GALLAGHER ARTHUR J & CO
Form 10-Q
July 30, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

for the quarterly period ended June 30, 2010 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: 1-9761

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. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 June 30, 2010 was 105,203,000.

Table of Contents

Arthur J. Gallagher & Co.

Index

Table of Contents

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 June 30, 2010	Three-month period ended June 30, 2009	Six-month period ended June 30, 2010	Six-month period ended June 30, 2009
Commissions	$ 257.0	$ 249.7	$ 461.2	$ 447.7
Fees	179.4	186.9	344.4	353.5
Supplemental and contingent commissions	19.3	11.8	62.7	41.3
Investment income	2.1	1.7	3.5	3.2
Gains realized on books of business sales	0.6	3.3	1.5	9.4
Revenues from clean-coal activities	2.4		65.1	0.4
Other net revenues (loss)	(1.3)	0.2	3.5	(0.8)
Total revenues	459.5	453.6	941.9	854.7
Compensation	275.8	270.4	538.0	521.7
Operating	87.4	79.1	168.6	158.0
Cost of revenues from clean-coal activities			64.0	
Interest	8.7	7.0	17.3	14.3
Depreciation	8.0	7.5	15.7	15.2
Amortization	16.6	14.1	30.5	26.5
Change in estimated acquisition earnout payables	(0.9)	1.4	1.0	1.4
Total expenses	395.6	379.5	835.1	737.1
Earnings from continuing operations before income taxes	63.9	74.1	106.8	117.6
Provision for income taxes	22.0	30.3	35.7	45.5
Earnings from continuing operations	41.9	43.8	71.1	72.1
Discontinued operations:				
Earnings (loss) on discontinued operations before income taxes	3.0		3.0	(3.3)
Gain on disposal of operations				0.1
Provision (benefit) for income taxes	0.9		0.9	(1.3)
Earnings (loss) from discontinued operations	2.1		2.1	(1.9)
Net earnings	$ 44.0	$ 43.8	$ 73.2	$ 70.2
Basic net earnings (loss) per share:				
Earnings from continuing operations	$ 0.40	$ 0.44	$ 0.69	$ 0.73
Earnings (loss) from discontinued operations	0.02		0.02	(0.02)
Net earnings	$ 0.42	$ 0.44	$ 0.71	$ 0.71

Diluted net earnings (loss) per share:				
Earnings from continuing operations	$ 0.40	$ 0.44	$ 0.69	$ 0.73
Earnings (loss) from discontinued operations	0.02		0.02	(0.02)
Net earnings	$ 0.42	$ 0.44	$ 0.71	$ 0.71
Dividends declared per common share	$ 0.32	$ 0.32	$ 0.64	$ 0.64

See notes to consolidated financial statements.

Table of Contents

Arthur J. Gallagher & Co.

Consolidated Balance Sheet

(In millions)

	June 30, 2010 (Unaudited)	December 31, 2009
Cash and cash equivalents	$ 230.0	$ 205.9
Restricted cash	566.0	522.6
Premiums and fees receivable	916.0	693.7
Other current assets	111.6	117.8
Total current assets	1,823.6	1,540.0
Fixed assets - net	79.0	80.7
Deferred income taxes	255.4	271.1
Other noncurrent assets	186.4	177.8
Goodwill - net	780.4	742.3
Amortizable intangible assets - net	431.0	438.4
Total assets	$ 3,555.8	$ 3,250.3
Premiums payable to insurance and reinsurance companies	$ 1,414.4	$ 1,166.5
Accrued compensation and other accrued liabilities	188.5	214.7
Unearned fees	43.7	41.5
Other current liabilities	43.3	51.7
Corporate related borrowings - current		
Total current liabilities	1,689.9	1,474.4
Corporate related borrowings - noncurrent	550.0	550.0
Other noncurrent liabilities	350.5	333.0
Total liabilities	2,590.4	2,357.4
Stockholders equity:		
Common stock - issued and outstanding 105.2 shares in 2010 and 102.5 shares in 2009	105.2	102.5
Capital in excess of par value	417.2	349.1
Retained earnings	456.3	450.3
Accumulated other comprehensive loss	(13.3)	(9.0)
Total stockholders equity	965.4	892.9
Total liabilities and stockholders equity	$ 3,555.8	$ 3,250.3

See notes to consolidated financial statements.

Table of Contents

Arthur J. Gallagher & Co.

Consolidated Statement of Cash Flows

(Unaudited - in millions)

	Six-month period ended June 30, 2010	Six-month period ended June 30, 2009
Cash flows from operating activities:		
Earnings from continuing operations	$ 71.1	$ 72.1
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:		
Net (gain) loss on investments	(3.3)	0.9
Depreciation and amortization	46.2	41.7
Change in estimated acquisition earnout payables	1.0	1.4
Amortization of deferred compensation and restricted stock	3.3	3.1
Stock-based and other noncash compensation expense	3.9	3.9
Net change in restricted cash	(34.3)	(66.7)
Net change in premiums receivable	(196.9)	(279.7)
Net change in premiums payable	222.3	334.7
Net change in other current assets	3.4	10.0
Net change in accrued compensation and other accrued liabilities	(30.4)	(54.2)
Net change in fees receivable/unearned fees	(6.3)	(28.4)
Net change in income taxes payable	8.7	6.4
Net change in deferred income taxes	12.9	26.2
Net change in other noncurrent assets and liabilities	(11.0)	5.2
Net cash provided by operating activities of continuing operations	90.6	76.6
Earnings (loss) from discontinued operations	2.1	(1.9)
Noncash items related to discontinued operations	(3.1)	3.0
Net gain on disposal of discontinued operations		(0.1)
Net cash provided by operating activities	89.6	77.6
Cash flows from investing activities:		
Net additions to fixed assets	(13.0)	(13.5)
Cash paid for acquisitions, net of cash acquired	(25.0)	(31.9)
Net proceeds of investment transactions	13.2	0.3
Net cash used by investing activities	(24.8)	(45.1)
Cash flows from financing activities:		
Proceeds from issuance of common stock	23.1	4.5
Tax impact from issuance of common stock	2.4	(3.1)
Repurchases of common stock	(0.3)	(0.3)
Dividends paid	(65.9)	(62.9)
Borrowings on line of credit facility	48.0	105.0
Repayments on line of credit facility	(48.0)	(44.0)
Net cash used by financing activities	(40.7)	(0.8)
Net increase in cash and cash equivalents	24.1	31.7
Cash and cash equivalents at beginning of period	205.9	194.4

Cash and cash equivalents at end of period	$ 230.0	$ 226.1
Supplemental disclosures of cash flow information:		
Interest paid	$ 17.3	$ 14.3
Income taxes paid	12.8	15.4

See notes to consolidated financial statements.

Table of Contents

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)	Total
Balance at December 31, 2009	102.5	$ 102.5	$ 349.1	$ 450.3	$ (9.0)	$ 892.9
Net earnings				73.2		73.2
Net change in pension liability, net of taxes of $0.3 million					0.5	0.5
Foreign currency translation, net of taxes of $2.9 million					(4.8)	(4.8)
Comprehensive earnings						68.9
Compensation expense related to stock option plan grants			3.5			3.5
Tax expense from issuance of common stock			2.4			2.4
Common stock issued in:						
Fifteen purchase transactions	1.5	1.5	36.9			38.4
Stock option plans	1.0	1.0	18.1			19.1
Employee stock purchase plan	0.2	0.2	3.8			4.0
Deferred compensation and restricted stock			3.3			3.3
Other compensation expense			0.4			0.4
Common stock repurchases			(0.3)			(0.3)
Cash dividends declared on common stock				(67.2)		(67.2)
Balance at June 30, 2010	105.2	$ 105.2	$ 417.2	$ 456.3	$ (13.3)	$ 965.4

See notes to consolidated financial statements.

Notes to June 30, 2010 Consolidated Financial Statements (Unaudited)

1. Nature of Operations and Basis of Presentation

Arthur J. Gallagher & Co. (Gallagher) provides insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional and governmental organizations through two operating segments. Commission and fee revenue generated by the Brokerage Segment is primarily related to the negotiation and placement of insurance for Gallagher s clients. Fee revenue generated by the Risk Management Segment is primarily related to claims management, information management, risk control services and appraisals in the property/casualty (P/C) market. Investment income and other revenue is generated from Gallagher s investment portfolio, which includes invested cash and fiduciary funds, as well as tax-advantaged, clean-energy and other investments. Gallagher is headquartered in Itasca, Illinois, has operations in fifteen countries and does business in more than 100 countries globally through a network of correspondent brokers and consultants.

The accompanying unaudited consolidated financial statements have been prepared by Gallagher 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. Gallagher believes the disclosures are adequate to make the information presented not misleading. The unaudited consolidated financial statements included herein are, in the opinion of management, prepared on a basis consistent with the audited consolidated financial statements for the year ended December 31, 2009 and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the information set forth. The quarterly results of operations are not necessarily indicative of results of operations 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 Gallagher s Annual Report on Form 10-K for the year ended December 31, 2009. Certain reclassifications have been made to the amounts reported herein related to prior year amounts in order to conform them to the current year presentation.

In the preparation of Gallagher s consolidated financial statements as of June 30, 2010, 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 in its consolidated financial statements and/or disclosure in the notes thereto.

2. Effect of New Accounting Pronouncements

Revenue Arrangements with Multiple Deliverables

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13, Multiple Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 updates the existing multiple-element revenue arrangements guidance currently included in Accounting Standards Codification (ASC) 605-25.

The revised guidance provides for two significant changes to the existing multiple element revenue arrangements guidance. The first relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. This change is significant as it will likely result in the requirement to separate more deliverables within an arrangement, ultimately leading to changes in revenue deferral.

The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. Together, these items may cause a change in the recognition of revenue for multiple-element arrangements from previous guidance. ASU 2009-13 also significantly expands the disclosures required for multiple-element revenue arrangements.

The revised multiple-element revenue arrangements guidance will be effective for the first annual reporting period beginning on or after June 15, 2010, and may be applied retrospectively for all periods presented or prospectively to arrangements entered into or materially modified after the adoption date. Early adoption is permitted provided that the revised guidance is retroactively applied to the beginning of the year of adoption. If the guidance is adopted prospectively, certain transitional disclosures are required for each reporting period in the initial year of adoption. Gallagher is currently evaluating the impact that the adoption of ASU 2009-13 could have, if any, on its consolidated financial statements and notes thereto. Gallagher has not yet determined whether it will elect to early adopt ASU 2009-13.

Table of Contents

Consolidation of Variable Interest Entities

In June 2009, the FASB issued an amendment to the consolidation rules for variable interest entities (VIEs), which (i) addresses the effects of eliminating the qualifying special-purpose entity concept from existing guidance and (ii) responds to concerns about the application of certain key provisions in existing guidance, including concerns over the transparency of disclosures related to an enterprise s involvement with VIEs.

These amendments are applicable to all enterprises and to all entities with which those enterprises are involved, regardless of when that involvement arose. Therefore, upon adoption of these amendments, all enterprises must reconsider the conclusions previously reached for the consolidation of a VIE. These amendments, among other things:

Amended certain guidance for determining whether an entity is a VIE, which may change an enterprise s assessment of which entities with which it is involved are VIEs.

Require a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE.

Amended existing considerations of related party relationships in the determination of the primary beneficiary of a VIE by providing, among other things, an exception with respect to de facto agency relationships in certain circumstances.

Require continuous assessments of whether an enterprise is the primary beneficiary of a VIE.

Require enhanced disclosures about an enterprise s involvement with a VIE.

These amendments are effective as of the beginning of an enterprise s first annual reporting period that began after November 15, 2009 and for interim periods within that first annual reporting period. Thus, these amendments were effective for Gallagher beginning on January 1, 2010. The adoption of these amendments did not have any impact on Gallagher s consolidated financial statements or notes thereto.

3. Investments

The following is a summary of Gallagher s investments reported in other current and non-current assets in the accompanying consolidated balance sheet and the related funding commitments (in millions):

	June 30, 2010		December 31, 2009
	Assets	Funding Commitments	Assets
Clean-coal related ventures	$ 21.6	$	$ 29.8
Biomass energy ventures	8.5		8.5
Venture capital funds and other	7.2	1.3	7.4
Total investments	$ 37.3	$ 1.3	$ 45.7

Clean-Coal Related Ventures

Gallagher owns portions of various clean-coal production facilities and two early-stage clean-coal ventures, all of which have been deemed to be VIEs.

Eight Clean-Coal Facilities - Gallagher incurred capital expenditures totaling $31.4 million to build eight commercial clean-coal production facilities, and placed each into service in December 2009 at several coal-fired power plants. These facilities apply certain chemicals and technologies (licensed from Chem-Mod, LLC (Chem-Mod) as discussed below) to coal feedstock which, when mixed, reduce harmful emissions. In first quarter 2010, Gallagher sold portions of its ownership in six facilities, which reduced its net investment in the facilities to $22.3 million, and recognized a $4.8 million net pretax gain on the sales. Gallagher is currently seeking other utilities to purchase the coal produced by the two remaining facilities and additional partners to invest in these facilities.

Table of Contents

For the first two months of 2010, Gallagher was required to consolidate the operating results of these facilities because of its majority ownership position. Effective March 1, 2010, Gallagher sold a portion of its ownership interests in six of these facilities. As part of the sales of the interests in the six facilities, all owners must now consent to actions that would denote control, which eliminated the requirement for Gallagher to consolidate these facilities. These facilities are now accounted for using equity method accounting.

Chem-Mod Clean-Coal Venture - At June 30, 2010, Gallagher held a 42% interest in Chem-Mod s U.S. and Canadian operations and 20% of its other international operations. At June 30, 2010, Gallagher s carrying value of its investment in these Chem-Mod operations was zero. Chem-Mod, a multi-pollutant reduction venture, possesses rights, information and technologies for the reduction of unwanted emissions created during the combustion of coal. Chem-Mod has developed and is the exclusive licensee of proprietary emissions technologies it refers to as The Chem-Mod Solution, which uses a dual injection sorbent system to reduce mercury, sulfur dioxide and other toxic emissions at coal-fired power plants. Gallagher also believes that the application of The Chem-Mod Solution will qualify for refined coal tax credits under Internal Revenue Code Section 45 (IRC Section 45).

Chem-Mod has been determined to be a VIE. Gallagher is deemed to be the primary beneficiary based on the level of control it exerts on the operations of Chem-Mod, and therefore was required to consolidate this investment into its consolidated financial statements beginning in third quarter 2008. At June 30, 2010, total assets and total liabilities of this investment that were included in Gallagher s consolidated balance sheet were each less than $0.9 million. Gallagher is under no obligation to fund Chem-Mod s operations in the future and Chem-Mod has no debt that is recourse to Gallagher.

C-Quest Clean-Coal Venture - On April 15, 2010, Gallagher purchased an additional 3% interest in the global operations of C-Quest Technology LLC (C-Quest) for $1.5 million, which was written-off under equity method accounting. At June 30, 2010, Gallagher held an 8% interest in C-Quest s global operations and its carrying value in C-Quest was zero. Gallagher also has options to acquire an additional 19% interest in C-Quest s global operations (total price $9.5 million) at any time on or prior to August 1, 2013. C-Quest possesses rights, information and technology for the reduction of carbon dioxide emissions created by burning fossil fuels. C-Quest is deemed to be a VIE, but due to Gallagher s lack of control over the operation of C-Quest, Gallagher is not required to consolidate this investment.

Biomass Energy Ventures

Gallagher has made investments in various biomass energy ventures. At June 30, 2010, Gallagher s remaining investment of $8.5 million consisted of a 13.4% equity interest in a biomass company and related partnerships which own the rights to biogas from landfills and the wells, infrastructure and a pipeline to capture, distribute and sell biogas.

Venture Capital Funds and Other

At June 30, 2010, Gallagher s remaining investment of $7.2 million consisted of (i) four venture capital funds totaling $6.2 million, (ii) a 20% interest in an investment management company totaling $1.0 million, (iii) twelve certified low-income housing developments with zero carrying value, and (iv) two real estate entities with zero carrying value. Fourteen of the nineteen ventures have been determined to be VIEs, but are not required to be consolidated. At June 30, 2010, total assets and total debt of these fourteen ventures were approximately $63.0 million and $19.0 million, respectively. Gallagher s maximum exposure to a potential loss related to these investments was zero at June 30, 2010, which equaled the net aggregate carrying value of these ventures.

Table of Contents

4. Business Combinations

During the six-month period ended June 30, 2010, Gallagher acquired policy renewal rights and substantially all of the net assets of the following brokerage firms in exchange for Gallagher common stock and/or cash (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
Securitas Re (SRE) February 12, 2010		$	$ 1.0	$ 0.3	$	$	$ 1.3	$
Winn & Company Insurance Brokers, Inc. (WIB) March 1, 2010	121	2.7	1.0		0.4	1.0	5.1	2.3
Policy renewal rights from FirstCity Partnership Ltd. (FCP) April 1, 2010	456	11.8	12.7			2.9	27.4	5.6
Risk & Reward Group (RRG) May 28, 2010			5.9			1.7	7.6	4.7
Bowen, Miclette, Britt & Merry of Arkansas, Inc. May 1, 2010	52	1.2			0.1	0.1	1.4	0.3
Joseph James & Associates (JJA) June 1, 2010	152	3.8	1.1		0.1	2.2	7.2	5.0
Two other acquisitionscompleted in first and second quarter	49	1.1	0.3		0.1	0.9	2.4	1.2
	830	$ 20.6	$ 22.0	$ 0.3	$ 0.7	$ 8.8	$ 52.4	$ 19.1

Common shares issued in connection with acquisitions are valued at closing market prices as of the effective date of the applicable acquisition. Escrow deposits that are returned to Gallagher as a result of adjustments to net assets acquired are recorded 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 respective purchase agreement related to each applicable acquisition. The amounts recorded as earnout payables are primarily based upon the 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. Subsequent changes in these estimated earnout obligations, including the accretion of discount, will be recorded in the 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. In determining fair value, the acquired entity s future performance was estimated using financial projections developed by management for the acquired entity and market participant assumptions that were derived for revenue growth and/or profitability. The future payments are estimated using the earnout formula and performance targets specified in each purchase agreement and these financial projections. These payments were then discounted to present value using a risk-adjusted rate that takes into consideration market based rates of return which reflect the ability of the acquired entity to achieve the forecast. During the three-month periods ended June 30, 2010 and 2009, Gallagher recognized $1.5 million and $1.4 million, respectively, of expense in its consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations

Table of Contents

related to its 2009 and 2010 acquisitions. During the six-month periods ended June 30, 2010 and 2009, Gallagher recognized $2.9 million and $1.4 million, respectively, of expense in its consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations related to its 2009 and 2010 acquisitions. In addition, Gallagher recognized $2.5 million and $2.0 million of income during the three-month and six-month periods ended June 30, 2010, respectively, related to net adjustments in the estimated fair market values of earnout obligations related to four 2009 acquisitions. The aggregate amount of maximum earnout obligations related to the 2009 and 2010 acquisitions was $160.4 million, of which $70.5 million was recorded in the consolidated balance sheet as of June 30, 2010 based on the estimated fair value of the expected future payments to be made.

For all acquisitions made prior to 2009, potential earnout obligations were not included in the purchase price that was recorded for each applicable acquisition at its acquisition date because such obligations were not fixed and determinable. Future payments made under these arrangements, if any, will generally be recorded as additional goodwill when the earnouts are settled. The aggregate amount of maximum unrecorded earnout payables outstanding as of June 30, 2010 was $207.6 million related to acquisitions made by Gallagher during the period from 2006 to 2008.

The following is a summary of the estimated fair values of the net assets acquired at the date of each acquisition based on preliminary purchase price allocations (in millions):

	SRE	WIB	FCP	RRG	JJA	Three Other Acquisitions	Total
Current assets	$ 0.7	$ 0.7	$ 28.0	$ 2.0	$ 0.1	$ 2.4	$ 33.9
Fixed assets		0.4	0.5				0.9
Noncurrent assets			2.9				2.9
Goodwill	0.3	2.5	11.1	5.4	4.4	2.5	26.2
Expiration lists	1.0	2.2	10.0	2.9	2.8	1.5	20.4
Non-compete agreements		0.1				0.1	0.2
Total assets acquired	2.0	5.9	52.5	10.3	7.3	6.5	84.5
Current liabilities	0.4	0.8	24.3	1.9	0.1	2.4	29.9
Noncurrent liabilities	0.3		0.8	0.8		0.3	2.2
Total liabilities assumed	0.7	0.8	25.1	2.7	0.1	2.7	32.1
Total net assets acquired	$ 1.3	$ 5.1	$ 27.4	$ 7.6	$ 7.2	$ 3.8	$ 52.4

These acquisitions allow Gallagher to expand into desirable geographic locations, further extend its presence in the retail and wholesale insurance brokerage services 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 within the Brokerage Segment to goodwill, expiration lists and non-compete agreements in the amounts of $26.2 million, $20.4 million and $0.2 million, respectively. Purchase price allocations are preliminarily established at the time of the acquisition and are subsequently reviewed within the first year of operations to determine the necessity for allocation adjustments. The fair value of the current assets and current liabilities for each applicable acquisition at the acquisition date approximated their carrying values due to their short-term duration. 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. The fair value is estimated 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. The acquired non-compete agreements were valued 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 and non-compete agreements related to these acquisitions are currently being amortized on a straight-line basis over useful lives of three to fifteen years and three to five years, respectively. Goodwill is not amortized, but is subject to periodic reviews for impairment. Gallagher reviews its 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 is 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. Based on the results of impairment reviews during the three-month and six-month periods ended June 30, 2010, Gallagher wrote off $2.3 million of amortizable intangible assets related to the Brokerage Segment. No such indicators were noted in the six-month period ended June 30, 2009. Of the $20.4 million of expiration lists related to the 2010 acquisitions, $4.5 million is not expected to be deductible for income tax purposes. Accordingly, Gallagher recorded a deferred tax liability of $1.4 million and a corresponding amount of goodwill in 2010 related to the nondeductible amortizable intangible assets.

During the six-month period ended June 30, 2010, Gallagher issued 703,000 shares of its common stock, paid $1.3 million in cash, and accrued $5.4 million in current liabilities related to earnout obligations for acquisitions made prior to 2009 and recorded additional goodwill of $12.2 million. During the six-month period ended June 30, 2009, Gallagher issued 641,000 shares of its common stock, paid $3.9 million in cash and accrued $0.8 million in current liabilities related to earnout obligations for acquisitions made prior to 2009 and recorded additional goodwill of $11.2 million. During the six-month period ended June 30, 2009, Gallagher also issued 1.1 million shares of its common stock related to an acquisition made in December 2008 and recorded in the consolidated financial statements as of December 31, 2008.

Gallagher s consolidated financial statements for the six-month period ended June 30, 2010 includes the operations of the entities acquired from the dates of their respective acquisitions. The following is a summary of the unaudited pro forma historical results, as if these purchased entities had been acquired at January 1, 2009 (in millions, except per share data):

	Three-month period ended June 30,		Six-month period ended June 30,	
	2010	2009	2010	2009
Total revenues	$ 460.5	$ 467.4	$ 952.0	$ 876.9
Earnings from continuing operations	42.0	45.7	70.9	73.7
Basic earnings from continuing operations per share	0.40	0.45	0.68	0.74
Diluted earnings from continuing operations per share	0.40	0.45	0.68	0.74

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, 2009, nor are they necessarily indicative of future operating results. Annualized revenues of the entities acquired during the six-month period ended June 30, 2010 totaled approximately $44.2 million.

Table of Contents

5. Discontinued Operations

The assets and liabilities included in the accompanying June 30, 2010 and December 31, 2009 consolidated balance sheet related to discontinued operations were as follows (in millions):

	June 30, 2010	December 31, 2009
Restricted cash	$ 0.5	$ 0.3
Other noncurrent assets	8.5	12.9
Total assets	$ 9.0	$ 13.2
Premiums payable to insurance and reinsurance companies	$ 0.2	$ 0.2
Other current liabilities	0.9	1.0
Other noncurrent liabilities	7.9	12.0
Total liabilities	$ 9.0	$ 13.2

As part of integrating the operations of a London-based insurance brokerage firm acquired by Gallagher on April 1, 2010, Gallagher restored into service certain leased real estate space that was abandoned in 2008 as part of the wind-down of certain of its discontinued operations. In the three-month and six-month periods ended June 30, 2010, Gallagher recognized $2.1 million of pretax earnings from discontinued operations for the reversal of a portion of the lease abandonment charges incurred in 2008.

6. Intangible Assets

The carrying amount of goodwill at June 30, 2010 allocated by domestic and foreign operations is as follows (in millions):

	Brokerage	Risk Management	Corporate	Total
United States	$ 731.2	$ 9.5	$	$ 740.7
Foreign, principally Australia, Canada and the U.K.	39.5	0.2		39.7
Total goodwill - net	$ 770.7	$ 9.7	$	$ 780.4

The changes in the carrying amount of goodwill for the six-month period ended June 30, 2010 are as follows (in millions):

	Brokerage	Risk Management	Corporate	Total
Balance as of January 1, 2010	$ 732.6	$ 9.7	$	$ 742.3
Goodwill acquired during the period	26.2			26.2
Goodwill related to earnouts recognized during the period	12.2			12.2
Foreign currency translation adjustments during the period	(0.3)			(0.3)
Balance as of June 30, 2010	$ 770.7	$ 9.7	$	$ 780.4

Table of Contents

Major classes of amortizable intangible assets consist of the following (in millions):

	June 30, 2010	December 31, 2009
Expiration lists	$ 617.6	$ 594.8
Accumulated amortization - expiration lists	(196.0)	(166.6)
	421.6	428.2
Non-compete agreements	22.3	22.2
Accumulated amortization - non-compete agreements	(19.0)	(18.4)
	3.3	3.8
Trade name	7.9	7.9
Accumulated amortization - trade name	(1.8)	(1.5)
	6.1	6.4
Net amortizable assets	$ 431.0	$ 438.4

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

2010 (remaining six months)	$ 28.2
2011	55.5
2012	52.8
2013	51.3
2014	49.5
Total	$ 237.3

7. Credit and Other Debt Agreements

Note Purchase Agreement - Gallagher is party to an amended and restated note purchase agreement dated as of December 19, 2007, with certain accredited institutional investors, pursuant to which Gallagher issued and sold $100.0 million in aggregate principal amount of Gallagher s 6.26% Senior Notes, Series A, due August 3, 2014 and $300.0 million in aggregate principal amount of Gallagher s 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 on February 3 and August 3. In connection with entering into this note purchase agreement, Gallagher incurred approximately $1.3 million of debt acquisition costs that were capitalized and are being amortized on a pro rata basis over a seven-year period.

Gallagher is also party to a note purchase agreement dated as of November 30, 2009, with certain accredited institutional investors, pursuant to which Gallagher issued and sold $150.0 million in aggregate principal amount of Gallagher s 5.85% Senior Notes, Series C, due in three equal installments on each of 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 on May 30 and November 30.

Under the terms of the respective note purchase agreements, the notes are redeemable by Gallagher at any time, in whole or in part, at 100% of the principal amount of such notes being redeemed, together with accrued and unpaid interest and a make-whole amount. The make-whole amount is derived from a net present value computation of the remaining scheduled payments of principal and interest using a discount rate based on U.S. Treasury yields plus 0.5% and is designed to compensate the purchasers of the notes for their investment risk in the event prevailing interest rates at the time of prepayment are less favorable than the interest rates under the notes. Gallagher currently has no intention of prepaying the notes.

The note purchase agreements contain customary provisions for transactions of this type, including representations and warranties regarding Gallagher and its subsidiaries and various financial covenants, including covenants that require Gallagher to maintain specified financial ratios. Gallagher was in compliance with these covenants at June 30, 2010. The note purchase agreements also provide customary events of default, generally with corresponding grace periods, including, without limitation, payment defaults with respect to the notes, covenant defaults, cross-defaults to other agreements evidencing indebtedness of Gallagher or its subsidiaries, certain judgments against Gallagher or its subsidiaries and events of bankruptcy involving Gallagher or its material subsidiaries.

Table of Contents

The notes issued under the note purchase agreements are senior unsecured obligations of Gallagher and rank equal in right of payment with Gallagher s Credit Agreement discussed below.

Credit Agreement - On July 15, 2010, Gallagher entered into an unsecured multicurrency credit agreement (Credit Agreement), which expires on July 14, 2014, with a group of twelve financial institutions. The Credit Agreement replaced a $450.0 million unsecured revolving credit facility (that was scheduled to expire on October 4, 2010), which was terminated upon the execution of the Credit Agreement. All indebtedness, liabilities and obligations outstanding under the previous facility were fully paid and satisfied, except for the letters of credit (LOCs) which became LOCs under the Credit Agreement. Gallagher incurred no early termination fees in connection with replacing the previous credit agreement.

The Credit Agreement provides for a revolving credit commitment of up to $500.0 million, of which up to $75.0 million may be used for issuances of standby or commercial LOCs and up to $50.0 million may be used for the making of swing loans, as defined in the Credit Agreement. Gallagher may from time to time request, subject to certain conditions, an increase in the revolving credit commitment up to a maximum aggregate revolving credit commitment of $600.0 million.

The Credit Agreement provides that Gallagher may elect that each borrowing in U.S. dollars be either base rate loans or Eurocurrency loans, as defined in the Credit Agreement. All loans denominated in currencies other than U.S. dollars are Eurocurrency loans. Interest rates on base rate loans and outstanding drawings on LOCs in U.S. dollars under the Credit Agreement are based on the base rate, as defined in the Credit Agreement. Interest rates on Eurocurrency loans or outstanding drawings on LOCs in currencies other than U.S. dollars under the Credit Agreement are based on adjusted LIBOR, as defined in the Credit Agreement, plus a margin of 1.45%, 1.65%, 1.85% or 2.00%, depending on the financial leverage ratio maintained by Gallagher. Interest rates on swing loans are based, at the election of Gallagher, on either the base rate, as defined in the Credit Agreement, or such alternate rate as may be quoted by the lead lender. The annual facility fee related to the Credit Agreement is either .30%, .35%, .40% or .50% of the used and unused portions of the revolving credit facility, depending on the financial leverage ratio maintained by Gallagher. In connection with entering into the Credit Agreement, Gallagher incurred approximately $3.3 million of debt acquisition costs that were capitalized and will be amortized on a pro rata basis over the term of the Credit Agreement.

The terms of Gallagher s Credit Agreement and the previous credit agreement include various financial covenants, including covenants that require Gallagher to maintain specified levels of net worth and financial leverage ratios. Gallagher was in compliance with these covenants at June 30, 2010 and July 15, 2010. The Credit Agreement also includes customary events of default, with corresponding grace periods, including, without limitation, payment defaults, cross-defaults to other agreements evidencing indebtedness and bankruptcy-related defaults.

At June 30, 2010 and July 15, 2010, $15.2 million and $16.0 million of LOCs (for which Gallagher had $7.6 million of liabilities recorded at June 30, 2010) were outstanding under the previous credit agreement and the Credit Agreement, respectively. There were no borrowings outstanding under either facility at June 30, 2010 or July 15, 2010. Accordingly, as of July 15, 2010, $484.0 million remained available for potential borrowings, of which $59.0 million may be in the form of additional LOCs.

Table of Contents

The following is a summary of Gallagher s debt (in millions):

	June 30, 2010	December 31, 2009
Note Purchase Agreements:		
Semi-annual payments of interest, fixed rate of 6.26%, balloon due 2014	$ 100.0	$ 100.0
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
Total Note Purchase Agreements	550.0	550.0
Credit Agreement:		
Periodic payments of interest and principal, prime or LIBOR plus up to 2.00%, expires July 14, 2014		
Total debt	$ 550.0	$ 550.0

The fair value of the $550.0 million in debt under the note purchase agreements at June 30, 2010 was $602.7 million due to the long-tem duration and fixed interest rates associated with these debt obligations. There is no active or observable market for Gallagher s private placement long-term debt. Therefore, the estimated fair value of this debt is based on discounted future cash flows using current interest rates available for debt with similar terms and remaining maturities. To estimate an all-in interest rate for discounting, market quotes were obtained for notes with the same terms as Gallagher s. There is no rate adjustment for the risk profile changes, covenant issues or credit ratings changes at Gallagher. Therefore, the market quotes are deemed to be the closest approximation of current market rates.

See Note 14 to the consolidated financial statements for additional discussion on commitments and contingencies.

8. Earnings Per Share

The following table sets forth the computation of basic and diluted net earnings per share (in millions, except per share data):

	Three-month period ended June 30,		Six-month period ended June 30,	
	2010	2009	2010	2009
Earnings from continuing operations	$ 41.9	$ 43.8	$ 71.1	$ 72.1
Earnings (loss) from discontinued operations	2.1		2.1	(1.9)
Net earnings	$ 44.0	$ 43.8	$ 73.2	$ 70.2
Weighted average number of common shares outstanding	104.4	100.6	103.6	99.3
Dilutive effect of stock options using the treasury stock method	0.2	0.1	0.2	0.1
Weighted average number of common and common equivalent shares outstanding	104.6	100.7	103.8	99.4
Basic net earnings (loss) per share:				
Earnings from continuing operations	$ 0.40	$ 0.44	$ 0.69	$ 0.73
Earnings (loss) from discontinued operations	0.02		0.02	(0.02)
Net earnings	$ 0.42	$ 0.44	$ 0.71	$ 0.71
Diluted net earnings (loss) per share:				
Earnings from continuing operations	$ 0.40	$ 0.44	$ 0.69	$ 0.73
Earnings (loss) from discontinued operations	0.02		0.02	(0.02)

Net earnings	$ 0.42	$ 0.44	$ 0.71	$ 0.71

Table of Contents

Options to purchase 9.6 million and 12.6 million shares of common stock were outstanding at June 30, 2010 and 2009, respectively, but were not included in the computation of the dilutive effect of stock options for the three-month periods then ended. Options to purchase 11.4 million and 12.6 million shares of common stock were outstanding at June 30, 2010 and 2009, respectively, but were not included in the computation of the dilutive effect of stock options for the six-month periods then ended. These options were excluded from the computation because the options exercise prices were greater than the average market price of Gallagher s common shares during the respective periods, and therefore would be antidilutive to earnings per share under the treasury stock method.

9. Stock Option Plans

On May 12, 2009, Gallagher s stockholders approved the 2009 Long-Term Incentive Plan (LTIP). The LTIP s term began May 12, 2009 and terminates on the date of the first annual meeting of stockholders to occur on or after the fifth anniversary of its effective date, unless terminated earlier by Gallagher s Board of Directors. All officers, employees and non-employee directors of Gallagher and persons expected to become officers, employees or non-employee directors of Gallagher are eligible to receive awards under the LTIP. The Compensation Committee of Gallagher s Board of Directors determines the participants under the LTIP. Awards include non-qualified and incentive stock options, stock appreciation rights, restricted stock, restricted stock units and performance units, any or all of which may be made contingent upon the achievement of performance criteria. Subject to the LTIP limits, the Compensation Committee has the discretionary authority to determine the size of an award.

As of the effective date of the LTIP, 3.0 million shares of Gallagher s common stock were available for awards granted under the LTIP. The number of available shares will be reduced by the aggregate number of shares that become subject to outstanding awards granted under the LTIP. To the extent that shares subject to an outstanding award granted under either the LTIP or any of the predecessor plans are not issued or delivered by reason of the expiration, termination, cancellation or forfeiture of such award or by reason of the settlement of such award in cash, then such shares will again be available under the LTIP. Shares that are subject to a stock appreciation right and were not issued upon the net settlement or net exercise of such stock appreciation right, shares that are used to pay the exercise price of an option, delivered to or withheld by Gallagher to pay withholding taxes, and shares that are purchased on the open market with the proceeds of an option exercise, may not again be made available for issuance.

Shares of Gallagher s common stock available for issuance under the plan include authorized and unissued shares of common stock or authorized and issued shares of common stock reacquired and held as treasury shares or otherwise, or a combination thereof. The maximum number of shares available under the LTIP for restricted stock, restricted stock unit awards and performance unit awards settled with stock (i.e., all awards other than stock options and stock appreciation rights) is 600,000. The maximum number of shares with respect to which options or stock appreciation rights or a combination thereof that may be granted during any fiscal year to any person is 200,000. The maximum number of shares with respect to which performance-based restricted stock or restricted stock units that may be granted during any fiscal year to any person is 100,000. The maximum amount that may be payable with respect to performance units granted during any fiscal year of Gallagher to any person is $1.5 million.

The LTIP provides for the grant of stock options and stock appreciation rights. Stock options may be either tax-qualified incentive stock options or non-qualified options. The period for the exercise of a non-qualified stock option, tax-qualified incentive stock option or stock appreciation right is determined by the Compensation Committee, provided that no option can be exercised later than seven years after its date of grant. The exercise price of a non-qualified stock option or tax-qualified incentive stock option and the base price of a stock appreciation right cannot be less than 100% of the fair market value of a share of Gallagher common stock on the date of grant, provided that the base price of a stock appreciation right granted in tandem with an option will be the exercise price of the related option. A stock appreciation right entitles the holder to receive upon exercise (subject to withholding taxes), cash or shares of Gallagher common stock (which may be restricted stock) with a value equal to the difference between the fair market value of Gallagher common stock on the exercise date and the base price of the stock appreciation right.

Table of Contents

Upon exercise, the option exercise price may be paid in cash, by the delivery of previously owned shares of Gallagher common stock or through a cashless exercise arrangement. All of the terms relating to the exercise, cancellation or other disposition of an option or stock appreciation right upon a termination of employment, whether by reason of disability, retirement, death or any other reason, are determined by the Compensation Committee. Stock option and stock appreciation right awards under the plan are non-transferable.

Prior to 2009, Gallagher issued stock options under four stock option-based employee compensation plans. In May 2008, all of these plans expired. Under the expired plans, Gallagher granted both incentive and non-qualified stock options to officers and key employees of Gallagher and its subsidiaries. Most options granted under the incentive plan prior to 2007 become exercisable at the rate of 10% per year beginning the calendar year after the date of grant. Most options granted under the non-qualified plan prior to 2007 become exercisable at the rate of 10% per year beginning the calendar year after the date of grant or earlier in the event of death, disability or retirement (if the retirement eligible age requirement is met). Options granted prior to 2009 expire ten years from the date of grant, or earlier in the event of termination of the employee (if the retirement eligible age requirement is not met).

On March 2, 2010, the Compensation Committee granted 858,000 options to officers and key employees of Gallagher that become exercisable at the rate of 20% per year on the anniversary date of the grant. The 2010 options expire seven years from the date of grant, or earlier in the event of termination of the employee.

In addition to the employee plans discussed above, Gallagher had a non-employee directors stock option plan, under which, in 2007 and prior years, discretionary options were granted at the direction of the Compensation Committee and retainer options were granted in lieu of the directors annual retainer. Discretionary options were exercisable at such rates as determined by the Compensation Committee on the date of grant. Retainer options were cumulatively exercisable at the rate of 25% of the total retainer option at the end of each full fiscal quarter following the date of grant. Options granted under the non-employee directors plan contained provisions where the vesting of the stock options accelerates to 100% on the termination of the director.

All of the aforementioned stock option plans provide for the immediate vesting of all outstanding stock option grants in the event of a change in control of Gallagher, as defined in the plan documents.

During the three-month periods ended June 30, 2010 and 2009, Gallagher recognized $2.5 million and $2.8 million, respectively, of compensation expense related to its stock option grants. During the six-month periods ended June 30, 2010 and 2009, Gallagher recognized $3.5 million and $3.9 million, respectively, of compensation expense related to its stock option grants.

For purposes of expense recognition, the estimated fair values of the stock option grants are amortized to expense over the options expected lives. In 2010 and 2009, the fair value of stock options at the date of grant was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2010	2009
Expected dividend yield	5.0%	4.0%
Expected risk-free interest rate	2.8%	3.0%
Volatility	27.1%	27.3%
Expected life (in years)	6.1	7.0

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. Any option pricing model requires the input of highly subjective assumptions including the expected stock price volatility. Because Gallagher s employee and director stock options have characteristics significantly different from those of traded options, and because changes in the selective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee and director stock options. The weighted average fair value per option for all options granted during the six-month periods ended June 30, 2010 and 2009, as determined on the grant date using the Black-Scholes option pricing model, was $