

GALLAGHER ARTHUR J & CO
Form 10-Q
October 31, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2012

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)

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Delaware
(State or other jurisdiction of
incorporation or organization)

36-2151613
(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 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 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 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

The number of outstanding shares of the registrant's common stock, \$1.00 par value, as of September 30, 2012 was 124,387,000.

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Arthur J. Gallagher & Co.

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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 September 30, | | Nine-month period ended September 30, | |
|--|---|--------------|--|----------------|
| | 2012 | 2011 | 2012 | 2011 |
| Commissions | \$ 346.0 | \$ 308.0 | \$ 962.7 | \$ 829.7 |
| Fees | 248.2 | 225.1 | 706.0 | 628.8 |
| Supplemental commissions | 16.6 | 14.5 | 50.3 | 42.0 |
| Contingent commissions | 7.7 | 9.9 | 37.0 | 34.6 |
| Investment income | 2.7 | 2.6 | 8.0 | 6.7 |
| Net gains on books of business sales | 0.7 | 0.8 | 1.4 | 4.4 |
| Revenues from clean coal activities | 28.4 | 1.9 | 80.3 | 10.0 |
| Other net revenues | 0.1 | | 1.4 | 0.1 |
| Total revenues | 650.4 | 562.8 | 1,847.1 | 1,556.3 |
| Compensation | 373.9 | 345.2 | 1,082.4 | 965.1 |
| Operating | 121.6 | 110.5 | 353.6 | 312.7 |
| Cost of revenues from clean coal activities | 27.7 | 0.7 | 74.4 | 12.4 |
| Interest | 10.7 | 10.3 | 32.1 | 30.4 |
| Depreciation | 10.7 | 9.4 | 30.6 | 26.6 |
| Amortization | 25.8 | 20.0 | 73.1 | 54.7 |
| Change in estimated acquisition earnout payables | 3.7 | (4.3) | 1.0 | (6.0) |
| Total expenses | 574.1 | 491.8 | 1,647.2 | 1,395.9 |
| Earnings before income taxes | 76.3 | 71.0 | 199.9 | 160.4 |
| Provision for income taxes | 14.6 | 24.3 | 38.4 | 56.8 |
| Net earnings | \$ 61.7 | \$ 46.7 | \$ 161.5 | \$ 103.6 |
| Basic net earnings per share | \$ 0.50 | \$ 0.41 | \$ 1.35 | \$ 0.93 |
| Diluted net earnings per share | 0.50 | 0.41 | 1.33 | 0.93 |
| Dividends declared per common share | 0.34 | 0.33 | 1.02 | 0.99 |

See notes to consolidated financial statements.

Table of Contents**Arthur J. Gallagher & Co.****Consolidated Statement of Comprehensive Earnings****(Unaudited - in millions)**

| | Three-month period ended September 30, | | Nine-month period ended September 30, | |
|--|---|----------------|--|----------------|
| | 2012 | 2011 | 2012 | 2011 |
| Net earnings | \$ 61.7 | \$ 46.7 | \$ 161.5 | \$ 103.6 |
| Change in pension liability, net of taxes | 1.0 | 0.2 | 2.0 | 0.7 |
| Foreign currency translation | 19.6 | (15.1) | 17.4 | (13.7) |
| Change in fair value of derivative investments, net of taxes | 1.7 | (0.9) | 2.0 | (1.3) |
| Comprehensive earnings | \$ 84.0 | \$ 30.9 | \$ 182.9 | \$ 89.3 |

See notes to consolidated financial statements.

Table of Contents**Arthur J. Gallagher & Co.****Consolidated Balance Sheet****(In millions)**

| | September 30, 2012 (Unaudited) | December 31, 2011 |
|---|---|------------------------------|
| Cash and cash equivalents | \$ 305.2 | \$ 291.2 |
| Restricted cash | 805.5 | 692.5 |
| Premiums and fees receivable | 1,031.7 | 1,027.1 |
| Other current assets | 182.5 | 188.6 |
| Total current assets | 2,324.9 | 2,199.4 |
| Fixed assets - net | 101.0 | 91.3 |
| Deferred income taxes | 240.9 | 240.2 |
| Other noncurrent assets | 245.9 | 235.8 |
| Goodwill - net | 1,373.9 | 1,155.3 |
| Amortizable intangible assets - net | 722.7 | 561.5 |
| Total assets | \$ 5,009.3 | \$ 4,483.5 |
| Premiums payable to insurance and reinsurance companies | \$ 1,703.6 | \$ 1,621.9 |
| Accrued compensation and other accrued liabilities | 285.1 | 304.1 |
| Unearned fees | 67.7 | 69.7 |
| Other current liabilities | 33.9 | 67.9 |
| Corporate related borrowings - current | | 10.0 |
| Total current liabilities | 2,090.3 | 2,073.6 |
| Corporate related borrowings - noncurrent | 725.0 | 675.0 |
| Other noncurrent liabilities | 557.8 | 491.3 |
| Total liabilities | 3,373.1 | 3,239.9 |
| Stockholders' equity: | | |
| Common stock - issued and outstanding 124.4 shares in 2012 and 114.7 shares in 2011 | 124.4 | 114.7 |
| Capital in excess of par value | 1,017.9 | 693.2 |
| Retained earnings | 519.7 | 482.9 |
| Accumulated other comprehensive loss | (25.8) | (47.2) |
| Total stockholders' equity | 1,636.2 | 1,243.6 |
| Total liabilities and stockholders' equity | \$ 5,009.3 | \$ 4,483.5 |

See notes to consolidated financial statements.

Table of Contents**Arthur J. Gallagher & Co.****Consolidated Statement of Cash Flows****(Unaudited - in millions)**

| | Nine-month period ended September 30, | |
|---|--|----------------|
| | 2012 | 2011 |
| Cash flows from operating activities: | | |
| Net earnings | \$ 161.5 | \$ 103.6 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Net gain on investments and other | (1.4) | (1.2) |
| Depreciation and amortization | 103.7 | 81.3 |
| Change in estimated acquisition earnout payables | 1.0 | (6.0) |
| Amortization of deferred compensation and restricted stock | 6.4 | 5.3 |
| Stock-based and other noncash compensation expense | 5.5 | 11.4 |
| Effect of changes in foreign exchange rates | 0.9 | 0.1 |
| Net change in restricted cash | (65.7) | 3.0 |
| Net change in premiums receivable | 75.1 | 95.2 |
| Net change in premiums payable | (55.5) | (80.2) |
| Net change in other current assets | 12.2 | 20.6 |
| Net change in accrued compensation and other accrued liabilities | (42.6) | (34.9) |
| Net change in fees receivable/unearned fees | (7.9) | (6.6) |
| Net change in income taxes payable | 12.9 | (9.8) |
| Net change in deferred income taxes | 3.3 | 28.3 |
| Net change in other noncurrent assets and liabilities | (30.0) | (24.5) |
| Net cash provided by operating activities | 179.4 | 185.6 |
| Cash flows from investing activities: | | |
| Net additions to fixed assets | (36.1) | (35.3) |
| Cash paid for acquisitions, net of cash acquired | (137.9) | (241.8) |
| Net proceeds from sales of operations/books of business | 8.9 | 12.7 |
| Net proceeds (funding) of investment transactions | 10.7 | (3.7) |
| Net cash used by investing activities | (154.4) | (268.1) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock | 60.9 | 54.8 |
| Tax impact from issuance of common stock | 3.7 | 2.2 |
| Repurchases of common stock | | (1.1) |
| Dividends paid | (119.7) | (108.6) |
| Borrowings on line of credit facility | 162.0 | 102.0 |
| Repayments on line of credit facility | (172.0) | (102.0) |
| Borrowings of long-term debt | 50.0 | 125.0 |
| Net cash (used) provided by financing activities | (15.1) | 72.3 |
| Effect of changes in foreign exchange rates on cash and cash equivalents | 4.1 | 1.8 |
| Net increase (decrease) in cash and cash equivalents | 14.0 | (8.4) |
| Cash and cash equivalents at beginning of period | 291.2 | 249.8 |

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| | | |
|--|----------|----------|
| Cash and cash equivalents at end of period | \$ 305.2 | \$ 241.4 |
| Supplemental disclosures of cash flow information: | | |
| Interest paid | \$ 38.0 | \$ 33.8 |
| Income taxes paid | 17.0 | 31.0 |

See notes to consolidated financial statements.

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Table of Contents**Arthur J. Gallagher & Co.****Consolidated Statement of Stockholders Equity****(Unaudited - in millions)**

| | Common Stock | | Capital in | Retained | Accumulated | Total |
|---|--------------|----------|------------|----------|---------------|------------|
| | Shares | Amount | Excess of | Earnings | Other | |
| | | | Par Value | | Comprehensive | |
| | | | | | Loss | |
| Balance at December 31, 2011 | 114.7 | \$ 114.7 | \$ 693.2 | \$ 482.9 | \$ (47.2) | \$ 1,243.6 |
| Net earnings | | | | 161.5 | | 161.5 |
| Change in pension liability, net of taxes of \$1.3 million | | | | | 2.0 | 2.0 |
| Foreign currency translation | | | | | 17.4 | 17.4 |
| Change in fair value of derivative instruments, net of taxes of \$1.3 million | | | | | 2.0 | 2.0 |
| Compensation expense related to stock option plan grants | | | 5.2 | | | 5.2 |
| Tax impact from issuance of common stock | | | 3.7 | | | 3.7 |
| Common stock issued in: | | | | | | |
| Thirty-three acquisition transactions | 7.3 | 7.3 | 252.2 | | | 259.5 |
| Stock option plans | 2.1 | 2.1 | 52.2 | | | 54.3 |
| Employee stock purchase plan | 0.2 | 0.2 | 6.4 | | | 6.6 |
| Deferred compensation and restricted stock | 0.1 | 0.1 | 4.7 | | | 4.8 |
| Other compensation expense | | | 0.3 | | | 0.3 |
| Common stock repurchases | | | | | | |
| Cash dividends declared on common stock | | | | (124.7) | | (124.7) |
| Balance at September 30, 2012 | 124.4 | \$ 124.4 | \$ 1,017.9 | \$ 519.7 | \$ (25.8) | \$ 1,636.2 |

See notes to consolidated financial statements.

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Notes to September 30, 2012 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 or us, provide insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional and governmental organizations through two 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 is generated from our investment portfolio, which includes invested cash and restricted funds, as well as tax-advantaged, clean energy and other investments. We are headquartered in Itasca, Illinois, have operations in 17 countries and offer client-service capabilities in more than 110 countries through a global 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. We believe 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 our audited consolidated financial statements for the year ended December 31, 2011 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, 2011.

Certain reclassifications have been made to the amounts reported in the prior year's unaudited consolidated financial statements in order to conform to the current year presentation.

In the preparation of our unaudited consolidated financial statements as of September 30, 2012, 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.

2. Effect of New Accounting Pronouncements

Other Comprehensive Income

In June 2011, the Financial Accounting Standards Board (which we refer to as the FASB) issued ASU 2011-05, *Comprehensive Income (Topic 220)* to make the presentation of items within other comprehensive income (which we refer to as OCI) more prominent. The guidance requires companies to present items of net income, items of OCI and total comprehensive income in one continuous statement or two separate consecutive statements. We adopted this guidance for reporting in the first quarter of 2012 by presenting the required information in two separate consecutive statements in the accompanying unaudited consolidated financial statements. We were able to make the changes required by this guidance without incurring any costs or operational challenges because we had all of the necessary information, and previously presented it in the statement of stockholders' equity and notes to our consolidated financial statements.

Testing Goodwill for Impairment

In August 2011, the FASB issued ASU 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment* that gives companies the option to perform a qualitative assessment that may allow them to skip the annual two-step test on goodwill impairment. The previously mandated two-step test requires companies to first assess goodwill for impairment by quantitatively comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the reporting unit's fair value is less than its carrying amount, an analysis must then be performed to measure the amount of the goodwill impairment, if any. ASU 2011-08 gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not (a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If a company concludes that this is the case, it must perform the two-step test. Otherwise, a company does not have to perform the two-step test.

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Using the optional qualitative screen introduced in the new guidance to test goodwill for impairment will require significant judgment. The qualitative assessment should consider not only company-specific information but all significant inputs used to determine fair value. Companies that use the screen will have to consider and weigh both positive and negative evidence that has a significant effect on a reporting unit's fair value and thoroughly document their analyses. Companies that appropriately apply the screen and achieve a positive result do not have to perform the annual two-step test and achieve the intended cost relief. The ASU is effective for fiscal years beginning after December 15, 2011. We do not plan to use the qualitative assessment provisions of this new guidance for our 2012 annual goodwill impairment review.

3. Business Combinations

During the nine-month period ended September 30, 2012, 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 |
|---|--------------------------------------|--------------------------|--------------|----------------------|---------------------|--------------------------------|--|--|
| Riley & Associates, Inc. January 1, 2012 | 64 | \$ 1.9 | \$ 0.7 | \$ | \$ 0.3 | \$ 1.2 | \$ 4.1 | \$ 1.6 |
| Detlefs & Company Benefit Resources, LLC February 1, 2012 | 52 | 1.7 | 0.6 | | 0.1 | | 2.4 | 1.4 |
| First Premium Insurance Group, Inc. (FPI) February 1, 2012 | 599 | 19.9 | 0.4 | | 1.0 | 2.8 | 24.1 | 7.0 |
| Gary Johnson & Associates, Inc. February 1, 2012 | 55 | 1.8 | 0.7 | | 0.1 | 0.3 | 2.9 | 1.4 |
| ProSource Financial, LLC February 1, 2012 | 207 | 7.3 | 6.7 | | 0.5 | 1.3 | 15.8 | 9.5 |
| BenefitLink Resource Group, Inc. (BRG) March 1, 2012 | 357 | 12.3 | | | 0.5 | 6.0 | 18.8 | 8.0 |
| Human Resource Management Systems, LLC March 1, 2012 | 143 | 5.0 | 1.7 | | 0.1 | 1.8 | 8.6 | 5.3 |
| Wischmeyer Financial, LP March 1, 2012 | 142 | 4.9 | 1.6 | | 0.1 | 1.4 | 8.0 | 5.5 |
| Besselman & Little Agency, LLC April 1, 2012 | 195 | 7.0 | 2.4 | | 0.1 | 1.8 | 11.3 | 4.6 |
| Schiff, Kreidler-Shell Insurance and Risk Services (SKS) April 1, 2012 | 744 | 27.6 | 13.3 | | | 1.4 | 42.3 | 18.5 |
| CGM Gallagher Group Limited (CGM) April 1, 2012 | | | 12.0 | | | | 12.0 | |
| VEBA Service Group, LLC May 1, 2012 | 162 | 5.8 | 2.0 | | 0.1 | 2.2 | 10.1 | 4.2 |

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| 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 |
|--|--------------------------------------|--------------------------|--------------|----------------------|---------------------|--------------------------------|--|--|
| Professional Claims Managers, Inc. May 1, 2012 | 175 | \$ 5.4 | \$ 2.2 | \$ | \$ 0.6 | \$ 1.3 | \$ 9.5 | \$ 3.9 |
| Insurance Dialogue Limited (IDL) May 1, 2012 | | | 26.7 | | | | 26.7 | |
| Grossman & Associates, Inc. June 1, 2012 | 99 | 3.3 | | | 0.1 | 0.6 | 4.0 | 5.6 |
| Broker Benefit Services, LLC June 1, 2012 | 180 | 6.2 | 2.1 | | 0.1 | 1.4 | 9.8 | 4.0 |
| Whitehaven Insurance Group, Inc. June 1, 2012 | 75 | 2.6 | 0.6 | | 0.2 | 0.7 | 4.1 | 1.6 |
| Contego Underwriting Limited July 1, 2012 | | | 7.1 | | | 5.0 | 12.1 | 6.3 |
| Grace/Mayer Insurance Agency, Inc. (GMI) July 1, 2012 | 549 | 19.5 | 1.5 | | 2.6 | 2.4 | 26.0 | 7.0 |
| G.S. Chapman & Associates Insurance Brokers, Inc. (GSC) July 1, 2012 | 905 | 28.6 | 7.0 | | 6.7 | 6.6 | 48.9 | 19.5 |
| Miller Buettner & Parrott, Inc. July 1, 2012 | 127 | 4.4 | 1.5 | | 0.1 | 1.1 | 7.1 | 6.0 |
| Triad USA, Inc. July 1, 2012 | 164 | 5.6 | 1.9 | | 0.2 | 1.4 | 9.1 | 7.3 |
| Blenheim Park Ltd. (BPL) August 1, 2012 | 254 | 9.1 | 5.0 | | | 12.3 | 26.4 | 17.2 |
| Sunday and Associates, Inc. August 1, 2012 | 99 | 3.3 | | | 0.1 | 0.9 | 4.3 | 2.6 |
| Acumus Limited (ACL) September 21, 2012 | | | 25.0 | 5.5 | | | 30.5 | |
| Thirteen other acquisitions completed in 2012 | 208 | 7.0 | 9.9 | | 0.7 | 4.0 | 21.6 | 8.4 |
| | 5,555 | \$ 190.2 | \$ 132.6 | \$ 5.5 | \$ 14.3 | \$ 57.9 | \$ 400.5 | \$ 156.4 |

In 2007, we acquired a 38.5% equity interest in CGM for \$11.9 million and accounted for our non-controlling interest in CGM's common stock using equity method accounting. CGM is an insurance intermediary and risk management company that provides property/casualty, health, risk management and other related services to clients throughout the Caribbean. CGM is headquartered in St. Lucia and has operations in Jamaica, Barbados, St. Vincent and St. Lucia. Effective April 1, 2012, we increased our ownership interest in CGM to 80%, with the option to increase our ownership in CGM to 100%, and consolidated its operations into our consolidated financial statements. CGM's acquisition date balance sheet and the excess of the purchase price over the estimated fair value of the tangible net assets acquired at the acquisition date, has been included in the tables above and below, respectively. We recognized a loss of \$3.5 million and a corresponding reduction in goodwill for the decrease in fair value of our initial 38.5% equity interest in CGM upon the acquisition of the additional 41.5% equity interest. The carrying

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value of our non-controlling interest in CGM was \$13.6 million as of the acquisition date. The fair value of our initial 38.5% equity interest in CGM was determined by allocating, on a pro rata basis, the fair value of the CGM entity as adjusted for the prior non-controlling ownership position. We determined the fair value of the CGM entity using the valuation techniques discussed below related to net assets acquired.

Effective May 1, 2012, we acquired a 78.5% ownership interest in IDL, with the option to increase our ownership in IDL to 100%, and consolidated its operations into our consolidated financial statements. IDL is a retail insurance broker that provides personal lines insurance within the homeowner and automobile markets in the U.K. IDL's acquisition date balance sheet and the excess of the purchase price over the estimated fair value of the tangible net assets acquired at the acquisition date, has been included in the tables above and below, respectively.

Common shares issued in connection with acquisitions are valued at closing market prices as of the date on which the consideration was paid for 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 on these obligations, 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. 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. 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 which reflect the ability of the acquired entity to achieve the targets. 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.

During each of the three-month periods ended September 30, 2012 and 2011, we recognized \$2.4 million and \$2.3 million, respectively, of expense in our consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations related to our 2009 to 2012 acquisitions. During the nine-month periods ended September 30, 2012 and 2011, we recognized \$7.0 million and \$6.2 million, respectively, of expense in our consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations related to our 2009 to 2012 acquisitions. In addition, during the three-month periods ended September 30, 2012 and 2011, we recognized \$1.3 million of expense and \$6.6 million of income, respectively, related to net adjustments in the estimated fair value of earnout obligations related to revised projections of future performance for twelve and eight acquisitions, respectively. In addition, during the nine-month periods ended September 30, 2012 and 2011, we recognized \$6.0 million and \$12.2 million, respectively, of income related to net adjustments in the estimated fair value of earnout obligations related to revised projections of future performance for thirty-one and thirteen acquisitions, respectively. The aggregate amount of maximum potential earnout obligations related to acquisitions made in 2009 and subsequent years was \$314.4 million as of September 30, 2012, of which \$114.8 million was recorded in our consolidated balance sheet as of September 30, 2012, based on the estimated fair value of the expected future payments to be made.

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The following is a summary of the estimated fair values of the net assets acquired at the date of each acquisition made in 2012 (in millions):

| | FPI | BRG | SKS | IDL | GMI | GSC | BPL | ACL | Thirty Other Acquisitions | Total |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|---------------------------|-----------------|
| Cash | \$ 0.2 | \$ 1.7 | \$ 0.4 | \$ | \$ 0.2 | \$ 0.7 | \$ 1.6 | \$ 0.6 | \$ 8.4 | \$ 13.8 |
| Other current assets | 5.5 | | 5.6 | 9.6 | 2.1 | 0.8 | 4.9 | 11.1 | 37.5 | 77.1 |
| Fixed assets | 0.5 | 0.1 | 0.1 | 0.4 | 0.1 | 0.1 | 0.3 | 0.1 | 1.8 | 3.5 |
| Noncurrent assets | | | | 3.8 | 1.8 | | | 6.4 | | 12.0 |
| Goodwill | 13.8 | 9.7 | 24.8 | 11.1 | 18.3 | 19.3 | 16.5 | 17.9 | 78.7 | 210.1 |
| Expiration lists | 14.1 | 8.7 | 27.2 | 19.4 | 15.3 | 29.0 | 11.9 | 9.7 | 89.8 | 225.1 |
| Non-compete agreements | 0.3 | 0.2 | 0.4 | | 0.1 | 0.2 | 0.3 | 0.5 | 2.8 | 4.8 |
| Trade names | | | | 0.6 | | | | | | 0.6 |
| Total assets acquired | 34.4 | 20.4 | 58.5 | 44.9 | 37.9 | 50.1 | 35.5 | 46.3 | 219.0 | 547.0 |
| Current liabilities | 4.8 | 1.6 | 5.6 | 10.7 | 6.0 | 1.2 | 5.7 | 13.2 | 37.4 | 86.2 |
| Noncurrent liabilities | 5.5 | | 10.6 | 7.5 | 5.9 | | 3.4 | 2.6 | 24.8 | 60.3 |
| Total liabilities assumed | 10.3 | 1.6 | 16.2 | 18.2 | 11.9 | 1.2 | 9.1 | 15.8 | 62.2 | 146.5 |
| Total net assets acquired | \$ 24.1 | \$ 18.8 | \$ 42.3 | \$ 26.7 | \$ 26.0 | \$ 48.9 | \$ 26.4 | \$ 30.5 | \$ 156.8 | \$ 400.5 |

These acquisitions are expected to allow us to, among other things, expand into desirable geographic locations, further extend our 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 to goodwill, expiration lists, non-compete agreements and trade names in the amounts of \$210.1 million, \$225.1 million, \$4.8 million and \$0.6 million, respectively, within the brokerage segment.

Provisional estimates of fair value are established at the time of the 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. We estimate 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. 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 (ten years for trade names, three to fifteen years for expiration lists and three to five years for non-compete agreements), 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 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 nine-month periods ended September 30, 2012, we wrote off \$0.3 million and \$3.4 million, respectively, of amortizable intangible assets related to the brokerage segment. No such indicators were noted in the three-month and nine-month periods ended September 30, 2011.

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Of the \$225.1 million of expiration lists, \$4.8 million of non-compete agreements and \$0.6 million of trade names related to our 2012 acquisitions, \$121.5 million, \$2.5 million and \$0.6 million, respectively, is not expected to be deductible for income tax purposes. Accordingly, we recorded a deferred tax liability of \$40.4 million and a corresponding amount of goodwill in 2012 related to the nondeductible amortizable intangible assets.

During the nine-month period ended September 30, 2012, we issued 425,000 shares of our common stock and paid \$3.4 million in cash related to earnout obligations of four acquisitions made prior to 2009 and recorded additional goodwill of \$0.1 million. During the nine-month period ended September 30, 2011, we issued 153,000 shares of our common stock, paid \$7.3 million in cash and accrued \$10.2 million in liabilities related to earnout obligations of seventeen acquisitions made prior to 2009 and recorded additional goodwill of \$11.7 million.

Our consolidated financial statements for the nine-month period ended September 30, 2012 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, 2011 (in millions, except per share data):

| | Three-month period ended September 30, | | Nine-month period ended September 30, | |
|--------------------------------|---|----------|--|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Total revenues | \$ 653.6 | \$ 601.8 | \$ 1,902.8 | \$ 1,679.8 |
| Net earnings | 62.0 | 49.2 | 165.6 | 115.7 |
| Basic net earnings per share | 0.50 | 0.42 | 1.35 | 0.99 |
| Diluted net earnings per share | 0.49 | 0.41 | 1.34 | 0.99 |

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, 2011, nor are they necessarily indicative of future operating results. Annualized revenues of the businesses acquired during the nine-month period ended September 30, 2012 totaled approximately \$155.5 million. For the nine-month period ended September 30, 2012, total revenues and net earnings recorded in our unaudited consolidated statement of earnings related to our 2012 acquisitions in the aggregate were \$62.6 million and \$2.0 million, respectively.

4. Intangible Assets

The carrying amount of goodwill at September 30, 2012 and December 31, 2011 allocated by domestic and foreign operations is as follows (in millions):

| | Brokerage | Risk Management | Corporate | Total |
|---|------------|--------------------|-----------|------------|
| At September 30, 2012 | | | | |
| United States | \$ 1,085.9 | \$ 18.5 | \$ | \$ 1,104.4 |
| Foreign, principally Australia, Canada and the U.K. | 267.4 | 2.1 | | 269.5 |
| Total goodwill net | \$ 1,353.3 | \$ 20.6 | \$ | \$ 1,373.9 |
| At December 31, 2011 | | | | |
| United States | \$ 951.0 | \$ 18.5 | \$ | \$ 969.5 |
| Foreign, principally Australia, Canada and the U.K. | 185.6 | 0.2 | | 185.8 |
| Total goodwill net | \$ 1,136.6 | \$ 18.7 | \$ | \$ 1,155.3 |

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The changes in the carrying amount of goodwill for the nine-month period ended September 30, 2012 are as follows (in millions):

| | Brokerage | Risk Management | Corporate | Total |
|--|-------------------|----------------------------|------------------|-------------------|
| Balance as of December 31, 2011 | \$ 1,136.6 | \$ 18.7 | \$ | \$ 1,155.3 |
| Goodwill acquired during the period | 210.1 | | | 210.1 |
| Goodwill related to earnouts recognized during the period | 0.1 | | | 0.1 |
| Goodwill adjustments due to appraisals and other acquisition adjustments | (0.6) | (0.2) | | (0.8) |
| Goodwill related to transfers of operations between segments | (2.0) | 2.0 | | |
| Foreign currency translation adjustments during the period | 9.1 | 0.1 | | 9.2 |
| Balance as of September 30, 2012 | \$ 1,353.3 | \$ 20.6 | \$ | \$ 1,373.9 |

Major classes of amortizable intangible assets at September 30, 2012 and December 31, 2011 consist of the following (in millions):

| | September 30, 2012 | December 31, 2011 |
|---|-------------------------------|------------------------------|
| Expiration lists | \$ 1,066.8 | \$ 837.5 |
| Accumulated amortization - expiration lists | (367.3) | (296.7) |
| | 699.5 | 540.8 |
| Non-compete agreements | 30.4 | 26.3 |
| Accumulated amortization - non-compete agreements | (22.9) | (21.3) |
| | 7.5 | 5.0 |
| Trade name | 20.5 | 19.0 |
| Accumulated amortization - trade name | (4.8) | (3.3) |
| | 15.7 | 15.7 |
| Net amortizable assets | \$ 722.7 | \$ 561.5 |

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

| | |
|-------------------------------|-----------------|
| 2012 (remaining three months) | \$ 25.7 |
| 2013 | 102.4 |
| 2014 | 99.7 |
| 2015 | 94.5 |
| 2016 | 89.0 |
| Total | \$ 411.3 |

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5. Credit and Other Debt Agreements

Note Purchase Agreement - 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 \$100.0 million in aggregate principal amount of our 6.26% Senior Notes, Series A, due August 3, 2014 and \$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 also 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 also 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 our 5.49% Senior Notes, Series E, due February 10, 2023, in a private placement. These notes require semi-annual payments of interest that are due in February and August of each year.

We are also a party to a note purchase agreement dated July 10, 2012, with certain accredited institutional investors, pursuant to which we issued and sold \$50.0 million in aggregate principal amount of our 3.99% Senior Notes, Series F, due July 10, 2020, in a private placement. These notes require semi-annual payments of interest that are due in January and July of each year.

Under the terms of the note purchase agreements, we may redeem the notes 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. We do not currently intend to prepay the notes.

The note purchase agreements contain customary provisions for transactions of this type, including representations and warranties regarding us and our subsidiaries and various financial covenants, including covenants that require us to maintain specified financial ratios. We were in compliance with these covenants as of September 30, 2012. 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 our or our subsidiaries' indebtedness, certain judgments against us or our subsidiaries and events of bankruptcy involving us or our material subsidiaries.

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

Credit Agreement - On July 15, 2010, we entered into an unsecured multicurrency credit agreement (which we refer to as the Credit Agreement), which expires on July 14, 2014, with a group of twelve financial institutions.

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 letters of credit and up to \$50.0 million may be used for the making of swing loans, as defined in the Credit Agreement. We 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 we 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 will be Eurocurrency loans. Interest rates on base rate loans and outstanding drawings on letters of credit 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 letters of credit in currencies other than U.S. dollars are based on an adjusted London Interbank Offered Rate, 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 we maintain. Interest rates on swing loans are based, at our election, 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 commitment, depending on the financial leverage ratio we maintain.

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The terms of our Credit Agreement include various financial covenants, including covenants that require us to maintain specified levels of net worth and financial leverage ratios. We were in compliance with these covenants as of September 30, 2012. 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 September 30, 2012, \$15.9 million of letters of credit (for which we had \$8.6 million of liabilities recorded at September 30, 2012) were outstanding under the Credit Agreement. There were no borrowings outstanding under the Credit Agreement at September 30, 2012. Accordingly, as of September 30, 2012, \$484.1 million remained available for potential borrowings under the Credit Agreement, of which \$59.1 million may be in the form of additional letters of credit.

See Note 12 to these unaudited consolidated financial statements for additional discussion on our contractual obligations and commitments as of September 30, 2012.

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

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| 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 |
| 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 5.49%, balloon due 2023 | 50.0 | 50.0 |
| Semi-annual payments of interest, fixed rate of 3.99%, balloon due 2020 | 50.0 | |
| Total Note Purchase Agreements | 725.0 | 675.0 |
| Credit Agreement: | | |
| Periodic payments of interest and principal, prime or LIBOR plus up to 2.00%, expires July 14, 2014 | | 10.0 |
| | \$ 725.0 | \$ 685.0 |

The fair value of the \$725.0 million in debt under the note purchase agreements at September 30, 2012 was \$826.8 million due to the long-term duration and fixed interest rates associated with these debt obligations. No active or observable market exists for our private placement long-term debt. Therefore, the estimated fair value of this debt is based on discounted future cash flows, which is a Level 3 fair value measurement, using current interest rates available for debt with similar terms and remaining maturities. To estimate an all-in interest rate for discounting, we obtain market quotes for notes with the same terms as ours, which we have deemed to be the closest approximation of current market rates. We have not adjusted this rate for risk profile changes, covenant issues or credit ratings changes.

Table of Contents**6. 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 | | Nine-month period ended | |
|--|--------------------------|---------|-------------------------|----------|
| | September 30, | | September 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Net earnings | \$ 61.7 | \$ 46.7 | \$ 161.5 | \$ 103.6 |
| Weighted average number of common shares outstanding | 123.1 | 112.6 | 119.7 | 111.0 |
| Dilutive effect of stock options using the treasury stock method | 1.4 | 0.5 | 1.5 | 0.7 |
| Weighted average number of common and common equivalent shares outstanding | 124.5 | 113.1 | 121.2 | 111.7 |
| Basic net earnings per share | \$ 0.50 | \$ 0.41 | \$ 1.35 | \$ 0.93 |
| Diluted net earnings per share | \$ 0.50 | \$ 0.41 | \$ 1.33 | \$ 0.93 |

Options to purchase 1.4 million and 5.0 million shares of common stock were outstanding at September 30, 2012 and 2011, 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 1.0 million and 3.8 million shares of common stock were outstanding at September 30, 2012 and 2011, respectively, but were not included in the computation of the dilutive effect of stock options for the nine-month periods then ended. These options were excluded from the computation because the options' exercise prices were greater than the average market price of our common shares during the respective period, and therefore would be anti-dilutive to earnings per share under the treasury stock method.

7. Stock Option Plans**Long-Term Incentive Plan**

On May 10, 2011, our stockholders approved the Arthur J. Gallagher 2011 Long-Term Incentive Plan (which we refer to as the LTIP), which replaced our previous stockholder-approved Arthur J. Gallagher & Co. 2009 Long-Term Incentive Plan (which we refer to as the 2009 LTIP). The LTIP term began May 10, 2011 and it terminates on the date of the annual meeting of stockholders that occurs during the year of the seventh anniversary of its effective date, unless terminated earlier by our board of directors. All of our officers, employees and non-employee directors are eligible to receive awards under the LTIP. The compensation committee of our board of directors determines the participants under the LTIP. The LTIP provides for 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. A stock appreciation right entitles the holder to receive, upon exercise and subject to withholding taxes, cash or shares of our common stock (which may be restricted stock) with a value equal to the difference between the fair market value of our common stock on the exercise date and the base price of the stock appreciation right. Subject to the LTIP limits, the compensation committee has the discretionary authority to determine the size of awards.

Shares of our common stock available for issuance under the LTIP 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 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 the 2009 LTIP 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 for grant 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 us 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.

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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 1.2 million. To the extent necessary to be qualified performance-based compensation under Section 162(m) of the Internal Revenue Code (which we refer to as the IRC): (i) 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; (ii) 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; and (iii) the maximum amount that may be payable with respect to performance units granted during any fiscal year to any person is \$3.0 million.

The LTIP provides for the grant of stock options, which may be either tax-qualified incentive stock options or non-qualified options and stock appreciation rights. The compensation committee determines the period for the exercise of a non-qualified stock option, tax-qualified incentive stock option or stock appreciation right, 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 our 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.

Upon exercise, the option exercise price may be paid in cash, by the delivery of previously owned shares of our common stock, through a net-exercise arrangement, or through a broker-assisted cashless exercise arrangement. The compensation committee determines 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. Stock option and stock appreciation right awards under the LTIP are non-transferable.

On March 16, 2012, the compensation committee granted 1,355,000 options to our officers and key employees that become exercisable at the rate of 34%, 33% and 33% on the anniversary date of the grant in 2015, 2016 and 2017, respectively. On March 8, 2011, the compensation committee granted 851,000 options under the 2009 LTIP to our officers and key employees that become exercisable at the rate of 20% per year on each anniversary date of the grant. The 2012 and 2011 options expire seven years from the date of grant, or earlier in the event of certain terminations of employment.

Other Information

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

During the three-month periods ended September 30, 2012 and 2011, we recognized \$2.2 million and \$2.0 million, respectively, of compensation expense related to our stock option grants. During the nine-month periods ended September 30, 2012 and 2011, we recognized \$5.2 million and \$5.0 million, respectively, of compensation expense related to our stock option grants.

For purposes of expense recognition, the estimated fair values of the stock option grants are amortized to expense over the options' vesting period. We estimated the fair value of stock options at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | 2012 | 2011 |
|----------------------------------|-------|-------|
| Expected dividend yield | 4.0% | 4.5% |
| Expected risk-free interest rate | 1.2% | 2.7% |
| Volatility | 26.9% | 26.8% |
| Expected life (in years) | 5.0 | 6.0 |

Option valuation models require the input of highly subjective assumptions including the expected stock price volatility. 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. Because our 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 our employee and non-employee director stock options. The weighted average fair value per option for all options granted during the nine-month periods ended September 30, 2012 and 2011, as determined on the grant date using the Black-Scholes option pricing model, was \$5.49 and \$5.25, respectively.

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The following is a summary of our stock option activity and related information for 2012 (in millions, except exercise price and year data):

| | Nine-month period ended September 30, 2012 | | | |
|------------------------------------|--|---------------------------------|--|---------------------------|
| | Shares Under Option | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
| Beginning balance | 10.6 | \$ 27.20 | | |
| Granted | 1.4 | 35.71 | | |
| Exercised | (2.1) | 25.98 | | |
| Forfeited or canceled | (0.1) | 30.87 | | |
| Ending balance | 9.8 | \$ 28.62 | 3.54 | \$ 70.3 |
| Exercisable at end of period | 5.8 | \$ 27.38 | 2.68 | \$ 49.0 |
| Ending vested and expected to vest | 9.7 | \$ 28.58 | 3.52 | \$ 70.1 |

Options with respect to 10.0 million shares (less any shares of restricted stock issued under the LTIP see Note 9 to these unaudited consolidated financial statements) were available for grant under the LTIP at September 30, 2012.

The total intrinsic value of options exercised during the nine-month periods ended September 30, 2012 and 2011 was \$19.1 million and \$6.9 million, respectively. As of September 30, 2012, we had approximately \$19.2 million of total unrecognized compensation expense related to nonvested options. We expect to recognize that expense over a weighted average period of approximately four years.

Other information regarding stock options outstanding and exercisable at September 30, 2012 is summarized as follows (in millions, except exercise price and year data):

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|--------------------------|---------------------|--|---------------------------------|---------------------|---------------------------------|
| | Number Outstanding | Weighted Average Remaining Contractual Term (in years) | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| \$ 5.79 - \$ 24.90 | 2.4 | 2.92 | \$ 24.25 | 1.6 | \$ 24.27 |
| 24.99 - 27.25 | 2.4 | 3.11 | 26.94 | 1.7 | 26.94 |
| 27.35 - 29.42 | | | | | |