GALLAGHER ARTHUR J & CO
Form 10-Q
October 28, 2015
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

(Mark One)

x **Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the quarterly period ended September 30, 2015**

**or**

¨ **Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the transition period from______ to ______**

**Commission File Number: 1-09761**

# ARTHUR J. GALLAGHER & CO.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **36-2151613** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**Two Pierce Place, Itasca, Illinois 60143-3141**

**(Address of principal executive offices) (Zip code)**

**(630) 773-3800**

**(Registrant s telephone number, including area code)**

**Not Applicable**

**(Former name, former address and former fiscal year, if changed since last report)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Smaller reporting company | ¨ |
| (Do not check if a smaller reporting company) | | | |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of outstanding shares of the registrant s common stock, $1.00 par value, as of September 30, 2015 was approximately 176,695,000.

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**Arthur J. Gallagher & Co.**

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**Part I - Financial Information**

**Item 1. Financial Statements (Unaudited)**

**Arthur J. Gallagher & Co.**

**Consolidated Statement of Earnings**

**(Unaudited - in millions, except per share data)**

| | Three-month period ended September 30, 2015 | Three-month period ended September 30, 2014 | Nine-month period ended September 30, 2015 | Nine-month period ended September 30, 2014 |
|---|---|---|---|---|
| Commissions | $ 594.6 | $ 572.5 | $ 1,748.6 | $ 1,523.5 |
| Fees | 360.7 | 337.7 | 1,051.2 | 912.3 |
| Supplemental commissions | 29.2 | 24.2 | 90.9 | 77.5 |
| Contingent commissions | 14.5 | 14.4 | 81.8 | 68.4 |
| Investment income | 13.1 | 18.4 | 38.5 | 23.1 |
| Gains on books of business sales | 2.6 | 0.9 | 7.0 | 2.6 |
| Revenues from clean coal activities | 408.1 | 321.2 | 1,009.0 | 750.4 |
| Other net revenues (losses) | 32.0 | (2.5) | 30.5 | 23.3 |
| Total revenues | 1,454.8 | 1,286.8 | 4,057.5 | 3,381.1 |
| Compensation | 604.9 | 564.6 | 1,795.2 | 1,560.9 |
| Operating | 208.1 | 197.3 | 618.7 | 525.3 |
| Cost of revenues from clean coal activities | 418.9 | 326.2 | 1,035.0 | 767.7 |
| Interest | 25.6 | 25.9 | 77.2 | 63.3 |
| Depreciation | 23.8 | 18.6 | 68.1 | 50.0 |
| Amortization | 58.1 | 54.3 | 172.3 | 135.3 |
| Change in estimated acquisition earnout payables | 9.7 | 4.5 | 25.9 | 16.6 |
| Total expenses | 1,349.1 | 1,191.4 | 3,792.4 | 3,119.1 |
| Earnings before income taxes | 105.7 | 95.4 | 265.1 | 262.0 |
| Benefit for income taxes | (35.2) | (5.9) | (55.8) | (10.8) |
| Net earnings | 140.9 | 101.3 | 320.9 | 272.8 |
| Net earnings attributable to noncontrolling interests | 7.6 | 7.7 | 26.4 | 20.9 |
| Net earnings attributable to controlling interests | $ 133.3 | $ 93.6 | $ 294.5 | $ 251.9 |
| Basic net earnings per share | $ 0.76 | $ 0.58 | $ 1.73 | $ 1.68 |
| Diluted net earnings per share | 0.75 | 0.58 | 1.71 | 1.67 |
| Dividends declared per common share | 0.37 | 0.36 | 1.11 | 1.08 |

See notes to consolidated financial statements.

**Arthur J. Gallagher & Co.**

**Consolidated Statement of Comprehensive Earnings**

**(Unaudited - in millions)**

| | Three-month period ended September 30, 2015 | Three-month period ended September 30, 2014 | Nine-month period ended September 30, 2015 | Nine-month period ended September 30, 2014 |
|---|---|---|---|---|
| Net earnings | $ 140.9 | $ 101.3 | $ 320.9 | $ 272.8 |
| Change in pension liability, net of taxes | 0.6 | 0.5 | 1.3 | 1.4 |
| Foreign currency translation | (152.7) | (136.5) | (237.9) | (82.0) |
| Change in fair value of derivative investments, net of taxes | (5.5) | (1.9) | 0.9 | (0.5) |
| Comprehensive earnings (loss) | (16.7) | (36.6) | 85.2 | 191.7 |
| Comprehensive earnings attributable to noncontrolling interests | 21.6 | 1.7 | 16.2 | 0.4 |
| Comprehensive earnings (loss) attributable to controlling interests | $ (38.3) | $ (38.3) | $ 69.0 | $ 191.3 |

See notes to consolidated financial statements.

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**Arthur J. Gallagher & Co.**

**Consolidated Balance Sheet**

**(In millions)**

| | September 30, 2015 (Unaudited) | December 31, 2014 |
|---|---|---|
| Cash and cash equivalents | $ 369.7 | $ 314.4 |
| Restricted cash | 1,349.6 | 1,367.6 |
| Premiums and fees receivable | 1,600.8 | 1,462.5 |
| Other current assets | 700.0 | 666.7 |
| Total current assets | 4,020.1 | 3,811.2 |
| Fixed assets - net | 200.7 | 195.4 |
| Deferred income taxes | 487.8 | 392.6 |
| Other noncurrent assets | 480.4 | 385.2 |
| Goodwill - net | 3,579.6 | 3,449.6 |
| Amortizable intangible assets - net | 1,741.8 | 1,776.0 |
| Total assets | $ 10,510.4 | $ 10,010.0 |
| Premiums payable to insurance and reinsurance companies | $ 2,707.1 | $ 2,623.3 |
| Accrued compensation and other accrued liabilities | 648.3 | 623.7 |
| Unearned fees | 51.7 | 66.1 |
| Other current liabilities | 54.5 | 61.7 |
| Premium financing debt | 114.6 | 127.9 |
| Corporate related borrowings - current | 153.0 | 140.0 |
| Total current liabilities | 3,729.2 | 3,642.7 |
| Corporate related borrowings - noncurrent | 2,125.0 | 2,125.0 |
| Other noncurrent liabilities | 948.3 | 937.2 |
| Total liabilities | 6,802.5 | 6,704.9 |
| Stockholders equity: | | |
| Common stock - issued and outstanding 176.7 shares in 2015 and 164.6 shares in 2014 | 176.7 | 164.6 |
| Capital in excess of par value | 3,193.6 | 2,649.4 |
| Retained earnings | 778.4 | 676.0 |
| Accumulated other comprehensive loss | (496.3) | (260.6) |
| Stockholders equity attributable to controlling interests | 3,652.4 | 3,229.4 |
| Stockholders equity attributable to noncontrolling interests | 55.5 | 75.7 |
| Total stockholders equity | 3,707.9 | 3,305.1 |
| Total liabilities and stockholders equity | $ 10,510.4 | $ 10,010.0 |

See notes to consolidated financial statements.

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**Arthur J. Gallagher & Co.**

**Consolidated Statement of Cash Flows**

**(Unaudited - in millions)**

| | Nine-month period ended September 30, 2015 | Nine-month period ended September 30, 2014 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net earnings | $ 294.5 | $ 251.9 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Net gain on investments and other | (7.0) | (23.2) |
| Net loss on noncontrolling interests | 26.4 | 20.9 |
| Depreciation and amortization | 240.4 | 185.3 |
| Change in estimated acquisition earnout payables | 25.9 | 16.6 |
| Amortization of deferred compensation and restricted stock | 16.8 | 17.3 |
| Stock-based and other noncash compensation expense | 8.2 | 7.8 |
| Effect of changes in foreign exchange rates | 0.2 | (0.7) |
| Net change in restricted cash | 15.3 | 2.7 |
| Net change in premiums receivable | (86.3) | (50.1) |
| Net change in premiums payable | 218.7 | 39.0 |
| Net change in other current assets | (43.7) | (123.5) |
| Net change in accrued compensation and other accrued liabilities | 37.4 | 116.0 |
| Net change in fees receivable/unearned fees | (56.0) | (23.8) |
| Net change in income taxes payable | (11.7) | 5.9 |
| Net change in deferred income taxes | (111.4) | (75.5) |
| Net change in other noncurrent assets and liabilities | (91.4) | (75.6) |
| Unrealized foreign currency remeasurement loss | (149.8) | (32.8) |
| Net cash provided by operating activities | 326.5 | 258.2 |
| Cash flows from investing activities: | | |
| Net additions to fixed assets | (71.8) | (59.7) |
| Cash paid for acquisitions, net of cash acquired | (176.5) | (1,834.6) |
| Net proceeds from sales of operations/books of business | 8.7 | 3.1 |
| Net funding of investment transactions | (20.6) | (19.5) |
| Net cash used by investing activities | (260.2) | (1,910.7) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock | 199.0 | 960.6 |
| Tax impact from issuance of common stock | 7.4 | 6.7 |
| Payments for noncontrolling interests | (30.1) | (25.0) |
| Dividends paid | (192.5) | (164.3) |
| Net borrowings on premium financing debt facility | 4.4 | 36.3 |
| Borrowings on line of credit facility | 534.0 | 1,017.4 |
| Repayments on line of credit facility | (521.0) | (1,400.9) |
| Net borrowings of corporate related long-term debt | | 1,200.0 |
| Net cash provided by financing activities | 1.2 | 1,630.8 |
| Effect of changes in foreign exchange rates on cash and cash equivalents | (12.2) | 14.1 |

| | | |
|---|---|---|
| Net increase (decrease) in cash and cash equivalents | 55.3 | (7.6) |
| Cash and cash equivalents at beginning of period | 314.4 | 298.1 |
| Cash and cash equivalents at end of period | $ 369.7 | $ 290.5 |
| Supplemental disclosures of cash flow information: | | |
| Interest paid | $ 81.0 | $ 59.7 |
| Income taxes paid | 55.8 | 51.6 |

See notes to consolidated financial statements.

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**Arthur J. Gallagher & Co.**

**Consolidated Statement of Stockholders Equity**

**(Unaudited - in millions)**

| | Common Stock Shares | Common Stock Amount | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Earnings (Loss) | Noncontrolling Interests | Total |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2014 | 164.6 | $ 164.6 | $ 2,649.4 | $ 676.0 | $ (260.6) | $ 75.7 | $ 3,305.1 |
| Net earnings | | | | 294.5 | | 26.4 | 320.9 |
| Purchase of subsidiary shares from noncontrolling interests | | | | | | (15.0) | (15.0) |
| Dividends paid to noncontrolling interests | | | | | | (21.4) | (21.4) |
| Change in pension liability, net of taxes of $0.8 million | | | | | 1.3 | | 1.3 |
| Foreign currency translation | | | | | (237.9) | (10.2) | (248.1) |
| Change in fair value of derivative instruments, net of taxes of $0.6 million | | | | | 0.9 | | 0.9 |
| Compensation expense related to stock option plan grants | | | 8.2 | | | | 8.2 |
| Tax impact from issuance of common stock | | | 7.4 | | | | 7.4 |
| Common stock issued in: | | | | | | | |
| Thirty-eight purchase transactions | 7.1 | 7.1 | 334.1 | | | | 341.2 |
| Stock option plans | 1.4 | 1.4 | 37.3 | | | | 38.7 |
| Employee stock purchase plan | 0.3 | 0.3 | 10.8 | | | | 11.1 |
| Deferred compensation and restricted stock | 0.2 | 0.2 | 0.3 | | | | 0.5 |
| Stock issuance under dribble-out program | 3.1 | 3.1 | 146.1 | | | | 149.2 |
| Cash dividends declared on common stock | | | | (192.1) | | | (192.1) |
| Balance at September 30, 2015 | 176.7 | $ 176.7 | $ 3,193.6 | $ 778.4 | $ (496.3) | $ 55.5 | $ 3,707.9 |

See notes to consolidated financial statements.

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**Notes to September 30, 2015 Consolidated Financial Statements (Unaudited)**

**1. Nature of Operations and Basis of Presentation**

Arthur J. Gallagher & Co. and its subsidiaries, collectively referred to herein as we, our, us or the company, provide insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional and governmental organizations through three reportable operating segments. Commission and fee revenue generated by the brokerage segment is primarily related to the negotiation and placement of insurance for our clients. Fee revenue generated by the risk management segment is primarily related to claims management, information management, risk control consulting (loss control) services and appraisals in the property/casualty market. Investment income and other revenue are generated from our premium financing operations and our investment portfolio, which includes invested cash and restricted funds, as well as clean energy and other investments. We are headquartered in Itasca, Illinois, have operations in 31 countries and offer client-service capabilities in more than 140 countries globally through a network of correspondent insurance brokers and consultants.

We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been omitted pursuant to such rules and regulations. The unaudited consolidated financial statements included herein are, in the opinion of management, prepared on a basis consistent with our audited consolidated financial statements for the year ended December 31, 2014 and include all normal recurring adjustments necessary for a fair presentation of the information set forth. The quarterly results of operations are not necessarily indicative of the results of operations to be reported for subsequent quarters or the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014. In the preparation of our unaudited consolidated financial statements as of September 30, 2015, management evaluated all material subsequent events or transactions that occurred after the balance sheet date through the date on which the financial statements were issued, for potential recognition or disclosure therein.

**Reclassification -** In first quarter 2015, we transferred management of a claims handling operation from the brokerage segment to the risk management segment. Total revenues related to this operation were $4.9 million and $4.6 million in third quarters 2015 and 2014, respectively, and $14.7 million and $13.5 million in the nine-month periods ended September 30, 2015 and 2014, respectively. We made the applicable segment reclassifications to the prior-period amounts to conform to the current period presentation. The changes in the segment structure affect only the manner in which the results for the reportable segments were previously reported. These reclassifications did not impact our previously reported consolidated net earnings or financial position.

**Correction of Immaterial Error -** Effective January 1, 2015, we obtained control over a previously uncontrolled partially-owned subsidiary and beginning January 1, 2015 we began consolidating its financial results, which were previously accounted for using the equity method of accounting. In conjunction with this change, effective January 1, 2015, we also changed our consolidated statement of earnings and consolidated balance sheet to separately present the noncontrolling interests portions for other partially owned subsidiaries that we had been consolidating. In accordance with Accounting Standards Codification Topic No. 250, Accounting Changes and Error Corrections (ASC 250), we evaluated the materiality of these changes from quantitative and qualitative perspectives and concluded that the change in presentation was not material to any of our prior period financial statements and in particular, these changes had no impact on net earnings per share. We revised our consolidated statement of earnings for the three-month and nine-month periods ended September 30, 2014 and the consolidated balance sheet as of December 31, 2014 to conform to the current period presentation. In prior reporting periods, we included such amounts in operating expenses and other non-current liabilities, respectively. Net earnings and total stockholders equity in prior reporting periods are now referred to as net earnings attributable to controlling interests and stockholders equity attributable to controlling interests, respectively, in the current period presentation. As stated above, this change in presentation had no impact on net earnings per share.

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The effect of the immaterial changes to the presentation of our consolidated statement of earnings for the three-month and nine-month periods ended September 30, 2014 is summarized below:

| | Three-month period ended September 30, | | Nine-month period ended September 30, | |
|---|---|---|---|---|
| | As Previously Reported | As Restated | As Previously Reported | As Restated |
| Operating expense | $ 205.0 | $ 197.3 | $ 546.2 | $ 525.3 |
| Earnings before income taxes | $ 87.7 | $ 95.4 | $ 241.1 | $ 262.0 |
| Benefit for income taxes | (5.9) | (5.9) | (10.8) | (10.8) |
| Net earnings | $ 93.6 | 101.3 | $ 251.9 | 272.8 |
| Net earnings attributable to noncontrolling interests | | 7.7 | | 20.9 |
| Net earnings attributable to controlling interests | | $ 93.6 | | $ 251.9 |
| Basic net earnings per share | $ 0.58 | $ 0.58 | $ 1.68 | $ 1.68 |
| Diluted net earnings per share | $ 0.58 | $ 0.58 | $ 1.67 | $ 1.67 |

**2. Effect of New Accounting Pronouncements**

**Consolidations**

In February 2015, the Financial Accounting Standards Board (which we refer to as the FASB) issued new accounting guidance on consolidations, which eliminates the deferral granted to investment companies from applying the variable interest entities guidance and makes targeted amendments to the current consolidation guidance. The new guidance applies to all entities involved with limited partnerships or similar entities and will require re-evaluation of these entities under the revised guidance, which could change previous consolidation conclusions. The guidance is effective in first quarter of 2016. Management is currently reviewing the guidance, and the impact from its adoption on our consolidated financial statements cannot be determined at this time.

**Debt Issuance Costs**

In April 2015, the FASB issued new accounting guidance on the presentation of debt issuance costs, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability. The new guidance will be applied on a retrospective basis and is effective in first quarter of 2016. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

**Business Combinations**

In September 2015, the FASB issued new accounting guidance on the accounting for measurement-period adjustments, which requires that measurement period adjustments be recognized in the reporting period in which the adjustment amount is determined rather than retrospectively applying the change to the acquisition date. The new guidance will be applied and is effective in first quarter of 2016. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

**Revenue Recognition**

In May 2014, the FASB issued new accounting guidance on revenue from contracts with customers, which will supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principal of the new guidance is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. On July 9, 2015, the FASB decided to delay the effective date of the new revenue standard by one year. Reporting entities may choose to adopt the standard as of the original effective date. The FASB decided, based on its outreach to various stakeholders and the forthcoming amendments to the new revenue standard, that a deferral is necessary to provide adequate time to effectively implement the new revenue standard. This new guidance was originally effective for the first quarter of 2017 and early adoption is not permitted. With the one year deferral date, this new guidance is now effective for the first quarter of 2018, but it can be adopted earlier in first quarter of 2017. The guidance permits two methods of transition upon adoption; full

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retrospective and modified retrospective. Under the full retrospective method, prior periods would be restated under the new revenue standard, providing a comparable view across all periods presented. Under the modified retrospective method, prior periods would not be restated. Rather, revenues and other disclosures for pre-2017/2018 periods would be provided in the notes to the financial statements as previously reported under the current revenue standard. Management is currently reviewing the guidance, and the impact from its adoption on our consolidated financial statements cannot be determined at this time.

**3. Business Combinations**

During the nine-month period ended September 30, 2015, we acquired substantially all of the net assets of the following firms in exchange for our common stock and/or cash. These acquisitions have been accounted for using the acquisition method for recording business combinations (in millions except share data):

| Name and Effective Date of Acquisition | Common Shares Issued (000s) | Common Share Value | Cash Paid | Accrued Liability | Escrow Deposited | Recorded Earnout Payable | Total Recorded Purchase Price | Maximum Potential Earnout Payable |
|---|---|---|---|---|---|---|---|---|
| e3 Financial, Inc. January 1, 2015 | 2 | $ | $ 9.1 | $ | $ 0.1 | $ 0.7 | $ 9.9 | $ 7.0 |
| Aequus Trade Credit LLC January 31, 2015 | 11 | 0.3 | 1.5 | | 0.2 | 1.3 | 3.3 | 1.9 |
| Cohen & Lord Insurance Brokers Limited February 1, 2015 | 77 | 3.6 | 2.1 | | | | 5.7 | |
| Cohn Financial Group, LLC (CFG) February 1, 2015 | 407 | 19.0 | | | 0.3 | 4.1 | 23.4 | 14.0 |
| Excel Insurance Services, Inc. February 1, 2015 | 52 | 1.5 | 7.3 | | 1.0 | | 9.8 | |
| Metcom Excess February 1, 2015 | 49 | 1.8 | 2.3 | | 0.5 | | 4.6 | |
| NationAir Aviation Insurance February 1, 2015 | 288 | 12.3 | | | 1.3 | | 13.6 | |
| Evolution Group of Companies February 6, 2015 | 101 | 4.7 | 0.9 | 0.5 | 0.4 | 2.9 | 9.4 | 3.1 |
| Burns-Fazzi, Brock & Associates, LLC (BFB) April 1, 2015 | 709 | 33.4 | | | 1.0 | 7.4 | 41.8 | 27.0 |
| Madison Risk & Insurance Services, Inc. (MRI) April 1, 2015 | 232 | 10.3 | 3.7 | | 1.0 | 1.4 | 16.4 | 4.0 |
| Integrated Healthcare Strategies, LLC (IHS) May 1, 2015 | 990 | 41.4 | 0.5 | 3.1 | 6.2 | 4.5 | 55.7 | 20.8 |
| James R. Weir Insurance Agency, Inc. May 1, 2015 | 56 | 2.5 | | | 0.3 | 0.8 | 3.6 | 1.1 |
| McDowall Associates Human Resources Consultants Ltd. May 1, 2015 | 34 | 1.5 | 0.6 | 0.6 | 0.1 | 0.5 | 3.3 | 2.5 |

| Name and Effective Date of Acquisition | Common Shares Issued (000s) | Common Share Value | Cash Paid | Accrued Liability | Escrow Deposited | Recorded Earnout Payable | Total Recorded Purchase Price | Maximum Potential Earnout Payable |
|---|---|---|---|---|---|---|---|---|
| Vital Benefits, Inc. May 1, 2015 | 118 | 5.6 | | | 0.1 | | 5.7 | |
| Monument, LLC (ML) June 1, 2015 | 254 | 10.8 | 4.0 | | 1.7 | 2.4 | 18.9 | 5.0 |
| Solid Benefit Guidance Limited Liability Company (SBG) June 1, 2015 | 932 | 44.0 | 0.3 | 2.5 | 1.0 | 11.6 | 59.4 | 32.5 |
| ARM Re Ltda Corredores de Reaseguros July 1, 2015 | | | 0.9 | | 0.7 | 0.2 | 1.8 | 0.5 |
| National Administration Company, Inc. (NAC) August 1, 2015 | | | 19.1 | | 2.1 | 2.8 | 24.0 | 10.8 |
| William Gallagher Associates Insurance Brokers, Inc. (WGA) August 1, 2015 | 1,605 | 69.0 | 75.0 | | 7.5 | | 151.5 | |
| North Alabama Insurance, Inc. September 1, 2015 | 188 | 7.2 | | | 0.8 | | 8.0 | |
| Nine other acquisitions completed in 2015 | 128 | 6.0 | 13.1 | 0.4 | 1.1 | 3.6 | 24.2 | 32.2 |
| | 6,233 | $ 274.9 | $ 140.4 | $ 7.1 | $ 27.4 | $ 44.2 | $ 494.0 | $ 162.4 |

On June 15, 2015, we signed a definitive agreement to acquire substantially all the assets of William Gallagher Associates Insurance Brokers, Inc. (which we refer to as WGA) headquartered in Boston, Massachusetts for approximately $151.5 million of consideration in a combination of cash and our common stock. WGA has estimated annualized revenues of approximately $50.0 million. The transaction was subject to customary closing conditions and closed on July 31, 2015. WGA has approximately 200 employees and operations in Boston; Atlanta; New York City; Columbia, Maryland; Hartford, Connecticut and Princeton, New Jersey.

Common shares issued in connection with acquisitions are valued at closing market prices as of the effective date of the applicable acquisition. We record escrow deposits that are returned to us as a result of adjustments to net assets acquired as reductions of goodwill when the escrows are settled. The maximum potential earnout payables disclosed in the foregoing table represent the maximum amount of additional consideration that could be paid pursuant to the terms of the purchase agreement for the applicable acquisition. The amounts recorded as earnout payables, which are primarily based upon the estimated future operating results of the acquired entities over a two- to three-year period subsequent to the acquisition date, are measured at fair value as of the acquisition date and are included on that basis in the recorded purchase price consideration in the foregoing table. We will record subsequent changes in these estimated earnout obligations, including the accretion of discount, in our consolidated statement of earnings when incurred. The fair value of these earnout obligations is based on the present value of the expected future payments to be made to the sellers of the acquired entities in accordance with the provisions outlined in the respective purchase agreements, which is a Level 3 fair value measurement. In determining fair value, we estimated the acquired entity s future performance using financial projections developed by management for the acquired entity and market participant assumptions that were derived for revenue growth and/or profitability. Revenue growth rates generally ranged from 4.0% to 12.0% for our 2015 acquisitions. We estimated future payments using the earnout formula and performance targets specified in each purchase agreement and these financial projections. We then discounted these payments to present value using a risk-adjusted rate that takes into consideration market-based rates of return that reflect the ability of the acquired entity to achieve the targets. These discount rates generally ranged from 8.0% to 8.5% for all of our 2015 acquisitions. Changes in financial projections, market participant assumptions for revenue growth and/or profitability, or the risk-adjusted discount rate, would result in a change in the fair value of recorded earnout obligations.

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During the three-month periods ended September 30, 2015 and 2014, we recognized $3.7 million and $3.9 million, respectively, of expense in our consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations in connection with our acquisitions. During the nine-month periods ended September 30, 2015 and 2014, we recognized $12.2 million and $10.6 million, respectively, of expense in our consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations in connection with our acquisitions. In addition, during the three-month periods ended September 30, 2015 and 2014, we recognized $6.0 million and $0.6 million of expense, respectively, related to net adjustments in the estimated fair value of earnout obligations in connection with revised projections of future performance for 35 and 17 acquisitions, respectively. During the nine-month periods ended September 30, 2015 and 2014, we recognized $13.7 million and $6.0 million of expense, respectively, related to net adjustments in the estimated fair value of earnout obligations in connection with revised projections of future performance for 72 and 49 acquisitions, respectively. The aggregate amount of maximum earnout obligations related to acquisitions was $580.8 million as of September 30, 2015, of which $223.6 million was recorded in our consolidated balance sheet as of September 30, 2015, based on the estimated fair value of the expected future payments to be made.

The following is a summary of the estimated fair values of the net assets acquired at the date of each acquisition made in the nine-month period ended September 30, 2015 (in millions):

| | CFG | BFB | MRI | IHS | ML | SBG | NAC | WGA | Twenty-One Other Acquisitions | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash | $ 0.1 | $ 0.1 | $ 0.1 | $ | $ | $ | $ 0.3 | $ | $ 3.2 | $ 3.8 |
| Other current assets | | 0.3 | 0.6 | 8.3 | 0.2 | 1.4 | | 63.4 | 29.2 | 103.4 |
| Fixed assets | | | | 1.1 | | | 0.2 | 0.6 | 5.5 | 7.4 |
| Noncurrent assets | | | | | | | | 0.1 | 0.6 | 0.7 |
| Goodwill | 13.6 | 18.5 | 6.3 | 24.8 | 5.7 | 30.9 | 6.9 | 86.8 | 52.3 | 245.8 |
| Expiration lists | 9.6 | 23.0 | 9.9 | 24.8 | 13.0 | 27.7 | 16.5 | 62.7 | 46.1 | 233.3 |
| Non-compete agreements | 0.1 | 0.1 | 0.1 | 0.1 | | 0.1 | 0.1 | 0.3 | 1.1 | 2.0 |
| Total assets acquired | 23.4 | 42.0 | 17.0 | 59.1 | 18.9 | 60.1 | 24.0 | 213.9 | 138.0 | 596.4 |
| Current liabilities | | 0.2 | 0.6 | 3.4 | | 0.7 | | 62.4 | 24.2 | 91.5 |
| Noncurrent liabilities | | | | | | | | | 10.9 | 10.9 |
| Total liabilities assumed | | 0.2 | 0.6 | 3.4 | | 0.7 | | 62.4 | 35.1 | 102.4 |
| Total net assets acquired | $ 23.4 | $ 41.8 | $ 16.4 | $ 55.7 | $ 18.9 | $ 59.4 | $ 24.0 | $ 151.5 | $ 102.9 | $ 494.0 |

Among other benefits, these acquisitions allow us to expand into desirable geographic locations, further extend our presence in the retail and wholesale insurance brokerage services and risk management industries and increase the volume of general services currently provided. The excess of the purchase price over the estimated fair value of the tangible net assets acquired at the acquisition date was allocated to goodwill, expiration lists and non-compete agreements in the amounts of $245.8 million, $233.3 million and $2.0 million, respectively, within the brokerage and risk management segments.

Provisional estimates of fair value are established at the time of each acquisition and are subsequently reviewed within the first year of operations subsequent to the acquisition date to determine the necessity for adjustments. The fair value of the tangible assets and liabilities for each applicable acquisition at the acquisition date approximated their carrying values. The fair value of expiration lists was established using the excess earnings method, which is an income approach based on estimated financial projections developed by management for each acquired entity using market participant assumptions. Revenue growth and attrition rates generally ranged from 2.0% to 3.0% and 5.0% to 13.0%, respectively, for our 2014 and 2015 acquisitions for which valuations were performed in 2015. We estimate the fair value as the present value of the benefits anticipated from ownership of the subject customer list in excess of returns required on the investment in contributory assets necessary to realize those benefits. The rate used to discount the net benefits was based on a risk-adjusted rate that takes into consideration market-based rates of return and reflects the risk of the asset relative to the acquired business. These discount rates generally ranged from 11.0% to 13.0% for our 2014

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and 2015 acquisitions for which valuations were performed in 2015. The fair value of non-compete agreements was established using the profit differential method, which is an income approach based on estimated financial projections developed by management for the acquired company using market participant assumptions and various non-compete scenarios.

Expiration lists, non-compete agreements and trade names related to our acquisitions are amortized using the straight-line method over their estimated useful lives (three to fifteen years for expiration lists, three to five years for non-compete agreements and five to fifteen years for trade names), while goodwill is not subject to amortization. We use the straight-line method to amortize these intangible assets because the pattern of their economic benefits cannot be reasonably determined with any certainty. We review all of our intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings as a component of amortization expense. Based on the results of impairment reviews during the nine-month period ended September 30, 2015, we wrote off $0.5 million of amortizable intangible assets related to the brokerage segment. Based on the results of impairment reviews during the three-month and nine-month periods ended September 30, 2014, we wrote off $0.6 million and $1.2 million, respectively, of amortizable intangible assets related to the brokerage segment.

Of the $233.3 million of expiration lists and $2.0 million of non-compete agreements related to our acquisitions made during the nine-month period ended September 30, 2015, $23.2 million and $0.6 million, respectively, is not expected to be deductible for income tax purposes. Accordingly, we recorded a deferred tax liability of $7.2 million, and a corresponding amount of goodwill, in the nine-month period ended September 30, 2015 related to nondeductible amortizable intangible assets.

Our consolidated financial statements for the nine-month period ended September 30, 2015 include the operations of the acquired entities from their respective acquisition dates. The following is a summary of the unaudited pro forma historical results, as if these entities had been acquired at January 1, 2014 (in millions, except per share data):

| | **Three-month period ended September 30,** | | **Nine-month period ended September 30,** | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Total revenues | $ 1,461.7 | $ 1,332.5 | $ 4,133.3 | $ 3,518.2 |
| Net earnings attributable to controlling interests | 134.2 | 96.0 | 301.7 | 260.6 |
| Basic net earnings per share | 0.76 | 0.58 | 1.73 | 1.67 |
| Diluted net earnings per share | 0.76 | 0.57 | 1.72 | 1.66 |

The unaudited pro forma results above have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had these acquisitions occurred at January 1, 2014, nor are they necessarily indicative of future operating results. Annualized revenues of entities acquired during the nine-month period ended September 30, 2015 totaled approximately $184.5 million. For the nine-month period ended September 30, 2015, total revenues and net earnings recorded in our unaudited consolidated statement of earnings related to our acquisitions made during the nine-month period ended September 30, 2015 in the aggregate, were $67.4 million and $5.1 million, respectively.

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**4. Other Current Assets**

Major classes of other current assets consist of the following (in millions):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Premium finance advances and loans | $ 217.0 | $ 232.6 |
| Accrued supplemental, direct bill and other receivables | 167.6 | 156.3 |
| Refined coal production related receivables | 135.0 | 103.5 |
| Deferred income taxes - current | 109.4 | 102.2 |
| Prepaid expenses | 71.0 | 72.1 |
| Total other current assets | $ 700.0 | $ 666.7 |

The premium finance loans represent short-term loans which we make to many of our brokerage related clients and other non-brokerage clients to finance their premiums paid to insurance carriers. These premium finance loans are primarily generated by the Crombie/OAMPS operations which were acquired on June 16, 2014. Financing receivables are carried at amortized cost. Given that these receivables are collateralized, carry a fairly rapid delinquency period of only seven days post payment date, and that contractually the underlying insurance policies will be cancelled within one month of the payment due date in normal course, there historically has been a minimal risk of not receiving payment and therefore we do not maintain any significant allowance for losses against this balance.

**5. Intangible Assets**

The carrying amount of goodwill at September 30, 2015 and December 31, 2014 allocated by domestic and foreign operations is as follows (in millions):

| | Brokerage | Risk Management | Corporate | Total |
|---|---|---|---|---|
| **At September 30, 2015** | | | | |
| United States | $ 1,885.2 | $ 23.5 | $ | $ 1,908.7 |
| United Kingdom | 803.3 | 3.6 | | 806.9 |
| Canada | 293.3 | | | 293.3 |
| Australia | 342.9 | | | 342.9 |
| Other foreign, principally New Zealand | 227.5 | 0.3 | | 227.8 |
| Total goodwill - net | $ 3,552.2 | $ 27.4 | $ | $ 3,579.6 |
| **At December 31, 2014** | | | | |
| United States | $ 1,652.6 | $ 20.2 | $ | $ 1,672.8 |
| United Kingdom | 818.7 | 1.9 | | 820.6 |
| Canada | 318.5 | | | 318.5 |
| Australia | 336.8 | | | 336.8 |
| Other foreign, principally New Zealand | 300.9 | | | 300.9 |
| Total goodwill - net | $ 3,427.5 | $ 22.1 | $ | $ 3,449.6 |

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The changes in the carrying amount of goodwill for the nine-month period ended September 30, 2015 are as follows (in millions):

| | Brokerage | Risk Management | Corporate | Total |
|---|---|---|---|---|
| Balance as of December 31, 2014 | $ 3,427.5 | $ 22.1 | $ | $ 3,449.6 |
| Goodwill acquired during the period | 243.8 | 2.0 | | 245.8 |
| Goodwill related to transfer of operations between segments | (3.4) | 3.4 | | |
| Goodwill adjustments due to appraisals and other acquisition adjustments | 34.8 | | | 34.8 |
| Foreign currency translation adjustments during the period | (150.5) | (0.1) | | (150.6) |
| Balance as of September 30, 2015 | $ 3,552.2 | $ 27.4 | $ | $ 3,579.6 |

Major classes of amortizable intangible assets at September 30, 2015 and December 31, 2014 consist of the following (in millions):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Expiration lists | $ 2,590.7 | $ 2,461.9 |
| Accumulated amortization - expiration lists | (870.4) | (719.3) |
| | 1,720.3 | 1,742.6 |
| Non-compete agreements | 42.2 | 43.2 |
| Accumulated amortization - non-compete agreements | (33.4) | (29.5) |
| | 8.8 | 13.7 |
| Trade names | 26.1 | 29.7 |
| Accumulated amortization - trade names | (13.4) | (10.0) |
| | 12.7 | 19.7 |
| Net amortizable assets | $ 1,741.8 | $ 1,776.0 |

Estimated aggregate amortization expense for each of the next five years is as follows:

| | |
|---|---|
| 2015 (remaining three months) | $ 58.4 |
| 2016 | 228.7 |
| 2017 | 218.3 |
| 2018 | 204.3 |
| 2019 | 190.8 |
| Total | $ 900.5 |

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**6. Credit and Other Debt Agreements**

The following is a summary of our corporate and other debt (in millions):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Note Purchase Agreements: | | |
| Semi-annual payments of interest, fixed rate of 6.44%, balloon due 2017 | $ 300.0 | $ 300.0 |
| Semi-annual payments of interest, fixed rate of 5.85%, $50 million due in 2016, 2018 and 2019 | 150.0 | 150.0 |
| Semi-annual payments of interest, fixed rate of 2.80%, balloon due 2018 | 50.0 | 50.0 |
| Semi-annual payments of interest, fixed rate of 3.20%, balloon due 2019 | 50.0 | 50.0 |
| Semi-annual payments of interest, fixed rate of 3.99%, balloon due 2020 | 50.0 | 50.0 |
| Semi-annual payments of interest, fixed rate of 3.48%, balloon due 2020 | 50.0 | 50.0 |
| Semi-annual payments of interest, fixed rate of 5.18%, balloon due 2021 | 75.0 | 75.0 |
| Semi-annual payments of interest, fixed rate of 3.69%, balloon due 2022 | 200.0 | 200.0 |
| Semi-annual payments of interest, fixed rate of 5.49%, balloon due 2023 | 50.0 | 50.0 |
| Semi-annual payments of interest, fixed rate of 4.13%, balloon due 2023 | 200.0 | 200.0 |
| Semi-annual payments of interest, fixed rate of 4.58%, balloon due 2024 | 325.0 | 325.0 |
| Semi-annual payments of interest, fixed rate of 4.31%, balloon due 2025 | 200.0 | 200.0 |
| Semi-annual payments of interest, fixed rate of 4.73%, balloon due 2026 | 175.0 | 175.0 |
| Semi-annual payments of interest, fixed rate of 4.36%, balloon due 2026 | 150.0 | 150.0 |
| Semi-annual payments of interest, fixed rate of 4.98%, balloon due 2029 | 100.0 | 100.0 |
| Total Note Purchase Agreements | 2,125.0 | 2,125.0 |
| Credit Agreement: | | |
| Periodic payments of interest and principal, prime or LIBOR plus up to 1.45%, expires September 19, 2018 | 153.0 | 140.0 |
| Premium Financing Debt Facility - expires May 18, 2017: | | |
| Periodic payments of interest and principal, Interbank rates plus 1.05% for Facility B; plus 0.55% for Facilities C and D | | |
| Facility B | | |
| AUD denominated tranche | 91.8 | 95.0 |
| NZD denominated tranche | 7.9 | 17.8 |
| Facility C and D | | |
| AUD denominated tranche | 5.4 | 7.7 |
| NZD denominated tranche | 9.5 | 7.4 |
| Total Premium Financing Debt Facility | 114.6 | 127.9 |
| Total corporate and other debt | $ 2,392.6 | $ 2,392.9 |

**Note Purchase Agreements** - We are a party to an amended and restated note purchase agreement dated December 19, 2007, with certain accredited institutional investors, pursuant to which we issued and sold $300.0 million in aggregate principal amount of our 6.44% Senior Notes, Series B, due August 3, 2017, in a private placement. These notes require semi-annual payments of interest that are due in February and August of each year.

We are a party to a note purchase agreement dated November 30, 2009, with certain accredited institutional investors, pursuant to which we issued and sold $150.0 million in aggregate principal amount of our 5.85% Senior Notes, Series C, due in three equal installments on November 30, 2016, November 30, 2018 and November 30, 2019, in a private placement. These notes require semi-annual payments of interest that are due in May and November of each year.

We are a party to a note purchase agreement dated February 10, 2011, with certain accredited institutional investors, pursuant to which we issued and sold $75.0 million in aggregate principal amount of our 5.18% Senior Notes, Series D, due February 10, 2021 and $50.0 million in aggregate principal amount of