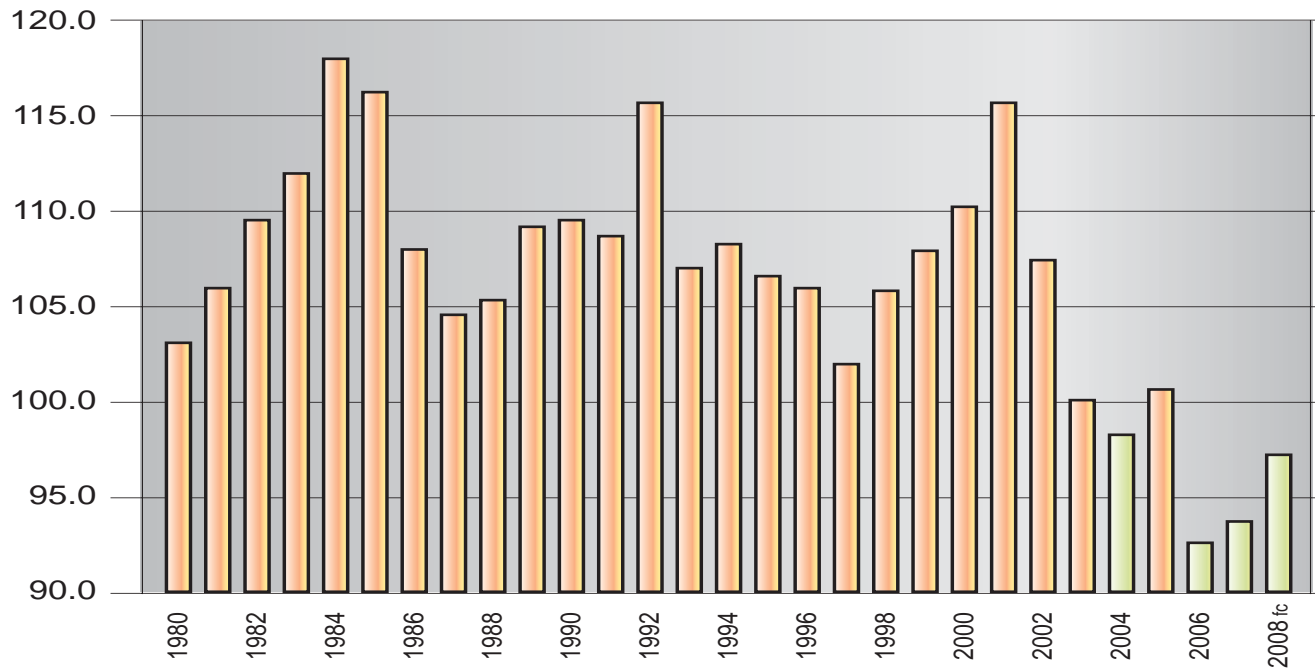
The current soft market in P&C has stifled revenue and profit growth for most insurance distributors and rate relief remains elusive. Without a marked and prolonged deterioration in the investment market or interest rates, it is our opinion that the P&C sector will not experience substantive rate relief in the next couple of years. While we may see the bottom of the trough as early as 2010, we do not expect to see any meaningful rate increases anytime soon, much less a trend toward a sustained hardening of rates.

Total industry P&C net written premiums were flat during 2007, the first year of lateral premium growth since the 1940's. Despite no growth, 2007 underwriting profits are expected to total \$25 billion when all the ballots are in, which is only faintly less than a strong 2006. While there was a slight slide in underwriting profitability during 2007, this decline was almost entirely offset by advancement in pre-tax investment income. In the final hour, 2007 will be the third underwriting profit since 1978 and the second best in the past 80 years. Yes, 80 years. Can you spell rate adequacy? At the same time, 2007 company net income will total as much as \$65 billion, which about matches 2006 net income even after the 2007 rate decreases. The combined ratio was projected to reach 97.5% during 2007, but the actual ratio will land around 94% by our estimates. It was a great year for carriers.

Enormous operating income achieved during 2006 was almost entirely sustained during 2007, leading to a record level surplus position of \$500+ billion, which is well ahead of the historical trend. Behind closed doors, carriers are telling us that the fat 2007 follow up to the fat 2006 year has created heightened investor demand for market share expansion. In light of strong carrier financials and the feeding frenzy abounding for capturing market share, the solution for most companies is to aggressively pursue cash flow underwriting. These conclusions are being made after an acknowledgement that performance during 2007 was heavily influenced by less than expected catastrophic losses.



Figure 6 - P&C Company Historical Combined Ratio

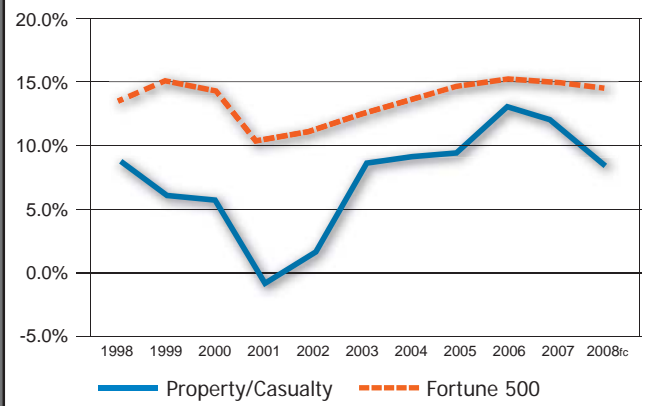


The 2007 versus 2006 year-over-year P&C analysis shows an average rate drop of around 13%. Heading into 2008, total U.S. Aggregate P&C net written premiums are expected to decline for the first time since 1943, falling 0.3%. Even after continued price reductions, the 2008 combined ratio is projected to be 97.3%. Carriers have concluded that there is still wind left in the sail. Logic would suggest that if the economy falls into a spiraling recession prompting a prolonged interest rate squeeze and a continued downward trend in the investment markets, P&C insurance companies will need to stabilize or increase rates given shrinking returns on bulging surplus. But a prolonged recession is not likely.

Despite strong P&C carrier operating income during 2007, P&C carriers are in a pickle. Most are aggressively pursuing rate reductions, which is counter intuitive to maintaining favorable return on equity ratios. While operating income remained staggeringly high during 2007, carrier return on equity (ROE) dropped. The reduction in ROE was due to the fact that strong pre-tax operating income was overshadowed by a large year-over-year increase in surplus. In short, the denominator increased. Looking toward 2008 and beyond, Wall Street is predicting a continued reduction to return on equity back to the high single digits. The ROE

projections show a continuing decline given a projected quadruple whammy of increased loss ratios on core business, increased catastrophes, worsening expense ratios and a further increase in the surplus. But even with dire predictions, continued soft market conditions are overwhelmingly being predicted by analysts for the next three years. When all the dust settles, falling return on equity projections will still outperform long-term historical levels (low-to-mid single digits).

Figure 7 - Return on Equity: P&C Companies versus Fortune 500 Companies



Despite predictions that ROE will decline, carriers are not sitting back letting it happen. As we travel across the country, we hear a very consistent story from the C-suite of P&C carriers. The story goes like this. "Regardless of what the street says, we are not going to sit back and watch our return on equity diminish. We are finally providing returns that we can be proud of relative to other Fortune 500 companies. Looking at our distribution system, the bottom 20% of our appointed agencies are contributing 1% of our premium with a loss ratio in excess of 125%. The top 20% of our agents control upwards of 70% of our premium and have a loss ratio in the 50s. If we could operate without the bottom 20%, we could drop premium to help our better agents grow market share while at the same time maintaining our return metrics. We cannot control catastrophes but we can dramatically improve our loss experience on core business by reallocating our resources toward growth oriented, high-quality agencies that write high-quality business. We can also reduce operating expenses to make additional room for premium reductions by cutting the number of appointed agencies, or in short, eliminating the drift wood."

While you have heard this for years, it is now truer than ever: every agency has been labeled with an A, B or a C. A's get fed, B's get watched and C's get terminated. C agencies around the country with no sales culture, loose field underwriting and immaterial premium are the clog in the arteries of the carriers and are increasingly being shut off. These agencies are exponentially flooding the market looking for buyers or are alternatively running toward working through aggregators or clusters.

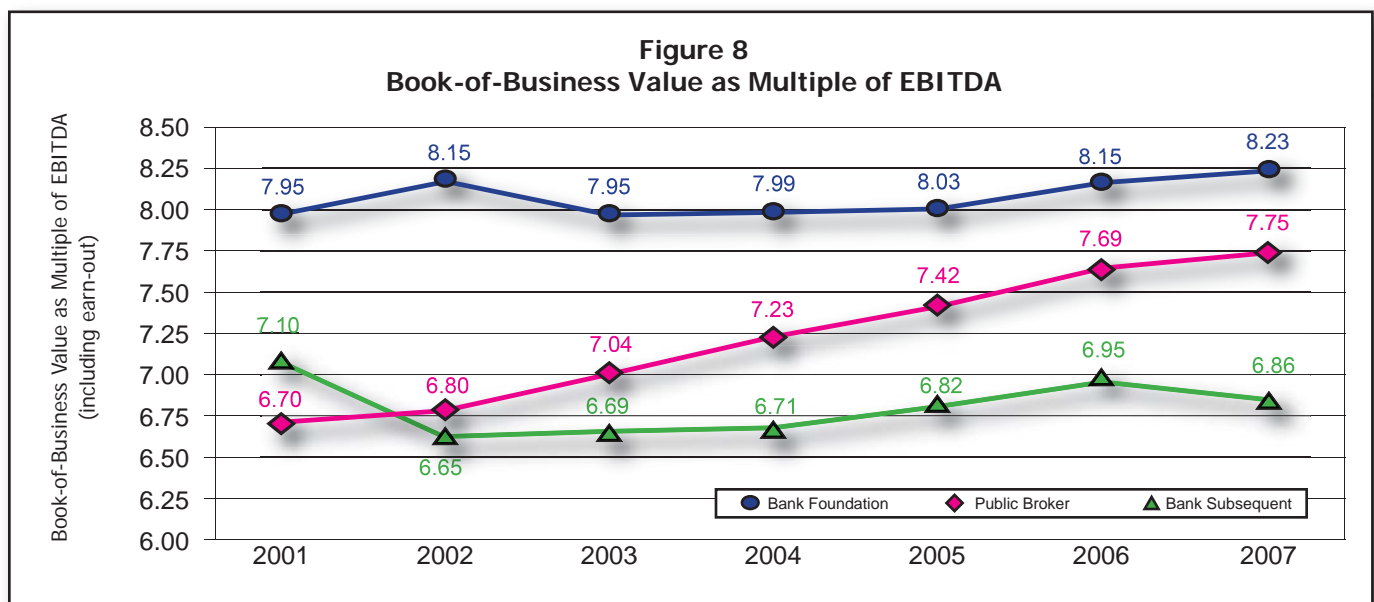
In short, carriers are seeking to simultaneously pursue rate reductions and maintain return on equity metrics by dealing with fewer agents with more premium and better risk mitigation platforms. Poor performers have a target on their back because they are often perceived as the impediment to the carrier's sustainability.

Current Premium Valuations

Agency value during 2007 reached an all time high. The overwhelming demand for insurance agency acquisitions drove average deal pricing to over 7.0 times EBITDA, including a portion allocated to an earn-out. High-performing agencies secured pricing as high as 10.0 times, including expected earn-out proceeds. From 1999 through 2007, public brokers continued to grab more deal market share from banks through enhanced pricing, flexible deal structures, and extremely aggressive prospecting.

Bank pricing has remained high on foundation deals. Foundation agencies are generally defined as peak-performing agencies with revenue in excess of \$5,000,000 acquired as a hub platform for a given bank market territory. Subsequent acquisitions by banks that represent spokes to the hub or fold in acquisitions, traded at a discount to foundation acquisitions.

Figure 8 illustrates the trend in agency value, including expected earn-out payments. Information considered in preparing estimated market comparables includes private transactions in which



we were involved, private transactions where we have general knowledge, transactions in the public record, our knowledge of the current M&A marketplace, discussions with buyers and sellers that are active in the marketplace and MarshBerry estimates.

The typical deal structure is split between guaranteed consideration and an earn-out. Earn-outs are contractual provisions that provide additional proceeds if an acquired agency attains certain financial goals. Earn-outs are generally calculated based on post closing EBITDA on stand alone acquisitions and on post closing revenue on fold in acquisitions. These payments are generally paid over a three year period, post closing. The guaranteed purchase portion of value generally ranges from 75%-90%. The average deal proceeds during 2007, including earn-out provisions, can be found in Figure 8. Guaranteed pricing was 7.27 times EBITDA on bank foundation deals, 6.75 on public broker deals and 5.63 on bank subsequent deals.

During 2007, almost every agency was marketable regardless of quality. During the next three years, buyers will become more selective, and aggressiveness will be reserved for those that are of better than average quality, fold-ins, stand-alone acquisitions with revenue of at least \$5,000,000 or agencies with a unique specialty. Agencies capturing the flag of high value in the coming cycle will have several of the following attributes:

1. *Strong new business production*
2. *Institutionalized production staff/stratified ages*
3. *Successfully executed organic growth strategy*
4. *Best practices executive leadership*
5. *Sustainable, strong profit margin*
6. *Strong profitability prior to contingents*
7. *Location in a medium to high-growth area*
8. *Agency differentiation and/or niche specialties*
9. *Fold in or large enough for a stand alone office*
10. *Corporate structure that enables an asset sale, providing buyers with tax amortization*

The seemingly unlimited demand by buyers and the shortage of agencies of scale pushed agency value to a new level during the past ten years. Public buyer demand has been driven in large by Wall Street pressure to grow revenue and earnings in the soft market.

Disintegrating Organic Growth

Rate changes in the health insurance and P&C market have had a devastating impact on the revenue growth of insurance distributors. Now rate challenges are being compounded by economic challenges. While it is uncertain how difficult the economy will become, it is hard to ignore the metrics. Economic growth is expected to slow to between 1.3% to 2.0% (down from original projections of 1.8% to 2.5%), job growth is retrenching, crude oil prices continue to increase reducing disposable income, housing prices are falling and retail sales are predicted to slow to 2.5%.

The Federal Reserve could have been the calm in the storm demonstrating stability and proactive decision-making. The Federal Reserve instead opted not to reduce the federal funds borrowing rate in August of 2007. That decision was then followed up by cuts in September, October, December and three quarters of a point in January of 2008, the largest single cut in over two decades. Then the rate was cut again just eight days later "in view of a weakening of the economic outlook and increasing downside risks to growth." March of 2008 saw yet another 75 basis point cut, bringing the federal funds rate down to 2.25% from a high of 5.25% in August of 2007.

Consumer and corporate confidence has eroded during the early stages of 2008 with the main debate revolving around whether or not we are already in a recession. In March, the Fed and the Treasury announced a series of steps aimed to provide relief to a spreading credit crisis that threatens to plunge the economy into recession. The central bank cut the lending rate to financial institutions and created another lending facility for large investment banks to secure short-term loans. The Treasury announced a sweeping regulatory reform proposal for an optional federal charter and the creation of a national insurance regulator.

During this period, the investment community was shocked to learn of a deal to save Bear Stearns which had run up big losses on mortgage linked investments. JP Morgan/Chase (backed by Federal Reserve guarantees) announced its intention to buy Bear Stearns for \$2.00 per share, which then increased to \$10.00 per share - a mere pittance of trading levels just days before. National City Bank, one of the nation's top ten largest banking institutions, hung up a for sale sign in March. It is impossible to predict the impact of all these changes, especially considering that rate cuts and regulatory reform can take months, if not years, to show up in the economy.

Unlike 2006 and 2007, soft rates are now occurring in tandem with the threat of a weakening economy. And the possibility of a sustained slow down in the economy will mean slower growth in commercial businesses which will impact revenue generated from insureds in property & casualty lines. The hit to group health and workers' compensation commission income will result from slower growth in staff and payroll.

At the core of agency value is the ability to demonstrate sustainable and predictable earnings growth. Agency revenue is largely comprised of commission income and contingent income. Commission income has taken a hit during the past four years from a soft market. Agencies that have not dialed down executive level accountability, producer accountability and differentiation strategies are in the masses incapable of writing enough new business to offset the softening. Contingent and supplemental income are now in jeopardy. A declining rate with the same claims means an increase in loss ratios which translates to a decline in contingent and supplemental income.

Given that every agency has fixed expenses, revenue deterioration is being accompanied by a decline in EBITDA as a percent of revenue. Or as they say on Wall Street, margin compression. One way to salvage EBITDA margin is to limit reinvestment, but restricting reinvestment just compounds the problem. Another alternative is to acquire while focusing on integration savings, but integration is difficult and independent agencies have historically found it challenging to close deals at premium deal pricing.

Lower profitability simply means lower value. No matter how you slice it, margins are coming down for most agencies and as a result, so is value, regardless of the EBITDA multiple. Profit margins are in jeopardy and expense management is not the solution to sustainable earnings growth. Continuous new business production is the key and it will never happen unless it is planned, funded and executed. See Figure 9.

The Past – Supply and Demand

For decades prior to 1995, agency value hovered between 5 times and 6 times EBITDA. Quite simply, public and large regional insurance broker demand was on balance with the supply of sellers. The delicate balance was disrupted between 1995 and 2007, when the number of buyers increased dramatically as banks entered the picture, followed by private equity.

Since January of 1999, there have been over 2,000 publicly announced insurance agency and brokerage transactions. The number of closed transactions remained relatively stable each year, hovering between 200 and 275 (see Figure 10). More buyers and limited sellers increased pricing. Supply probably would have subsided, but a consistent increase in pricing coaxed many agency owners to the deal table. Deal price increases were heavily influenced by a barrage of buyers and fueled by soft market conditions. Buyers needed to grow and many sellers could not.

Banks entered the business in the mid-1990s and quickly became a buyer segment of choice after the passage of Gramm-Leach-Bliley. Given that insur-

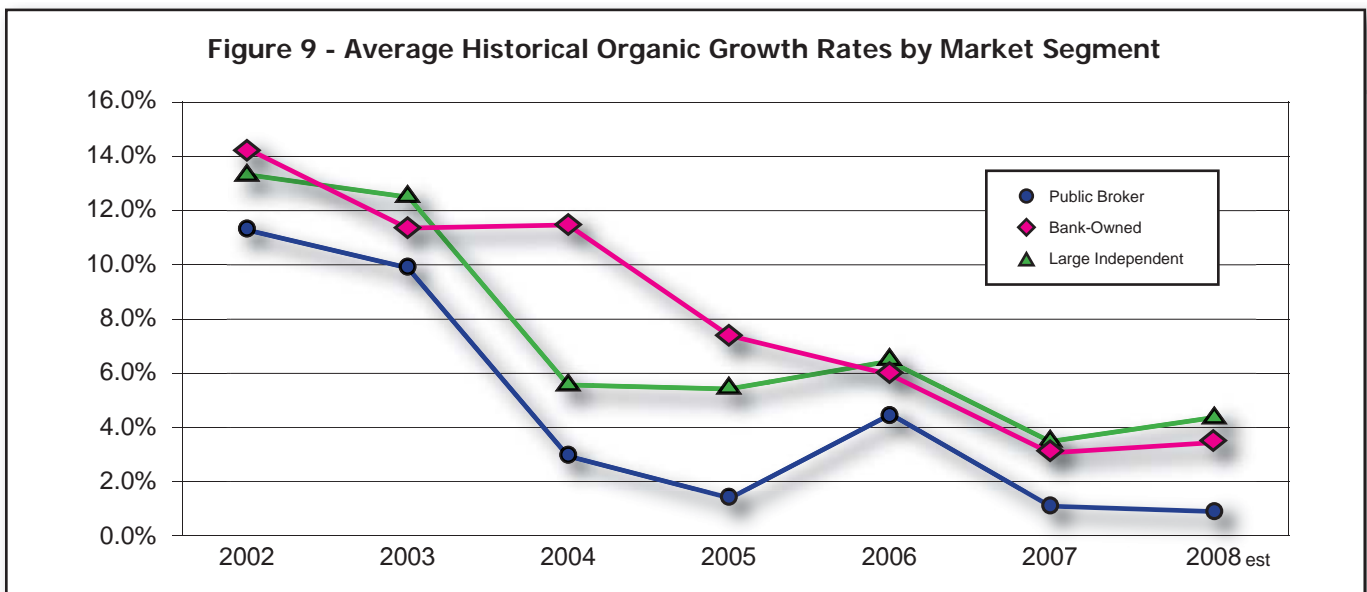
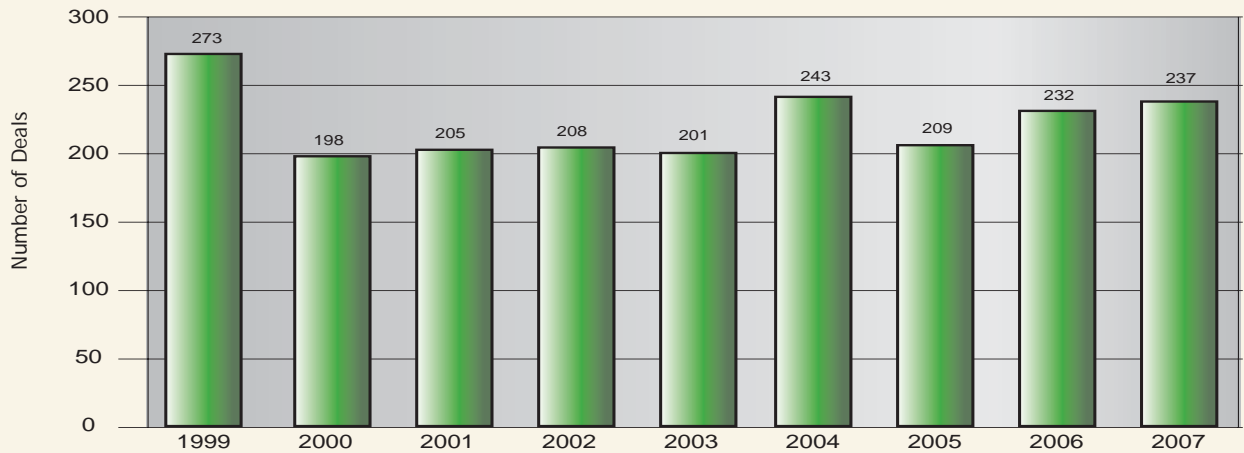


Figure 10 - Publicly Announced Insurance Brokerage Transactions



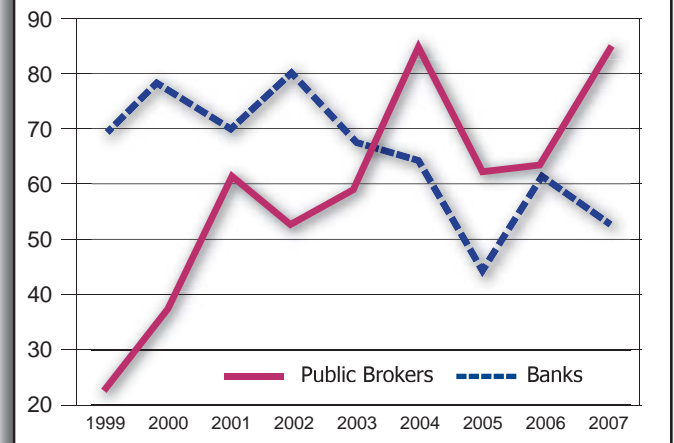
ance is not “core” but complementary to banking, banks sought to acquire high-quality foundation type agencies. Banks of all sizes scoured the nation trying to find foundation agencies comprised of an institutionalized production staff and a management team committed to remain with the business post closing. Banks that were lucky enough to acquire foundation agencies have largely succeeded.

Banks that succumbed to deal fever and bought agencies of inferior quality have largely failed. Given that banks were willing to pay handsomely for foundation agencies, valuations were pushed up to an average of over 8.0 times EBITDA, with some deals approaching 10 times, including the earn-out. Top of the market multiples are only achieved if sellers perform after the sale, given that most deals include an earn-out. The rising tide of the hard market in the early 2000s lifted all boats and in the end, most agencies that sold at the beginning of the hard market captured high valuations through the earn-out. Nothing like great timing.

When banks entered the arena and ran up deal valuations, public brokers were at first not willing to compete on price. As a result, the public brokers systematically lost deal market share. Recognizing the need to close deals to drive top line and bottom line growth (through integration savings and revenue synergies), deal pricing by the public brokers steadily increased and has now approached bank valuations. Today, brokers control deal market share. This success has come at the expense of banks. Banks experienced a decline in deal market share during 2007 to 22%, the lowest level since 1999. Public brokers consummated 35% (82 deals)

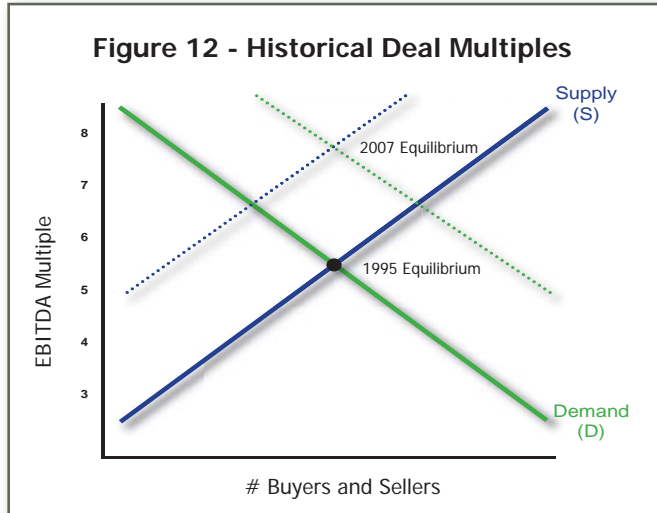
of all publicly announced transactions in 2007 versus only 24% (63 deals) during 2006. Growth in public broker acquired revenue totalled 40% year-over-year. Figure 11 compares the number of deals consummated by the two leading buyer segments:

Figure 11 - Number of Publicly Announced Transactions: Banks versus Public Brokers



As if the deal market was not challenging enough, 2007 brought on a whole different faction of deal competitors - private equity. Private equity investment in the insurance distribution space has been around for decades. What was new during 2007 was the unheard of volume of capital chasing insurance distributors. During the first half of 2007, over \$4 billion was spent on a handful of deals that went for as high as 12+ times EBITDA eclipsing even the most lofty premium valuations heretofore experienced.

Limited supply (romanced to the deal table by increasing demand) fueled valuations over the past decade, even despite the softening of the market. The feeding frenzy for deals pushed up valuations and allowed even agencies on the bubble the opportunity to ride the wave of premium value.



Strong deal activity has continued in early 2008. During the first 45 days of 2008, there were approximately 35 publicly announced transactions. The sellers ranged in size from \$1.5M in agency revenue to \$40M and spanned various geographic locations and product lines. In summary:

1. *Over \$200M in agency revenue changed hands*
2. *Public Brokers led the charge relative to number of deals*
3. *Private Equity firms acquired over \$100M in brokerage revenue, including two of the nation's Top 100 Brokers*
4. *A handful of notable bank expansion acquisitions (BancorpSouth, BB&T, Wells Fargo).*
5. *One notable bank divestiture (Webster).*

The feeding frenzy and premium pricing for agencies will soon change as supply increases and demand relaxes. The future will see deal pricing more aligned with real value for the average agency versus perceived value. This trend is no different than what banks are currently experiencing. For banks, the days of premium deal pricing at 3.0 times book is a bygone era and value of 1.75 times book is quickly becoming the norm.

The Future– Supply and Demand

Acquisition supply is already spiking. For years, sellers on the fence were pulled along by increasing valuations and the entrance of alternative buyers. We believe the tipping point will occur within the next three years as the industry witnesses an exponential increase in sellers and a retrenchment in the number of buyers. There are six main factors driving the exponential increase in the number of sellers.

1. **More Targets** The average agency in the industry is getting larger. Over time, a larger portion of the market is made up of agencies at or greater than \$5,000,000 which is becoming the minimum revenue size for public brokers and banks to support as a branch office. We predict that the trend of increased supply of desirable acquisition candidates will continue to increase over the next ten years as per the following table.

**Figure 13
Forecasted Number of Agencies by Size**

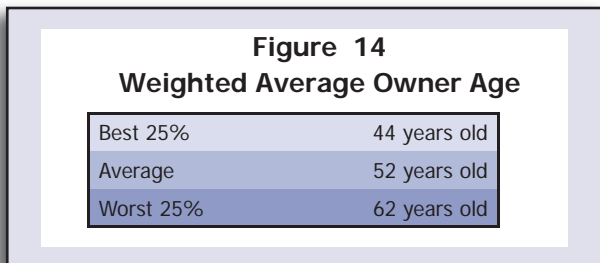
Comm. Rev. Size	2000	2005	2010	2015
100M +	12	21	28	46
10-100M	199	296	422	588
5-10M	939	1,115	1,371	1,610
2.5-5M	1,985	1,957	1,949	1,930
1.25-2.5M	4,094	3,482	2,988	2,477
0.5-1.25M	5,587	4,804	2,704	1,532
Total	12,816	11,675	9,462	8,183
Under 0.5M	25,754	18,601	9,474	3,507
Total	38,570	30,276	18,936	11,690

} Increase in Supply

2. **Agency Ownership** Many cannot cash flow internal perpetuation because too many agency owners retain too large an ownership position for too long a period of time. Internal ownership perpetuation is a process, not a transaction. Perpetuation requires an orderly transition of stock over a long period of time. A regimented transition of ownership enables stock of retiring shareholders to be acquired without placing too large of a financial burden on any one individual or the agency. If the burden is too large, the agency generally makes the decision to sell. Many agencies sell because of the personal risk the seller would otherwise retain by holding the note on their own buy-out. The risk is caused by the stress the deal would have on the agency's cash flow, which is a direct by-product of waiting too long. Allowing the average age



of the owners of an agency (weighted by stock ownership) to eclipse 52 invariably translates to a sale. Figure 14 reflects weighted average owner age for agencies ranging from the best to the worst.



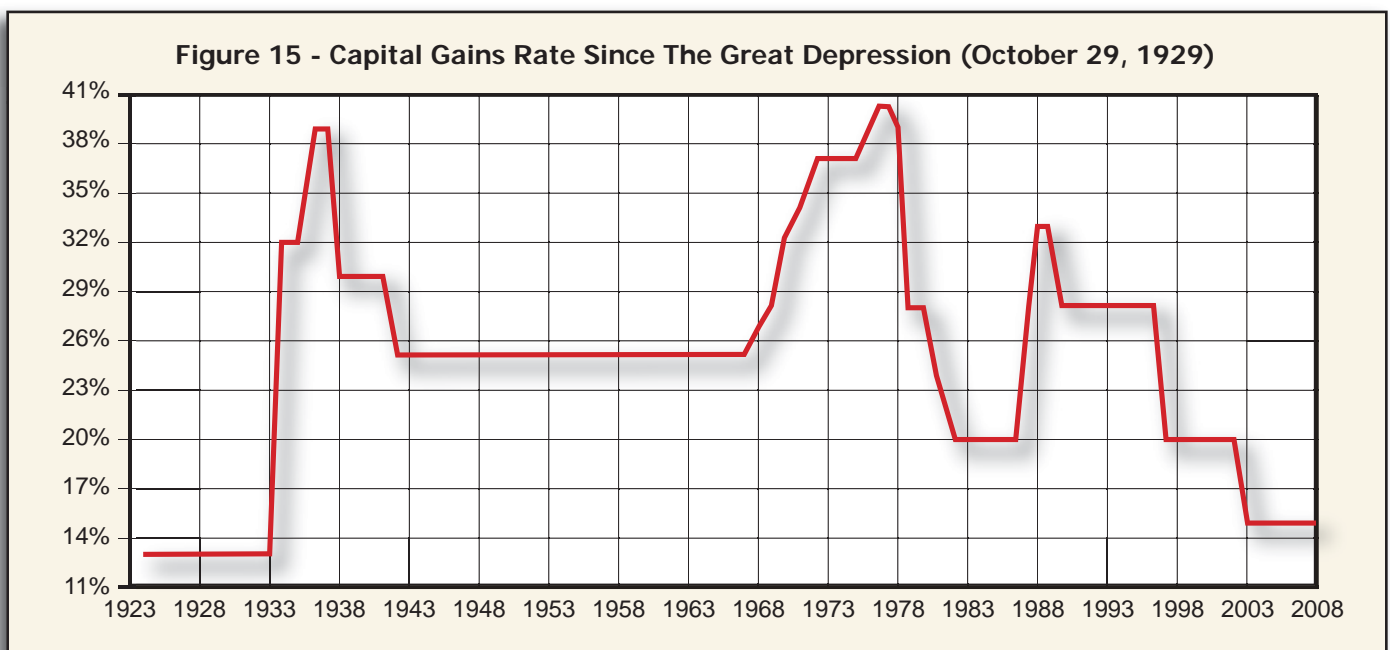
While most aging owners understand the merit of moving stock gradually, many agency principals resist. Many resist because they believe a systematic internal sale will reduce their long-term retirement value. Ironically, the opposite is most often true, even if the eventual plan is to sell to a third party. Agencies with the highest value generally have over time broadened ownership to a sizable group of key employees. Agencies that embrace broadening of ownership attract and retain higher quality employees who in turn have a vested interest in maximizing value. If you run the numbers, the dilution of ownership generally works to the advantage of the aging owner as the lowering of ownership over time is outrun by the leverage to agency value.

If the agency is eventually sold, broad ownership helps a buyer have more faith in the validity of non-compete and non-solicitation agreements. If key producers are owners, the proceeds from the transaction will represent consideration to signed covenants, lowering the risk of the deal to the buyer. Lower risk translates to higher value.

3. **Soft Market** The difficult rate environment, carrier tiering and the challenge in orchestrating a sustainable organic growth plan are prompting many agencies to sell. In this market, more agency owners are concluding that they do not have the stamina, personnel or capital resources to fund continued growth. Many agency owners are looking out the window and concluding that they are unwilling or unable to make necessary changes. Are you willing and able? To answer that question, look at the aggressiveness of your new business pipeline management system and your reinvestment in new producers. Are you willing and able to execute best practices?

4. **Political Changes** A Democratic president could be in the White House in 2009. The threat of an increase in the capital gains rate is very real and is creating a tidal wave of sellers. Rhetoric by Democrats is soundly supporting a move to revamp the Bush Jobs and Growth Tax Relief Reconciliation Act of 2003 wherein long-term capital gains were reduced to 15.0%, the lowest level since before The Great Depression. Even if the Democrats do not change taxes, the Bush tax reduction will expire in 2010.

Listening to election year economic plans, the long-term capital gains rate could increase from 15% to upwards of 28.5% should certain promises come to fruition or should the Bush tax cut sunset. Regardless of what will happen, fear prompts action and many agency owners are not willing to risk the tax consequences of prolonging a sale. See Figure 15 below.



5. **National Health Care** The fifth driver is the threat of national health care. While the proposals and plans for executing national health care are fuzzy and lack significant detail, retail agencies with a sizable health book-of-business fear having commission income legislated off their income statements. Many suggest that national health care will take decades to implement even if a plan is executed. Others suggest that there would be a role in such a system for a broker through consulting, ancillary products, excess coverage or other support services. And a certain percentage feel that national health care is nothing more than a pipe dream.

Irrespective of varying opinions, many agency owners feel that a formalization of the threat could increase perceived risk, and uncertainty alone will reduce the value of this line of business. There is no way of predicting what will happen to the health care system. But what *is* happening today is that a slew of agencies are flooding the deal market while valuations and demand for this line of business are at an all time high.

6. **Decline in Agency Value** A final driver of the increase in supply is the substantial overall decline in agency valuation that is predicted to unfold during the next three years. Valuations are at a 30-year high given a raft of aggressive buyers chasing a limited number of sellers. Could the recent boom in M&A deal activity be similar to the housing run up and crash over the past several years? Timing is everything and those that want to sell but miss the market will get hurt. We are not projecting M&A deal pricing to crash for all agencies, but we are projecting a sharp increase in inventory compared to a diminishing number of buyers, which will systematically soften pricing for the average agency. Lower demand and greater supply will bring the market back to equilibrium by 2010. High-quality agencies, by contrast, will stand apart and will continue to command a premium.

Banks

The aggressive acquisition of insurance agencies by banks has declined considerably and will continue to decline in the future. Many bank-owned agencies have performed well ahead of the market. Overwhelmingly, those banks that bought quality are pleased with their insurance operation. But, many banks today have bigger priorities than to allocate capital to a business line that is a tangent to their core business. The virtual

collapse of the credit market, liquidity concerns, and the hit to bank valuations has wreaked havoc. Some in the banking industry are experiencing a meltdown given inconceivable residential loan portfolio write-offs, requirements to post substantial loan loss reserves and underwater mortgage backed securities.

Even in banks that did not get hit by the sub-prime mess, less time is being spent debating the merits of building an insurance operation. Conversations in most banks are now squarely aimed at focusing on their core business, reserving capital for bank acquisitions and avoiding non-amortizable goodwill that stems from acquiring fee income businesses.

Fee income that results from acquiring insurance agencies can hold up the fragile margin spread-based earnings of the core banking business. Even though driving fee income is now more important than ever, many bank boards don't want to divert focus from stabilizing their retail and commercial banking portfolios. Rest assured, banks in insurance will not go away. This is an ebb not a flow. But the ebb in acquisition demand has removed a portion of the very buying segment that drove up agency valuations.

The retrenchment is aided by a perception, not a reality, that all banks are divesting of their insurance operations. There has been a number of divestitures such as BNC Corp, Capital One, Webster, Bank of America, Citizens and Commerce. Some banks have divested, others are divesting, and others will follow. Some banks will sell to secure capital. Others will divest because of poor performance. Some will sell given a failure to bring the insurance operation to scale sufficient to deem the line of business as material. But the recent sell activity is not an epidemic because many bank-owned agencies are outperforming the market and a large segment of banks remain absolutely committed to insurance.

To reinforce this point, consider the metrics. MarshBerry tracks the financial performance of a substantial portion of the bank insurance marketplace. The top banks in insurance that we track had average insurance revenue of over \$30,000,000, achieved double digit organic growth and posted an EBITDA margin of 29.6% during 2007. The landscape is changing, but a core group of bank-insurance operations remain industry leaders.



Over 60% of banks in the MarshBerry Bank Agency Network (BANK) report that they need and plan to acquire during 2008 to satisfy the bank's insurance growth/margin targets. Most of the remaining banks are interested in acquisition, but are holding off, reserving time and attention for their core business that will demand focus during the coming two to three years. There will be insurance deals by banks already in the business and by banks that desire to enter the insurance business. But, in sheer numbers, bank demand as measured in terms of the number of buyers has dropped off. 2008 will be a critical year for banks as most will revisit the commitment to fund continued insurance growth versus exiting the insurance business.

Private Equity

The \$4.5+ billion spent by private equity during 2007 represented only a portion of the many start ups formed to acquire and integrate insurance operations. In the first quarter of 2008, USI, HUB and Ascension all consummated deals and have the capital to continue executing their business plan. However, the mortgage meltdown has trickled down to an overall credit crunch in the private equity space. An endless list of private equity firms that were interested in insurance investments are now suffering from expiring credit lines that are not being renewed.

Debt remains available to private equity in smaller tranches, but the cost has increased resulting in the inability to layer off as much debt in an acquisition. The unforeseen high multiples paid in a handful of deals during 2007 resulted from creditor willingness to allow the deal to hold substantial debt at a favorable interest rate. The cost of debt has gone up and the willingness to fund leveraged buy-outs has gone down. Less debt leverage either reduces the return to the private equity fund in the deal or forces the private equity buyer to reduce pricing.

If there is one certainty, it is that private equity firms will not lower their return. As a result, innumerable deals in the final stretch with private equity are either being rewritten or have collapsed. The private equity movement is far from dead, but the pace will revert back to what it was for decades. The groundswell of private equity buyers is dissipating.

Public Brokers

Public brokers were the big winners in the acquisition market last year. A run up in their internal deal pricing, persistency in chasing deals and structure flexibility has fueled their success, but the run up occurred because the brokers had no choice. The competition for deals has been so intense that any reduction in pricing would have meant fewer closed deals, which was not an option given weak organic growth. Pricing has remained high for no other reason than heavy deal competition. Now, the public brokers have a gun to their head given that past pricing levels that were mandatory to close deals will be difficult to continue in the future because of the recent hit to their own public valuations.

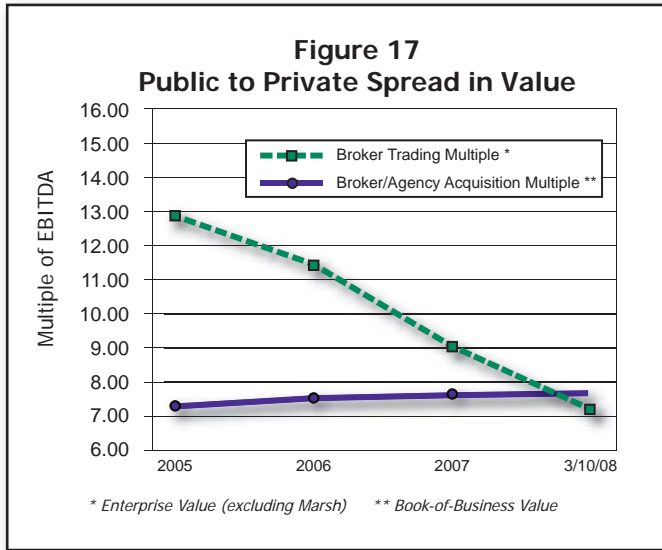
Most public brokers have rolled out expense cut strategies to help the math, but the air is getting thin at current deal pricing. During 2007, the public brokers were buying at 7.0 - 8.5 times EBITDA, which is now in many cases more than they are trading. Excluding Marsh (which has not been acquisitive in recent years), the enterprise value of the average public broker was trading at 7.28 times 12/31/07 EBITDA during mid March 2008.

Figure 16 - Public Broker Financial Performance as of 12/31/07

	Revenue	EBITDA %	Enterprise Value / EBITDA**	Organic Growth*
Marsh McLennan	11.35B	15.2%	9.979	-1.0%
AON	7.47B	18.2%	6.911	5.0%
Brown & Brown	945.14M	39.0%	7.269	-3.4%
Willis Group	2.58B	32.2%	8.867	1.0%
Arthur J. Gallagher	1.62B	16.9%	6.373	2.0%
Hilb Rogal Hobbs	797.63M	24.6%	6.979	-0.3%
AVERAGE	4.13B	24.4%	7.730	0.6%
AVG. (excluding Marsh)	2.68B	26.2%	7.280	0.9%

* Year End 2007 Estimates of US-Based Commissions & Fees

** Enterprise value as of 3/10/08 as multiple of 12/31/07 EBITDA



Since the beginning of time, the world has jealously watched public brokers exploit multiple arbitrage. Multiple arbitrage is the coveted position a public broker is in when public valuations exceed acquisition multiples. The public to private valuation spread, caused by buying at one level and trading at another, has evaporated. After removing the amortization of identifiable intangible assets from GAAP earnings, many deals on paper are dilutive to earnings. Brokers have continually increased deal pricing despite a decline in trading multiples. Perhaps the public brokers could justify the pricing during 2007, but pricing will be next to impossible to maintain in the coming cycle given the slide in broker trading multiples (Figure 17).

The impact of disintegrating organic growth is evident in public broker valuations. Analyzing the public broker stock prices as of 3/10/08, all six were trading at levels 20% to 40% below their respective 52-week highs. See Figure 18.

The investment community looks at past fundamentals to predict future earnings. Given that organic growth prospects for 2008 and 2009 look bleak, so does earnings growth. New business within the public brokers is not enough to outpace premium declines and natural attrition, thereby negatively impacting current and projected margins. Broker valuations are down. We do not see a reversal in their valuations in the near term.

Accounting Rules

In December of 2007, the Financial Accounting Standards Board (FASB) issued new accounting rules [FAS 141 (R)], impacting the financial treatment of M&A deals effective for annual reports beginning on or after December 15, 2008. The new FASB rules will impact the projected GAAP earnings and capital ratios of buyers and their resulting acquisition modeling. Without a corresponding reduction in deal pricing, the metrics on a deal will worsen for public buyers. Pricing will be pushed downward as few public buyers are in a position where they can accept a reduction in return on deals.

FAS 141 (R) requires that transaction costs (such as accounting, legal and advisory fees) be expensed. Currently, these costs are capitalized and either amortized over a period of years or treated as goodwill and not amortized unless there is impairment. In other words, these costs are either spread out or never hit the income statement. With FAS 141 (R), first year GAAP earnings will be directly reduced by acquisition expenses.

FASB also requires that the fair value of contingent consideration (i.e., earn-outs) be included as part of the acquisition cost as of the acquisition date. Currently contingent consideration is not included as part of the acquisition cost until the contingency is resolved (i.e., the earn-out is "earned"). Under the new statement, earn-outs must be estimated at closing and included as part of the purchase price. If cash is used for consideration, the fair value of the earn-out will have to be recorded as a contingent liability at closing, which will reduce buyer capital ratios. The change resulting from FAS 141 (R) will reduce the financial metrics of public buyers and as a result, will have a downward impact on pricing in agency acquisitions.

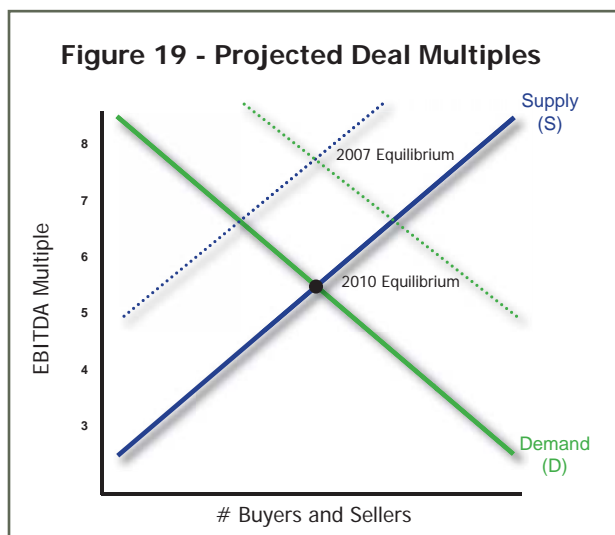
Figure 18 - Public Broker Stock Pricing as of 3/10/08

	AJG	AOC	BRO	HRH	MMC	WSH
Current Price	\$23.88	\$42.49	\$18.62	\$32.47	\$25.87	\$33.64
% Change Since YE07	-1%	-16%	-26%	-24%	-7%	-11%
% Change vs. 52-Week High	-23%	-20%	-38%	-40%	-26%	-27%



Projected Deal Multiples

Public brokers will continue to dominate the acquisition landscape during the next three years. With a growing inventory of sellers and less buyer competition, valuations for the masses are heading downward. With the continued decline in public broker trading values and accounting rule changes, brokers will not be able to sustain current pricing when buying an average agency. With waning demand from banks and private equity firms, fewer buyers will translate to decreasing deal competition. The insurance acquisition arena is in the midst of a shift in supply and demand. At the same time, public broker buyers and bank buyers have universally taken a hit to their own valuations. As a result of the changing dynamics, within three years the value of the average agency will revert back to that of yesteryear.



Growing to Maintain Value

Competition and current valuations will be sustained for the minority that can drive profitable organic growth. For the majority, valuation will unravel. Agency owners have three choices; capitalize on your current premium value, commit to a plan to drive value through profitable organic growth or sit on the sidelines and watch up to half of your current after-tax value slip between your fingertips.

If your choice is to remain independent and you are committed to driving value, your plan must be founded on driving organic growth of at least 8%. If capital gains rates increase, valuations decline and growth is less than 8%, the value of an independent insurance agency on an after-tax basis will be less in four years than it is today. Are you going to reap the harvest or sow the seeds to sustain agency value?

In order to illustrate this concept we have provided two examples of a \$5 million revenue agency: Figure 20, "Reaping the Harvest", assumes the owners sell the agency today. Figure 21, "Sowing the Seeds", illustrates the agency remaining independent. In both examples it is assumed that the capital gains rate increases from 15% to 28.5% in 2009 (plus a tax deductible state rate of 5%).

Major assumptions included in the Reaping the Harvest illustration include:

- The agency can achieve pro forma Earnings Before Interest, Depreciation and Amortization (EBITDA) equal to 25% of revenue.
- The agency is sold for a total of 8.25 times EBITDA with 7.0 times being paid at closing.
- The 1.25 times EBITDA earn-out is achieved and paid over a three year period.
- The sellers can earn a 5% pre-tax return each year by reinvesting sale proceeds.

Under this example, the owners realize an after-tax value of just under \$10 million at the end of four years.

In the second example, "Sowing the Seeds", the same agency with \$5 million in revenue and a 25% pro forma EBITDA margin, remains independent. The critical assumptions in this illustration include:

- The agency can run on a pro forma EBITDA basis of 25% but incurs additional expenses equal to 5% of revenue in the form of reinvestment for continued growth and additional capital expenditures. Thus, pre-tax profit is 20% of revenue each year (25% EBITDA minus 5%).
- Actual EBITDA is subject to ordinary income tax via Sub-S distributions but is reinvested and achieves pre-tax growth of 5%. Investment income on accumulated cash is taxed at ordinary income tax rates.
- Value at the end of four years equals 5.5 times EBITDA in a sale (assuming a guaranteed deal with no earn-out) plus accumulated invested profit, after-tax.
- In order to achieve the same after-tax return at the end of four years as in the "Reaping the Harvest" example, the agency must grow at an average annual rate of 8%.

Given the value that is in jeopardy, it is clear that those that remain independent must drive growth. In order to drive organic growth, three areas that require an acute focus are pipeline management, customer contact management and producer reinvestment.

Figure 20 - Reaping the Harvest

1. Reaping the Harvest; Sell today
2. Reinvest proceeds in securities, achieving pre-tax return of 5%
3. Tax on reinvested proceeds at ordinary income rate estimated at 40%
4. Capital gains rate increase from 15% to 28.5% (plus state 5%, tax deductible)
5. Assumes Sub-Chapter S Corporation

Year	Pro Forma	2008	2009	2010	2011
Revenue	5,000				
Pro Forma Expenses	<u>3,750</u>				
Pro Forma EBITDA	1,250				
<i>percent</i>	25%				
Pro Forma EBITDA	1,250			Total Multiple:	8.25
Closing Multiple	<u>7.00</u>			Less: Closing Multiple:	<u>7.00</u>
Book-of-Business Value	8,750			Earn-out Multiple:	1.25
<i>revenue multiple</i>	1.75				
Book-of-Business Value	8,750	521	521	521	
After Tax	7,066	421	354	354	
Cumulative Cost Basis	7,066	7,486	7,840	8,194	8,194
<i>state and capital gains</i>	19.3%	19.3%	32.1%	32.1%	
Beginning Balance, before E.O.	7,066	7,066	7,419	8,231	9,014
Additional Earn-Out, Beg. of Year	<u>0</u>	<u>0</u>	<u>421</u>	<u>354</u>	<u>354</u>
Beginning Balance after E.O.	7,066	7,066	7,839	8,585	9,368
Net Growth	<u>0</u>	<u>353</u>	<u>392</u>	<u>429</u>	<u>468</u>
<i>growth rate</i>		5.0%	5.0%	5.0%	5.0%
Ending Balance	7,066	7,419	8,231	9,014	9,837
<i>growth rate</i>		5.0%	5.0%	5.0%	5.0%
Ending Balance					9,837
Less: Cumulative Cost Basis					(8,194)
Gain					1,643
Tax					527
<i>state and capital gains</i>					32.1%
Ending Balance					9,837
Less: Tax					<u>(527)</u>
After-Tax					9,310

Figure 21 - Sowing the Seeds

1. Sowing the Seeds; Do not sell today
2. EBITDA after reinvestment and tax, accumulated and reinvested
3. Reinvestment of profit achieves 5% growth pre-tax, taxed at ordinary income rate estimated at 40%
4. Valuations return to long-term cycle
5. Long-term capital gains rate from 15% to 28.5% (plus state 5%, tax deductible)
6. Assumes Sub-Chapter S Corporation

Year	Pro Forma	2008	2009	2010	2011
Revenue	5,000	5,386	5,801	6,248	6,730
<i>growth</i>		8%	8%	8%	8%
Pro Forma Expenses	<u>3,750</u>	<u>4,039</u>	<u>4,351</u>	<u>4,686</u>	<u>5,047</u>
Pro Forma EBITDA	1,250	1,346	1,450	1,562	1,682
<i>percent</i>	25%	25%	25%	25%	25%
Pro Forma EBITDA					1,682
Book-of-Business Multiple					<u>5.50</u>
Book-of-Business Value					9,254
<i>revenue multiple</i>					1.38
Pro Forma EBITDA		1,346	1,450	1,562	1,682
Less: Capital Expenditures		(54)	(58)	(62)	(67)
Less: Reinvestment		<u>(215)</u>	<u>(232)</u>	<u>(250)</u>	<u>(269)</u>
<i>% revenue</i>		-5.0%	-5.0%	-5.0%	-5.0%
Actual EBITDA		1,077	1,160	1,250	1,346
After Tax		646	696	750	808
<i>est. ordinary income rate (sub-s distribution)</i>		40.0%	40.0%	40.0%	40.0%
Book-of-Business Value					9,254
Cum. After-Tax Profit Reinvested 5% growth pre-tax, taxed at ordinary income rate					<u>3,025</u>
Fair Market Value					12,278
After Tax					9,310
<i>state and capital gains</i>					32.1%
<i>no tax on after-tax profit other than investment income</i>					



Pipeline Management

The predictability of new business production is next to impossible without proactive pipeline management. To determine if your pipeline management is adequate, see if you can generate your corporate prospect pipeline in 10 minutes or less - by agency and by individual producer. Across the country, we regularly gather producers in a room and ask them to present their prospect pipeline. Generally we receive blank stares or hear the following response: "It's in my head". Organizations that grow organically have a corporate prospect pipeline that is a living and breathing roll up of individual producer prospect pipeline reports. It's not in their head, it is on paper.

Without the aggressive management of a prospect pipeline, organic growth will never happen. How can an organization have a sales culture without knowing how many prospects are in the pipeline, individual producer closing ratios, and the potential commission embedded within a concrete prospect list? It is difficult, if not impossible, to proactively predict the future with a limited understanding of the metrics of the past and present. You can only improve on that which you can measure. Most can accurately forecast expenditures by dollar and by day, but rarely can agencies accurately predict the revenue inflow that will cover these expenses. Are you proactively or reactively managing your prospect pipeline?

Customer Contact Management

Transparency and disclosure has solidified itself at the forefront of insurance distribution along with compensation justification to insureds. Leading agents and brokers have turned these market challenges into opportunities by proactively designing, implementing and executing differentiation strategies while at the same time holding themselves accountable through service timelines and stewardship reporting. Over 60% of high-growth agencies are fully disclosing commissions and contingents to insureds through web sites, proposals, and other communications. Why? Because they are comfortable with the service-to-price value proposition. In effect, they are proactively communicating and articulating the service provided to customers via formalized service timelines.

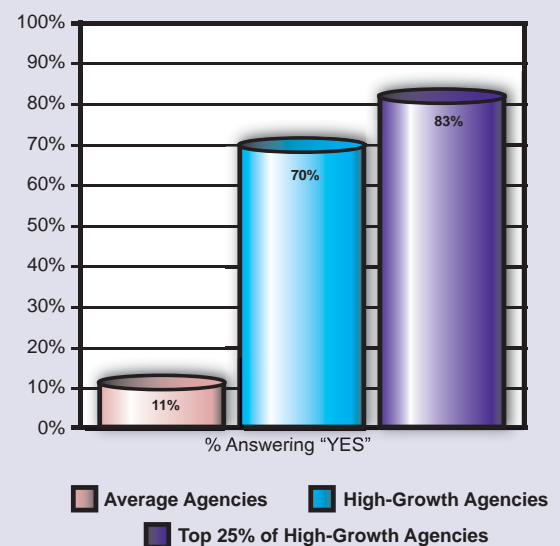
A service timeline, in its simplest form, is a proactive documentation of the agency insured relationship. It serves as an opportunity to define a differentiated customer contact strategy with consumers, thereby solidifying your relationship. Think about it. There are many things you already do for your customers. You know it. But, unfortunately, your customers do

not always remember everything you do for them. A service timeline documents what you will do for the client, who in the organization will deliver that service and the target date of completion. It also provides the opportunity to document your agency's differentiation story, capabilities, proactive culture and stewardship commitment. Our statistics reveal that 72% of leading banks and 70% of large regional independent agencies are now traveling down this path. We also want to note that the average organic growth rate of these entities is well above the industry as a whole.

Of agencies currently leveraging service timelines, approximately 80% report that their service timeline process provides their organization with a competitive advantage relative to new business and retention. The other 20% are competing with other agencies or brokers who are already using service timelines. The general masses are not leveraging such a tool. Most agents will idly sit back and wait for competitors to start this initiative and will act only when their top accounts start to leave.

Service timelines are no longer the wave of the future. They are a current reality. Market differentiation will come to those insurance distributors that can proactively establish an institutionalized process to both sell the value of services provided and hold themselves accountable to deliver on promises made. Such agencies are embracing transparency, seeking new business and retention differentiation, searching for cross-selling opportunities, and defining customer communication plans.

Figure 22
Does Your Organization Leverage Service Timeline Agreements with Insureds?



Producer Reinvestment

Reinvestment in youth is critical to sustaining organic growth. To evaluate your reinvestment success, answer the following question: What portion of your production staff is at or less than 40 years of age? Long-term growth is a by-product of reinvestment and growth cannot be sustained without fertilizing seedlings. Many agency owners are capable of executing a regimented reinvestment strategy, but have concluded that the return on investment from such a focus will inure to the benefit of others given their anticipated retirement date, so why bother. What is your plan?

Figure 23
Practices of High-Growth Agencies
Reinvestment

Age	Average	High-Growth
20-30	13%	33%
31-40	17%	16%
41-50	30%	26%
51-60	29%	18%
60+	11%	7%
Total	100%	100%
Under 40	30%	49%
Over 50	40%	25%

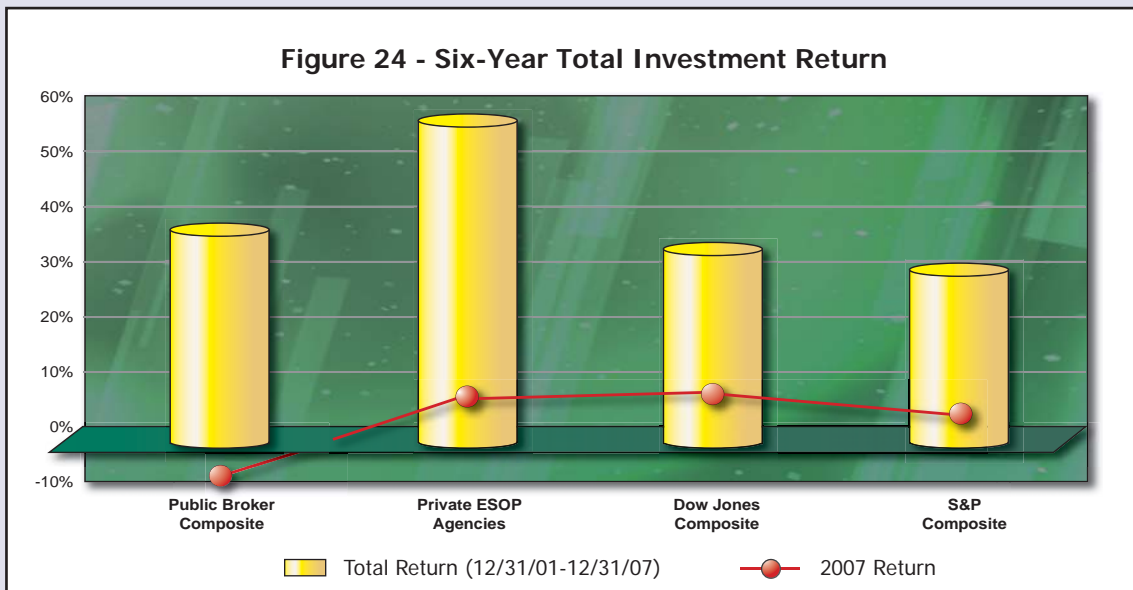
Growth Reinvestment

We routinely see peak-performing organizations carry up to 30% of the production force under validation at any point in time, annually budget producer recruiting expenses, and maintain sound and regimented internal training programs that will maximize the propensity for post-hire success. Such organizations have run the metrics and recognize that investments in sound producer hiring and training, when properly funded and executed, yield returns far in excess of those generated by the average agency acquisition.

Remaining Independent is a Sound Option

History would suggest that remaining independent is the best alternative, given the value creation achieved by the average ESOP agency during the past six years. Comparing various investment alternatives over the past six years, agency ownership has proved a sound investment. The question is, can you continue to drive more value as an independent over the long term relative to alternative investment vehicles? Historically, leading agencies have controlled their future. They maximized growth, margin, and distributions; and maintained the ability to perpetuate. Such were also the characteristics of agencies that sold at the absolute highest multiples. They were never for sale in the first place. They did not have to sell, but instead were offered uncharacteristically high values for their agency. And so it is with many of today's leading independent agencies. They continue to consistently drive organic growth, earnings, and shareholder return regardless of the external market conditions. See Figure 24.

Figure 24 - Six-Year Total Investment Return



Notes: 2007 Private ESOP Agency index values are estimated based on mid-year ESOP valuations. Public Broker Composite includes BRO, WSH, AJG and HRH.



Figure 25 - Low-Growth / Low-Value Agency

	3% Growth		Comments
Producer Books	8,100	81.0%	Producer Books = 90% of Total Comm.
House Commission	900	9.0%	House = 10% Total Comm., 2k Threshold
Other Income	<u>1,000</u>	<u>10.0%</u>	10% Revenue
Total Revenue	10,000	100.0%	Total
Executive Payroll	350	3.5%	3.5% Revenue
Producer Compensation	2,835	28.4%	35% N / 35% R
Account Executive	0	0.0%	No A/E Support
New Producer	0	0.0%	No Producer Investment
Customer Service	1,350	13.5%	15% Commission (13.5% Revenue)
Support	<u>550</u>	<u>5.5%</u>	5.5% Revenue
Total Payroll	5,085	50.9%	Total
Plus Benefits	<u>864</u>	<u>8.6%</u>	17% Payroll
Total Compensation	5,949	59.5%	Total
Selling Expense	300	3.0%	3% Revenue
Operating Expenses	1,550	15.5%	15.5% Revenue
Administrative Expenses	<u>100</u>	<u>1.0%</u>	1.0% Revenue
Total	1,950	19.5%	Total
Pre-Tax Profit	2,101	21.0%	Pre-Tax
EBITDA	2,201	22.0%	Pre-Tax + Adm.

Figure 26 - High-Growth / High-Value Agency

	15% Growth		Comments
Producer Books	6,300	63.0%	Producer Books = 70% of Total Comm.
House Commission	2,700	27.0%	House = 30% Total Comm., 5k Threshold
Other Income	<u>1,000</u>	<u>10.0%</u>	10% Revenue
Total Revenue	10,000	100.0%	Total
Executive Payroll	450	4.5%	3.5% Revenue + 1% Revenue Bonus
Producer Compensation	1,739	17.4%	40% N / 25% R
Account Executive	441	4.4%	70% Producer Books have A/E at 10%
New Producer	360	3.6%	4% Commission (3.6% Revenue)
Customer Service	1,350	13.5%	15% Commission (13.5% Revenue)
Support	<u>400</u>	<u>4.0%</u>	4% Rev., Economies resulting from growth
Total Payroll	4,740	47.4%	Total
Plus Benefits	<u>806</u>	<u>8.1%</u>	17% Payroll
Total Compensation	5,546	55.5%	Total
Selling Expense	350	3.5%	.5% More T&E
Operating Expenses	1,400	14.0%	Economies Resulting from Growth
Administrative Expenses	<u>100</u>	<u>1.0%</u>	1.0% Revenue
Total	1,850	18.5%	Total
Pre-Tax Profit	2,604	26.0%	Pre-Tax
EBITDA	2,704	27.0%	Pre-Tax + Adm.

Is it really possible to attain both growth and profitability? It is for the select few that have aggressively defined a plan, implemented world-class sales practices, and proactively manage their financials. While difficult to attain, such agencies have realized double digit growth, regardless of market cycle, and pro forma EBITDA levels in excess of 20%. In Figures 25 and 26, we compare contrasting operating strategies to isolate the major differences between a low-growth / low-value agency and a high-growth / high-value agency.

Fundamental differences include the volume of house business, minimum account thresholds, producer commission splits, the existence of sophisticated service staff capable of proactively managing relationships, and a budgeted amount for continued new producer investment. In the peak-performing agency, the three principles of planning, sales and financial management become apparent.

What Are You Going to do About it?

The time for agencies and brokers to fight back is now. Profitable organic growth is the name of the game and we believe three fundamental principles can help organizations control their own future. First, owners and executives must define a long-term strategic plan that will proactively manage the business objectives of the organization. Second, agencies must execute world-class sales practices. Third, agencies must proactively manage the agency by the financials while understanding that long-term growth requires short-term earnings hits.

Defining a long-term strategic plan:

Most agencies do not have a defined asset management strategy for the insurance agency. For a moment, step back and compare your ownership in an insurance agency to your ownership in a publicly traded security. Before investing in a security, astute investors define the purpose. The goal is to define whether the investor is seeking short-term returns, long-term growth potential, dividends, etc. Each investor needs to have a comprehensive asset management strategy and a clear vision of return expectations before investing.

Unfortunately, most agencies do not outline return expectations for their own business. Regardless of whether stockholders are seeking long-term agency value enhancement or short-term earnings distributions, all owners must maintain an acute and shared understanding of individual and corporate investment goals. Maximizing annual owner distributions, increasing retained earnings, reinvesting in staff, and funding perpetuation can all appear to be conflicting initiatives, but they need not be. A well defined asset management strategy combined with a sound business plan will help keep the organization on the desired track.

World-Class Sales Practices: For insurance agencies looking to maximize value, organic growth remains critical. Growth helps solidify carrier clout, provide reinvestment capital, drive profitability and attract and retain a winning team. And the best way to lay the foundation for growth is to implement and manage world-class sales practices. These sales practices are not germane only to large Fortune 500 organizations. Instead, world-class sales practices are fundamental tenets that create and support the organizational infrastructure that maximizes the propensity for predictable growth. Pipeline management, customer contact management and producer reinvestment were addressed in detail, but are only part of the overall practices that should be embraced. Best practices for organic growth include:

1. *Executive level accountability and participation*
2. *Understanding the correlation between the metrics and practices of sales success*
3. *Providing the internal staff with the tools to increase sales and service efficiency*
4. *Quantifying organizational and individual goals*
5. *Measuring, monitoring and improving the activities that will drive results (pipeline, service timeline and stewardship management)*
6. *Implementing pay for performance rewards and negative consequences*
7. *Institutionalizing a differentiation platform/pitch*
8. *Consistently funding growth initiatives*

Managing to the financials: Insurance distributors must proactively manage their business based on fundamental financial principles. High-growth organizations can consistently achieve EBITDA margins above 20% while continuing to fund future growth. The goal is to understand how to balance growth and profit. Such initiatives include:

1. *Aggressive growth budgeting, including an allocation of 2% to 5% of annual revenue for growth investments*
2. *Maintaining lean renewal compensation to producers to create cash flow to invest in high level service support*
3. *Investing in an "account executive staff." Regardless of the title, this level of staff is largely external and helps manage producer books of business to free time for new client acquisition*
4. *Increasing the spread between new and renewal compensation*
5. *Implementing minimum new business requirements of 15% to 20% of each producer's prior year book to retain the producer title*
6. *Reducing pay, terminating, or shifting roles for non-performers*
7. *Creating small business units that will service house business below high thresholds*
8. *Control operating, selling and administrative expenses to the high teens on revenue*
9. *Ensuring pre-tax profit is not overly dependent on contingent or supplemental income*
10. *Maintaining working capital of 60 to 90 days of expenses*



SNL Financial M&A Adviser Rankings

*Insurance Merger & Acquisition Deals
1999-2007*

Rank	Firm	# of Deals
1	Marsh Berry & Co. Inc.	217
2	Reagan Consulting Inc.	96
3	Hales & Co. Inc.	87
4	Goldman Sachs & Co.	78
5	Fox-Pitt Kelton Cochran Caronia Waller (USA) LLC	77
6	Mystic Capital Advisors Group LLC	70
7	Credit Suisse (USA) Inc.	53
8	Merrill Lynch & Co. Inc.	51
9	Philo Smith & Co.	40
10	Morgan Stanley	37
11	Keefe Bruyette & Woods Inc.	36
12	Citigroup Global Markets Inc.	33
13	Banc of America Securities LLC	32
13	J.P. Morgan Securities Inc.	32
15	Merger & Acquisition Services Inc.	30
16	Lazard Freres & Co. LLC	23
17	UBS Investment Bank	20
18	Bear Stearns & Co. Inc.	18
18	Lehman Brothers Inc.	18
20	Harbor Capital Advisors Inc.	14
20	Sandler O'Neill & Partners L.P.	14
22	Sica Consultants Inc.	13
23	North Bridge Advisors Inc.	12
23	Prisco Consulting Inc.	12
25	Wachovia Securities LLC	11
26	Curtis Financial Group LLC	9
26	Houlihan Lokey Howard & Zukin Inc.	9
28	Gill and Roeser Holdings Inc.	8
28	Raymond James & Associates Inc.	8
30	Nexus Group Inc.	7

*All States // Completed/Pending/Term Transactions
Whole and Asset deals as reported by SNL Financial, April, 2008*

Summary

For those agencies that have embarked on long-term valuation enhancement initiatives and are executing the internal fundamental principles that drive value, current pricing multiples will remain intact. These quality agencies will remain in high demand and will continue to command premium pricing. In agencies where performance is dictated primarily by external market conditions such as rate, buy-side demand and the overall economy, value will decline.

The upcoming shift in the insurance brokerage supply and demand dynamics will adversely impact deal pricing for the masses. The average agency owner has not reinvested to drive predictable growth and many have no concrete exit strategy. The premium rate environment remains soft in P&C and premium growth in the health insurance segment is weakening with no relief in sight. Carriers continue to tier their agencies based on long-term growth potential and loss experience. The overall economy has stagnated and is potentially headed for a recession. The entire financial services sector is feeling the pinch of valuation softening. Independent agencies and brokers are not immune. Valuation multiples will decline for those without a plan.

Will you sit back and allow your valuation to fall, bear down on a plan to drive value or seek an outside buyer during the short time that valuations remain high? Remaining independent remains the best alternative for those that embrace best practices and focus on a well-defined valuation enhancement strategy. Commitment is mandatory. Acting and executing a long-term plan will remain compulsory.



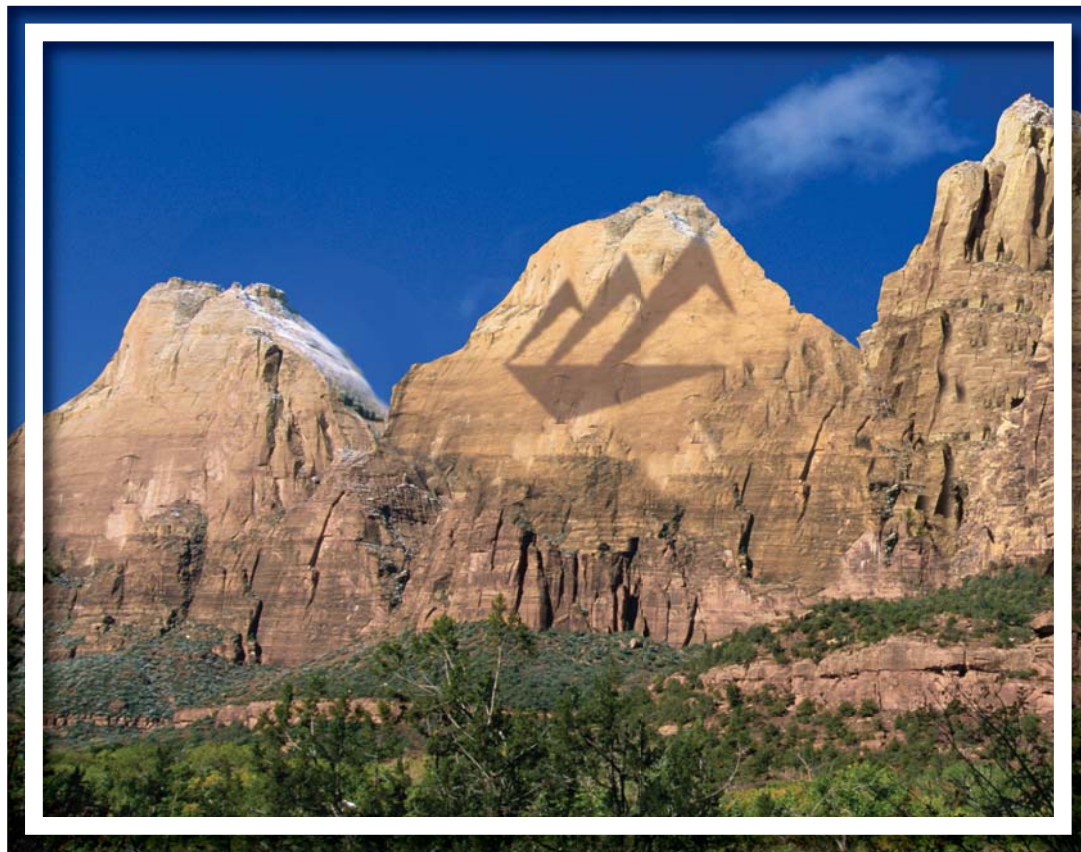
*John M. Wepler
President
440-392-6572
John@MarshBerry.com*

*Patrick T. Linnert
Executive Vice President
440-392-6568
Patrick@MarshBerry.com*

Reference

Figure 1	Page 3	Are You Willing and Able to Drive Growth and Profit? Source: MarshBerry
Figure 2	Page 3	Organic Growth Composition Source: MarshBerry
Figure 3	Page 4	New Business Comparables Source: MarshBerry
Figure 4	Page 4	Average Percentage Increase in Health Insurance Premiums Compared to Other Indicators, 1999-2007 Source: The 2007 Kaiser/HRET Survey of Employer Sponsored Health Benefits
Figure 5	Page 5	Among Firms Offering Health Benefits, Percentage that Offer a HDHP/HRA and/or a HSA-Qualified HDHP Source: Kaiser/HRET Survey of Employer Sponsored Health Benefits, 2005-2007
Figure 6	Page 6	P&C Company Historical Combined Ratio Source: Insurance Information Institute; MarshBerry
Figure 7	Page 6	Return on Equity: P&C Companies versus Fortune 500 Companies Source: Insurance Information Institute; MarshBerry
Figure 8	Page 7	Book-of-Business Value as Multiple of EBITDA Source: MarshBerry
Figure 9	Page 9	Average Historical Organic Growth Rates by Market Segment Source: MarshBerry
Figure 10	Page 10	Publicly Announced Insurance Brokerage Transactions Source: SNL Financial
Figure 11	Page 10	Number of Publicly Announced Transactions: Banks versus Public Brokers Source: SNL Financial
Figure 12	Page 11	Historical Deal Multiples Source: MarshBerry
Figure 13	Page 11	Forecasted Number of Agencies by Size Source: MarshBerry
Figure 14	Page 12	Weighted Average Owner Age Source: MarshBerry
Figure 15	Page 12	Capital Gains Rate Since The Great Depression Source: Top Rates on Capital Gains Citizens for Tax Justice, May, 2007
Figure 16	Page 14	Public Broker Financial Performance as of 3/10/08 Source: Bloomberg and Yahoo Finance, March, 2008
Figure 17	Page 15	Public to Private Spread in Value Source: Bloomberg and Yahoo Finance, March, 2008; MarshBerry
Figure 18	Page 15	Public Broker Stock Pricing as of 3/10/08 Source: Dowling & Partners, IBNR Weekly #7, Volume XV; MarshBerry
Figure 19	Page 16	Projected Deal Multiples Source: MarshBerry
Figure 20	Page 17	Reaping the Harvest Source: MarshBerry
Figure 21	Page 17	Sowing the Seeds Source: MarshBerry
Figure 22	Page 18	Does Your Organization Leverage Well-Defined Service Timelines with Insureds? Source: MarshBerry; TASC Network
Figure 23	Page 19	Practices of High-Growth Agencies Source: MarshBerry
Figure 24	Page 19	Six-Year Total Investment Return Source: Yahoo Finance; MarshBerry
Figure 25	Page 20	Low-Growth / Low-Value Agency Source: MarshBerry
Figure 26	Page 20	High-Growth / High-Value Agency Source: MarshBerry





#1 Insurance Information Resource

Proprietary benchmark statistics on over \$4.5 billion of aggregate brokerage revenue.

#1 Insurance Management Consulting Firm

Sales management, operational, and financial consulting services to 900 of the nation's leading agents, brokers and financial institutions.

#1 Insurance Exchange Networks

Own and operate 3 peer exchange networks comprised of agents and brokers representing more than \$3 billion in aggregate revenue.

#1 Insurance M&A Advisory Firm

- Over 200 transactions with Top 100 Brokers
- Over 550 transactions closed
- Ranked #1 by SNL for the past decade

