growth STRATEGIES FOR brokers

Expanding business through M&As, new business and new people

BUSINESS INSURANCE
WHITE PAPER

INTRODUCTION

Grow or die. It's that simple. For brokerages and independent insurance agencies, there can be no standing still. In an increasingly competitive marketplace, the brokerage that doesn't find a way to grow — and there are many ways to do so — isn't merely at a competitive disadvantage. It could be entangled in a losing battle for survival.

Opportunities for growth present themselves in multiple ways. Perhaps the highest-profile method is through acquisition. Some remarkably successful national brokerages — Arthur J. Gallagher & Co., Brown & Brown Inc. and Hub International Ltd., to name probably the best known — rarely go very long without announcing some major acquisition. Indeed, Brown & Brown announced a blockbuster spring 2013 deal that closed in July, paying $336.5 million for rival Beecher Carlson Holdings Inc.

And these acquisitions aren't confined to traditional property/casualty operations, either, as benefits-oriented brokerages prove to be increasingly attractive.

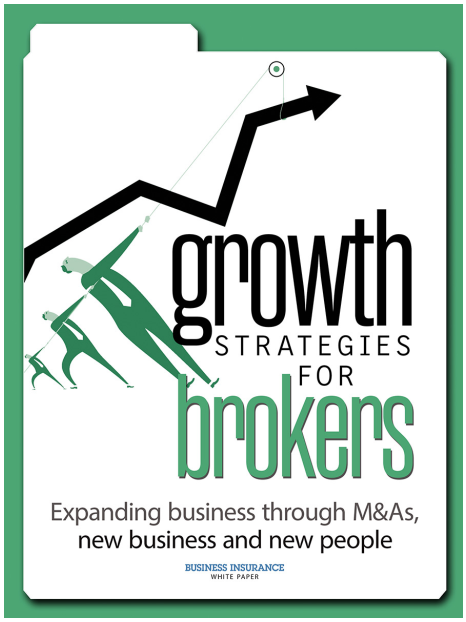
Part of the formula for success in the mergers and acquisitions arena is knowing who's likely to be selling and why. Is the inventory of attractive candidates likely to dry up any time soon? What effect will a continuing exodus of baby boomers from the ranks of agency owners have on acquisition opportunities? And how do you determine whether an acquisition is a going to be a good long-term fit? Due diligence is a must, but even the most thorough efforts can occasionally come up short. What happens then?

Expanding into new areas of business also can be key to growth and success. For example, traditional property/casualty insurance brokers have seen opportunities in the benefits area despite uncertainty over the effects the U.S. Patient Protection and Affordable Care Act may have on commissions.

Another promising area is meeting the insurance needs of wealthy individuals.

A third area for growth is making more of what you already have by increasing productivity. Achieving increased productivity is a never-ending quest. That's particularly true given current economic conditions. Risk managers and other customers feel pressure from management to do more with less. They in turn pressure their brokers and other service providers to provide more, including services that the customers could never provide for themselves.

Recruiting top talent for the future also must be part of any long-term growth strategy. Few college students put insurance in any form at the top of their career lists. Where can you find the industry leaders of tomorrow, and how do you persuade them insurance can provide a career opportunity as rewarding — and perhaps more stable — than seemingly more glamorous careers in other financial services?



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CHAPTER 1

Hooking up in the M&A market

Brokerages have become more attractive as their sector's own economic outlook has brightened. Years of soft property/casualty insurance market conditions have given way to a slow but steady firming, with experts such as Dallas-based electronic insurance exchange MarketScout reporting monthly rate increases for major lines of commercial coverage throughout 2012 and into 2013.

In addition to the improved property/casualty market climate, brokerages are expected to benefit from employee benefits consulting spurred by the Patient Protection and Affordable Care Act. Traditional property/casualty brokerages are finding employee benefits operations increasingly attractive. Given this convergence of forces, sellers can extract a premium from buyers. USI Holdings Corp., for example, sold at more than four times revenue, yet hedge funds are willing to pay that price to get into what appears to be an improving market. Most recently, Hub International Ltd. announced that its current owners were selling to another private equity group in a deal that valued the brokerage at $4.4 billion.

Brokerages with a steady cash flow throughout good and bad economic times present tempting targets. While no one can predict the future with 100% certainty, high valuations posted by brokerages acquired by private equity-backed deals could auger well for more such deals going forward.

Buyers are also looking at new business as a percentage of prior-year book. If an agency is at least 15% new business, a buyer looks at that as an organic growth business, John Wepler, president of Marsh Berry & Co. Inc., said. If it's 20%, they're considered a peak performer. If it's down to 10%, they start saying "it's a good business, but it really doesn't have a growth engine behind it," he said.

Growth through mergers and acquisitions has long been part of the brokerage landscape, as the Big Three grow even bigger. In the 1990s, a flurry of activity at the highest levels of the brokerage world resulted in Marsh & McLennan Cos. Inc. acquiring Johnson & Higgins and Sedgwick Group P.L.C., while Aon P.L.C. bought rival Alexander & Alexander Services Inc., in addition to several other smaller rivals.

THE ACCENTURE MERGER INTEGRATION SUCCESS FACTORS

1. **CREATE VALUE:** Move beyond integration to focus on customer value and retention in order to realize value.
2. **SET CLEAR ASPIRATIONS:** Establish clear baselines and set internal stretch targets; manage market expectations around achieving synergies.
3. **ENSURE FREQUENT COMMUNICATION:** Launch a comprehensive and consistent communications strategy immediately.
4. **AVOID GLUTTONY:** Achieve 80% planning certainty and quickly move to 100% implementation.
5. **MANAGE TOP FIVE TO 10 CRITICAL DECISIONS:** Focus on decisions that drive value; because there are hundreds of decisions, the sheer magnitude of change will require a comprehensive risk management approach.
6. **TAKE ACTION:** Take advantage of unprecedented opportunity for change: mergers create increased momentum for bold transformational change, but there is a limited window of 18 to 24 months to achieve synergies.
7. **ADDRESS CULTURE ISSUES EARLY:** Identify desired-state dimensions and actively manage employee transition using a transparent and quick appointment process; avoid slow decision-making.
8. **IMPLEMENT STRONG GOVERNANCE AND TIGHT PROCESS CONTROLS:** Create a single, strong project management office for integration; manage pace, interdependencies, common processes and releases to avoid overload.

Source: "Who says M&A doesn't create value?" Thomas J. Herd and Ryan McManus, Outlook: The Journal of High-Performance Business, 2012

Perhaps no brokerage was as active in the M&A field as Hilb, Rogal & Hobbs Co., which seemed to announce acquisitions almost monthly some years. But even the acquirer can become the acquired, as HRH became part of Willis Group Holdings P.L.C. in 2008.

TAKING ANOTHER LOOK

Banks continue to re-evaluate their participation in the insurance industry, as it is considered a noncore operation involving higher business risk and expenses compared with traditional banking activities. In the past seven years, the following transactions have taken place:

Date	Seller	Agency/Broker	Insurance revenue (in millions)
2012	TD Bank N.A.	TD Insurance Inc.	$59
2012	BBVA Compass	BBVA Compass Insurance Agency	$27
2011	First Place Bank	First Place Insurance Agency Ltd.	$4
2011	First Financial Holdings Inc.	First Southeast Insurance Services Inc.	$21
2010	PNC Financial Services Group Inc.	National City Insurance Group Inc.	$13
2009	First Bank Inc.	Adrian N. Baker & Co.	$10
2008	Webster Financial Corp.	Webster Insurance	$30
2007	Capital One Financial Corp.	Hibernia Corp.	$18
2007	BNC National Bank	BNC Insurance Services Inc.	$19
2006	Citizens Financial Group Inc.	Citizens Clair Insurance Group; Brewer & Lord L.L.C.	$45

Source: U.S. Retail Insurance Distribution Industry: Market Commentary - October 2012, Colonnade Advisors L.L.C.

A year later, the founder of HRH, Robert H. Hilb, and Robert J. Hilb launched the Hilb Group L.L.C., which itself has been active in the M&A market. On its website, the Hilb Group says it "seeks to grow through targeted acquisition and strategic alliances in the middle market insurance brokerage space."

Meanwhile, Arthur J. Gallagher & Co., Brown & Brown Inc. and Hub, among others, continued to acquire smaller firms in order to expand into new businesses or new geographic territories. Marsh Inc. launched its Marsh & McLennan Agency operation to expand in the middle market by acquiring strong brokerages.

In 2012, broker M&A activity hit a new high, according to an analysis prepared by Chicago-based investment banking and financial consulting firm Optis Partners L.L.C. According to Optis, 291 deals were closed in 2012, 12 more than in 2011 and surpassing the 2008 record of 285.

Gallagher reported the most deals, with 30 announced in 2012. Interestingly enough, the next three most active firms in the brokerage M&A area were all private-equity backed: Hub with 21 deals; Confie Seguros Insurance Services with 18; and Assured Partners Inc. with 17. Brown & Brown rounded out the top five with 15 announced deals.

M&A activity among public brokers as a whole was up, with 67 announced deals compared with 53 a year earlier. Private equity-owned brokers registered an increase in activity, too, with 86 announced deals, up from 75 in 2011. Although private brokers continued to account for the largest number of deals in any ownership category, the number of announced deals dropped to 93 in 2012 from 101 the year before.

Activity among bank-owned brokerages declined in 2012, dropping to 24 deals from 37 in 2011. Wells Fargo & Co., for example, reported no deals in 2012 compared with five a year earlier. In fact, the only bank-owned firm that did more than two deals was Western Financial Group, which closed five deals in 2012, down from seven a year earlier.

Some unusual forces helped drive the 2012 activity. There was concern that certain tax breaks enacted under the George W. Bush administration would expire at the end of the year, thus adding urgency to close deals in 2012 rather than waiting. In addition, the capital gains tax increased to 20% from 15% on Jan. 1, 2013, providing more impetus to finalize acquisitions by the end of the year. Sellers