GALLAGHER ARTHUR J & CO
Form 10-Q
April 29, 2008
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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 March 31, 2008

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)

(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 ¨ 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 March 31, 2008 was 92,800,000.

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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 March 31, 2008	2007
Commissions	$ 206.3	$ 188.7
Fees	160.5	143.9
Investment income - Brokerage and Risk Management	7.4	7.0
Investment income - Financial Services and Corporate	1.6	31.3
Investment gains		4.1
Total revenues	375.8	375.0
Compensation	237.2	213.9
Operating	87.9	77.6
Investment expenses	1.5	44.4
Interest	6.5	0.6
Depreciation	6.9	7.6
Amortization	8.9	7.1
Total expenses	348.9	351.2
Earnings from continuing operations before income taxes	26.9	23.8
Provision for income taxes	10.6	2.5
Earnings from continuing operations	16.3	21.3
Discontinued operations:		
Loss on discontinued operations before income taxes	(31.1)	(2.3)
Gain on disposal of operations	12.4	
Provision (benefit) for income taxes	3.6	(0.8)
Loss from discontinued operations	(22.3)	(1.5)
Net earnings (loss)	$ (6.0)	$ 19.8
Basic net earnings (loss) per share:		
Earnings from continuing operations	$ 0.18	$ 0.21
Loss from discontinued operations	(0.25)	(0.01)
Net earnings (loss)	$ (0.07)	$ 0.20
Diluted net earnings (loss) per share:		
Earnings from continuing operations	$ 0.18	$ 0.21
Loss from discontinued operations	(0.25)	(0.01)

Net earnings (loss)	$	(0.07)	$	0.20
Dividends declared per common share	$	.32	$	.31

See notes to consolidated financial statements.

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Arthur J. Gallagher & Co.

Consolidated Balance Sheet

(In millions)

	March 31, 2008 (Unaudited)	December 31, 2007
Cash and cash equivalents	$ 185.2	$ 255.9
Restricted cash	649.2	601.4
Investments - current	8.8	7.5
Premiums and fees receivable	1,063.0	1,303.7
Other current assets	114.6	107.3
Total current assets	2,020.8	2,275.8
Investments - noncurrent	25.8	26.3
Fixed assets related to consolidated investments - net		1.9
Other fixed assets - net	86.7	86.0
Deferred income taxes	289.2	292.6
Other noncurrent assets	122.1	118.0
Goodwill - net	450.1	440.6
Amortizable intangible assets - net	346.2	315.6
Total assets	$ 3,340.9	$ 3,556.8
Premiums payable to insurance and reinsurance companies	$ 1,684.3	$ 1,874.0
Accrued compensation and other accrued liabilities	211.6	281.3
Unearned fees	51.7	44.1
Other current liabilities	18.8	32.8
Corporate related borrowings - current	56.0	
Total current liabilities	2,022.4	2,232.2
Corporate related borrowings - noncurrent	400.0	400.0
Other noncurrent liabilities	219.9	209.1
Total liabilities	2,642.3	2,841.3
Stockholders equity:		
Common stock - issued and outstanding 92.8 shares in 2008 and 92.0 shares in 2007	92.8	92.0
Capital in excess of par value	138.1	120.2
Retained earnings	460.1	495.9
Accumulated other comprehensive earnings	7.6	7.4
Total stockholders equity	698.6	715.5
Total liabilities and stockholders' equity	$ 3,340.9	$ 3,556.8

See notes to consolidated financial statements.

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Arthur J. Gallagher & Co.

Consolidated Statement of Cash Flows

(Unaudited in millions)

	Three-month period ended March 31, 2008	2007
Cash flows from operating activities:		
Earnings from continuing operations	$ 16.3	$ 21.3
Adjustments to reconcile earnings from continuing operations to net cash used by operating activities:		
Net gain on investments and other		(4.1)
Depreciation and amortization	15.8	14.7
Amortization of deferred compensation and restricted stock	1.6	1.4
Stock-based compensation expense	2.5	2.7
Increase in restricted cash	(57.0)	(12.3)
Decrease in premiums receivable	69.7	127.3
Decrease in premiums payable	(12.6)	(109.6)
Increase in other current assets	(5.3)	(30.9)
Net change in accrued compensation and other accrued liabilities	(79.6)	(51.3)
Net change in fees receivable/unearned fees	9.7	(3.8)
Net change in income taxes payable	(0.9)	(51.2)
Net change in deferred income taxes	5.1	57.5
Net change in other assets and liabilities	(11.0)	(2.2)
Net cash used by operating activities of continuing operations	(45.7)	(40.5)
Loss from discontinued operations	(22.3)	(1.5)
Depreciation and amortization from discontinued operations	13.4	0.8
Other noncash items related to discontinued operations	3.6	
Net gain on disposal of discontinued operations	(12.4)	
Net cash used by operating activities	(63.4)	(41.2)
Cash flows from investing activities:		
Net additions to fixed assets	(8.2)	(9.9)
Cash paid for acquisitions, net of cash acquired	(68.9)	(79.5)
Proceeds from sales of discontinued operations	31.8	
Proceeds from sale of consolidated operation		0.7
Net proceeds from investment transactions	2.6	0.1
Net cash used by investing activities	(42.7)	(88.6)
Cash flows from financing activities:		
Proceeds from issuance of common stock	7.4	7.6
Tax benefit from issuance of common stock	1.1	1.4
Repurchases of common stock	(0.6)	(15.7)
Dividends paid	(28.5)	(29.5)
Borrowings on line of credit facilities	70.0	117.0
Repayments on line of credit facilities	(14.0)	
Repayments of investment related long-term debt		(0.2)
Net cash provided by financing activities	35.4	80.6

Net decrease in cash and cash equivalents		(70.7)		(49.2)
Cash and cash equivalents at beginning of period		255.9		208.0
Cash and cash equivalents at end of period	$	185.2	$	158.8
Supplemental disclosures of cash flow information:				
Interest paid	$	12.9	$	0.6
Income taxes paid		9.7		4.2

See notes to consolidated financial statements.

Notes to March 31, 2008 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. 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, fiduciary funds, tax advantaged and other investments. Gallagher is headquartered in Itasca, Illinois, has operations in thirteen 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, 2007 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, 2007.

2. Effect of New Accounting Pronouncements

Fair Value Measurements

In 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurement, which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS 157 also responds to investors requests for expanded information about the extent to which entities measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require or permit assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances.

Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts business. SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity s own data. Fair value measurements are required to be separately disclosed by level within the fair value hierarchy.

SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for all interim periods within those fiscal years. The adoption of SFAS 157 did not have any impact on the amounts reported in Gallagher s 2008 consolidated financial statements.

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Fair Value Option

In 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently.

Different measurement attributes have been required under U.S. generally accepted accounting principles (GAAP) for different assets and liabilities that can create artificial volatility in earnings. SFAS 159 helps to mitigate this type of accounting-induced volatility by enabling companies to report related assets and liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities.

SFAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company s choice to use fair value on its earnings. SFAS 159 also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS 157 and SFAS No. 107, Disclosures about Fair Value of Financial Instruments.

SFAS 159 is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. Gallagher elected not to report any financial assets or liabilities at fair value under SFAS 159 in its first quarter 2008 consolidated financial statements.

Business Combinations

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS 141(R)), Business Combinations, which is a revision of SFAS 141, Business Combinations. The primary requirements of SFAS 141(R) are as follows:

- Upon initially obtaining control, the acquiring entity in a business combination must recognize 100% of the fair value of the acquired assets, including goodwill, and assumed liabilities, with only limited exceptions, even if the acquirer has not acquired 100% of the target entity. As a consequence, the current step acquisition model will be eliminated.

- Contingent consideration arrangements will be fair valued at the acquisition date and included on that basis in the purchase price consideration. The concept of recognizing contingent consideration at a later date, when the amount of that consideration is determinable beyond a reasonable doubt, will no longer be applicable.

- All transaction costs will be expensed as incurred.

SFAS 141(R) is effective as of the beginning of an entity s first fiscal year beginning after December 15, 2008. Adoption is prospective and early adoption is not permitted. Gallagher is currently evaluating the impact that the adoption of SFAS 141(R) will have on its consolidated financial statements and notes thereto.

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3. Investments

The following is a summary of Gallagher s investments and the related outstanding letters of credit (LOCs) and funding commitments (in millions):

	March 31, 2008			December 31, 2007	
	Current	Noncurrent	Funding Commitments	Current	Noncurrent
Investments:					