PERSPECTIVES
from Industry Leaders

As Reagan Consulting pulled together our May 2009 analysis of the M&A Marketplace, we decided to reach out to several key industry leaders to ask them to offer their valuable insights as to how they saw the marketplace and the future of our industry. We greatly appreciate the willingness of these gentlemen to openly share how they view current events and how they see their organizations responding. We are confident that you will gain some useful information and perspectives from what they have shared.

J. Hyatt Brown
Chairman & CEO
Brown & Brown

Ken Crerar
President
The Council of Insurance Agents & Brokers

David Eslick
Chairman
Marsh & McLennan Agency

Marty Hughes
Chairman & CEO
Hub International

Wade Reece
Chairman & CEO
BB&T Insurance Services

Reagan Consulting
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In light of the economic challenges we are facing, what is your outlook for the future of our industry?

Hyatt Brown: The current economic downturn is certainly challenging in terms of growing the top line and bottom line of Brown & Brown. We expect to do just fine. As the old saying goes, "it will all work out." As regards the future of the industry, the impact of the collateralized home loan debacle and the entanglement of derivatives and credit swaps have left household names in peril. I am sure that we will get some kind of additional regulation from Washington, although the insurance industry is way down the line in terms of priority. The number one bug-a-boo in my opinion, is the unraveling and deciphering of all the derivative instruments that are currently interconnected with corporate balance sheets, not just in the United States, but around the world. The hedging of corporate balance sheets in the United States has been brought on, in part, by the influence of the Wall Street analysts who desire smooth earnings. The summation is that the insurance industry, both risk bearers and insurance agents and brokers, will continue to do well and those firms that are well led and well focused will do even better on the far side of this economic valley.

Ken Crerar: The p/c industry took a beating in 2008. Tough competition combined with the soft market, weak investment market and general economic forces drove profitability down sharply. According to AM Best, it was the first back-to-back decrease in premium since the Great Depression. Future profitability largely will depend on the insurers' willingness to discipline their underwriting and reserve practices. The predicted upward turn in the p/c market near the end of year should hopefully help insurers regain their footing. Reinsurers will drive the rates increases, but it won't all come at once. It's a very volatile and unpredictable market out there right now so things can change very quickly in either direction.

No doubt the fallout from AIG will affect how the industry is regulated and by whom well into the future. We expect regulators to turn their focus on systemic risk exposure to avoid a repeat of the "too big to fail" AIG scenario and much greater federal role in regulating insurers. It's too early to know what this will look like, so it's difficult to predict the impact, but no doubt there will be winners and losers depending on how the reform is structured and whether systemic risk insurers have a government guarantee, implied or actual, behind them. We also expect more regulatory coordination internationally on solvency regulation. U.S. insurers are also facing challenges and competition from foreign insurers which are gaining market share and who may look to buy into the market.

If federal regulation includes a federal charter option or surplus lines reform, brokers will benefit greatly from uniform regulation. We are hopeful that reforms will come this year, but next year is more likely in light of the other priorities facing the administration and Congress.

David Eslick: I believe that the outlook for the future of our industry has never looked better, with one major caveat, that I will discuss below. When economic times are great, people many times lose focus on the key foundational pillars that drive industry, facilitate growth, and protect all of the key assets in our lives - our families, households, business, employees and all the other key assets of a great society. With all of the turmoil that the world has experienced over the last eighteen months and the devastation of businesses, family income and wealth, and our confidence, the insurance industry, with a few exceptions, continues to stand strong. The value of an insurance agent/broker's resources and intellectual capital are critical as everyone looks to protection in their lives, at a cost that is competitive. The challenge will be on all within the industry to prove their value to the market and commitment to growing the resources and capabilities necessary to compete, not just today, but more importantly, in the business environment of the future -standing still is not an option!

The one caveat, is my concern around developing the human capital talent necessary for the future, and the future is not far away. The industry needs to focus on effective means to attract and train the production and support talent, necessary to move our industry forward. This is not a new concern to the leaders in our industry, but one in which we need to move from the concern to actionable solutions. The quality of our talented colleagues is our key deliverable in the market!

Marty Hughes: I believe the industry is facing a fundamental change. First of all, Marsh and Aon, in spite of previous failures, are going to make a push into the Middle Market. If they do it right, they can be formidable competition. In spite of that, I believe the future is bright for those of us who are disciplined enough to manage the business from a customer centric position. Most will not, however, and that means continued consolidation and continued pressure on profits.

Wade Reece: Two words - bright and different. This recessionary, difficult business environment will cause continued consolidation and those who can continue to perform at profitable levels (whether broker or carrier) will be the winners. The future will place greater value on high performing firms. Those who can generate superior sales volumes and operate very efficiently will be valued greatly. On an individual level, I think the business environment for the successful, surviving businesses (potential clients) of the future will provide more and more complex risks. Having a good agent/broker to partner with you becomes more and more important. For those agent/brokers who want to raise their level of expertise, specialize with intense levels of knowledge in the targeted industries, and work extremely hard, the future is bright. For those who resist change, expect relationships alone to supersede bringing value propositions to the client, they will find their success levels declining quickly. The future "ball game" will move at a very rapid pace. Specialization and organized sales plans will be tools for the winners to maximize productivity in a fast paced world. Opportunities will be more global, again placing value on specialized knowledge. Again, for those who bring value, the future holds great promise.

How will your firm change in response to the economic challenges being faced?

Marty Hughes: We have already begun our transformation. We will do business with far fewer markets, but the ones we focus on will be the ones who are willing to work with us by supporting our customer centric strategy. We are focused on driving top line growth while simultaneously improving the way we interact with our clients.

Wade Reece: We will focus intensely on profit margin improvement, which means we will constantly look for ways to lower operating costs while emphasizing sales excellence and client retention. While we will tightly manage costs in 2009, our real success will be defined by our level of new business sales.

Hyatt Brown: Brown & Brown continues to hone on the overall expense picture and at the same time, have increased our pot of dollars available to help to finance new recruits who are not included in our budgets. We are seeing a lot of good opportunities with people from outside the insurance industry who are looking to have a more secure future.

How do you see the Council firms changing in response to the economic challenges being faced?

Ken Crerar: Considering the economic conditions, overall, brokers have weathered the financial storm better than others in the industry and some are prospering. But brokers are feeling the pinch on revenues as the soft market and customer premium contraction cut into revenues and valuations are falling. Organic growth is still a real challenge and firms are looking at strategies to reduce margins and grow business where possible. It's a buyer's market for those with capital to acquire. Bank appetite for M&A has fallen off dramatically and some are looking to divest their agency business. With a decrease in demand from banks and equity firms, agents are able to take advantage of deals in the market if sellers are willing to sell at lower valuations. Some courtships have failed because the value wasn't there. Brokers are still looking for good firms and good deals in the market, but some are absorbing recent acquisitions and currently don't have the capital or appetite for additional acquisitions.

The top performers are finding that utilizing best practices and focusing on investment in their firms, hiring and training talent and internal management controls are paying off. The top performers will continue to use these strategies to their advantage. Those that don't invest in the future will sell or go out of business. We still expect to see a roll-up from the smaller firms into the large firms as the consolidation trend continues. Agents and brokers will continue to face the challenge of finding and training top talent, especially in firms where the average age of a producer is 56.

What is your vision for Marsh & McLennan Agency? What size and type organization do you plan to build?

David Eslick: The vision for Marsh & McLennan Agency is to become a significant agency operation focused on the middle market. This market focus also means that we will have the ability to service small accounts, personal lines, and even larger accounts. We are looking to build strong relationships with the business owners and provide a single source advisor for their commercial, employee benefits, and personal needs. We are excited about the ability to leverage the Marsh & McLennan Agency brand for market recognition and confidence in our business model. Our goal is to be recognized as "top 5" middle market agency within five years.

What will your acquisition appetite be in 2009?

Marty Hughes: Our acquisition appetite in 2009 will be more modest than it has been in the past. Sellers don't want to hear that their business will shrink in 2009, but in fact, it will. Also, the old multiples are out the window. So, until Sellers accept the new world order, we will be cautious. Having said that, we will still acquire somewhere in the vicinity of $80M in revenue in 2009 because there are still many sellers who buy into our values, vision and long term goals.

Wade Reece: We will continue to look for good strategic matches as we always have. We have a long term view of acquisitions, which means we always want to find strategic matches where both the seller and we are "better off together than apart." Therefore, we don't look at moving in and out of the acquisition arena, but rather, we are more of a steady player who is always there looking for strategic advantages.

Hyatt Brown: Our acquisition appetite in 2009 continues to be robust. Brown & Brown generates a very substantial free cash flow and inasmuch as our long-term debt is low in relation to our EBITDA, we do have substantial dry credit powder.

How will your transaction structure and pricing vary in 2009 as compared to 2008?

Wade Reece: For the most part, not much variation. There is some downward pressure on pricing, but we tend to look at the premier agencies, which will always command a relatively higher price for that level of quality. The biggest effect will be fair value accounting changes, especially FASB 141R which will cause us to re-evaluate earnout components as part of deal structure.

Hyatt Brown: Transaction structure for 2009 compared to 2008 is basically the same as it has been for years. We pay cash for assets and pricing is now back down to traditional levels which is about 6 times forward operating profit as a purchase price.

Marty Hughes: Each deal is unique, so it is impossible to answer the question. However, up front guarantees will certainly be minimized.

How will Marsh & McLennan Agency structure and value your acquisitions?

David Eslick: Even though Marsh is a significant organization, Marsh & McLennan Agency is starting basically from scratch. We are looking for strong local and regional operations to take a lead position on our management team and have the responsibility for building and managing our regional footprint. We will value organizations based on their historical earnings and growth results, management team and capabilities, and the ability to contribute to the future growth of the agency. We are flexible relative to structure, but have the financial resources, to provide significant consideration at closing.

What would you consider to be the biggest challenges your firm will face in the next three to five years?

Hyatt Brown: The biggest challenge for our firm is recruiting even more high quality people to be in a position to fill leadership positions as we grow and for the future as our current leadership team matures.

Wade Reece: The same challenge today will be the biggest challenge in the future - recruitment of top talent. That will always be the biggest challenge. Outside of talent recruitment, I think continued layering of new levels of regulatory burden will prove to be prohibitive of improving productivity. Finally, the next 3 - 5 years will provide accelerated opportunities for industry consolidation. Making sure our organization is in peak economic health to take advantage of those opportunities is a huge challenge.

Marty Hughes: The quest for talent. Our strategy is to completely transform the way we do business. However, executing that strategy will require that we identify and attract quality people in every area of the company.

What are the biggest challenges the Council firms will face in the next three to five years?

Ken Crerar:

Our members have faced some pretty big challenges over the past 18 months as the soft market has continued and the economy began and continues its contraction. One thing about the insurance cycle is that it's not usually correlated to the general economic upturns and downturns. This time, they've come together on the same wavelength trough, which presents our members with some unusual challenges.

Growth is always a top priority for top agencies and brokerages, whether by acquisition or organically. The current business environment has hit both of these methods, through the shrinking of capital available to help with expansion, through acquisition and through an economic downturn that has customers reviewing their coverages to see what they really need and what they can cut. Couple this last item with the continued soft market, and organic growth becomes very difficult. Depending on how long it takes the economy to recover, organic growth could remain a challenge, even for the agencies and brokerages that have historically been on top of this game.

Another big challenge facing members, but one where there may be a great opportunity right now is recruiting and training talent. I know most everyone has seen statistics that peg the average age of top producers somewhere in the mid-50s. This tells me that there is not a good pipeline of talent coming in to our industry that will be ready to step up when these producers retire. What happens then?

Our industry has never really made the effort to reach out to talented young people and to tell them why insurance is such a great business. And when we do attract young people, they are too often given minimal training and a sales goal with little additional investment in their future success. If we are to bring the next generation of top talent into our industry, we need to make those investments early in their careers and continue provide them with the tools they need in their careers. The recent financial turmoil has provided us with an opportunity to pursue people who might otherwise have gone into banking or other financial services jobs and who would never have thought about a career in the insurance industry. This industry is a big part of what keeps the economic engine of this country running, and we need to showcase that more.

One other area that will continue to be a challenge is the internal sales management process. As more and more firms move toward a consultative sales model, there will be more pressure on sales teams to produce new business than to rely on their renewal books. Senior producers will probably feel the impact of this process more than younger producers, and it remains to be seen whether management will press this issue with them or fall back to the status quo.