BROWN & BROWN INC
Form 10-Q
August 09, 2006

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, 2006

or

o **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 001-13619
BROWN & BROWN, INC.
(Exact name of Registrant as specified in its charter)

Florida (State or other jurisdiction of incorporation or organization)		**59-0864469** (I.R.S. Employer Identification Number)
	®	
220 South Ridgewood Avenue, Daytona Beach, FL (Address of principal executive offices)		**32114** (Zip Code)

Registrant's telephone number, including area code: (386) 252-9601
Registrant's Website: www.bbinsurance.com

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, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The number of shares of the Registrant's common stock, $.10 par value, outstanding as of August 2, 2006 was 139,480,235.

BROWN & BROWN, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS (UNAUDITED)

BROWN & BROWN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share data)	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
REVENUES				
Commissions and fees	$ 217,427	$ 192,738	$ 445,342	$ 393,053
Investment income	2,956	1,524	5,165	2,489
Other income, net	424	1,669	882	2,763
Total revenues	220,807	195,931	451,389	398,305
EXPENSES				
Employee compensation and benefits	103,180	94,100	203,910	184,484
Non-cash stock-based compensation	1,434	788	3,764	1,679
Other operating expenses	30,134	25,980	61,103	53,122
Amortization	8,978	8,357	17,978	15,892
Depreciation	2,785	2,527	5,380	4,894
Interest	3,329	3,711	6,851	7,253
Total expenses	149,840	135,463	298,986	267,324
Income before income taxes	70,967	60,468	152,403	130,981
Income taxes	26,536	23,435	57,946	50,930
Net income	$ 44,431	$ 37,033	$ 94,457	$ 80,051
Net income per share:				
Basic	$ 0.32	$ 0.27	$ 0.68	$ 0.58
Diluted	$ 0.32	$ 0.27	$ 0.67	$ 0.57
Weighted average number of shares outstanding:				
Basic	139,511	138,312	139,447	138,318
Diluted	141,006	139,476	140,915	139,448
Dividends declared per share	$ 0.05	$ 0.04	$ 0.10	$ 0.08

See accompanying notes to condensed consolidated financial statements.

BROWN & BROWN, INC.
CONDENSED CONSOLIDATED
BALANCE SHEETS
(UNAUDITED)

(in thousands, except per share data)		June 30, 2006		December 31, 2005
ASSETS				
Current Assets:				
Cash and cash equivalents	$	33,148	$	100,580
Restricted cash and investments		275,959		229,872
Short-term investments		2,799		2,748
Premiums, commissions and fees receivable		276,730		257,930
Other current assets		21,767		28,637
Total current assets		610,403		619,767
Fixed asset		43,730		39,398
Goodwill		646,027		549,040
Amortizable intangible assets, net		390,252		377,907
Investments		9,656		8,421
Other assets		15,163		14,127
Total assets	$	1,715,231	$	1,608,660
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current Liabilities:				
Premiums payable to insurance companies	$	463,352	$	397,466
Premium deposits and credits due customers		28,884		34,027
Accounts payable		33,784		21,161
Accrued expenses		62,837		74,534
Current portion of long-term debt		17,990		55,630
Total current liabilities		606,847		582,818
Long-term debt		208,181		214,179
Deferred income taxes, net		37,531		35,489
Other liabilities		12,688		11,830
Shareholders' Equity:				
Common stock, par value $0.10 per share; authorized 280,000 shares; issued and outstanding 139,480 at 2006 and 139,383 at 2005		13,948		13,938
Additional paid-in capital		197,581		193,313
Retained earnings		633,159		552,647
Accumulated of other comprehensive income, net of related income tax effect of $3,104 at 2006 and $2,606 at 2005		5,296		4,446

Total shareholders’ equity		849,984		764,344
Total liabilities and shareholders’ equity	$	1,715,231	$	1,608,660

See accompanying notes to condensed consolidated financial statements.

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BROWN & BROWN, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(n thousands)		For the six months ended June 30, 2006		2005
Cash flows from operating activities:				
Net income	$	94,457	$	80,051
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization		17,978		15,892
Depreciation		5,380		4,894
Non-cash stock-based compensation		3,764		1,679
Deferred income taxes		1,544		925
Net gain on sales of investments, fixed assets and customer accounts		(249)		(2,515)
Changes in operating assets and liabilities, net of effect from acquisitions and divestitures:				
Restricted cash and investments (increase)		(46,087)		(89,021)
Premiums, commissions and fees receivable (increase)		(18,328)		(44,814)
Other assets decrease		5,998		9,183
Premiums payable to insurance companies increase		55,621		128,046
Premium deposits and credits due customers (decrease)		(5,143)		(8,271)
Accounts payable increase		12,481		4,441
Accrued expenses (decrease)		(12,958)		(5,219)
Other liabilities increase (decrease)		666		(988)
Net cash provided by operating activities		115,124		94,283
Cash flows from investing activities:				
Additions to fixed assets		(9,096)		(7,210)
Payments for businesses acquired, net of cash acquired		(89,014)		(215,155)
Proceeds from sales of fixed assets and customer accounts		612		2,005
Purchases of investments		(47)		(190)
Proceeds from sales of investments		12		521
Net cash used in investing activities		(97,533)		(220,029)
Cash flows from financing activities:				
Payments on long-term debt		(71,593)		(8,766)
Borrowings on revolving credit facility		-		50,000
Payments on revolving credit facility		-		(50,000))
Issuances of common stock for employee stock benefit plans		514		410
Cash dividends paid		(13,944)		(11,064)
Net cash used in financing activities		(85,023)		(19,420)
Net decrease in cash and cash equivalents		(67,432)		(145,166)
Cash and cash equivalents at beginning of period		100,580		188,106
Cash and cash equivalents at end of period	$	33,148	$	42,940

See accompanying notes to condensed consolidated financial statements.

BROWN & BROWN, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 • Nature of Operations

Brown & Brown, Inc., a Florida corporation, and its subsidiaries (collectively, Brown & Brown or the "Company") is a diversified insurance agency, brokerage, and services organization that markets and sells to its customers insurance products and services, primarily in the property and casualty area. Brown & Brown's business is divided into four reportable segments: the Retail Division, which provides a broad range of insurance products and services to commercial, public entity, professional and individual customers; the National Programs Division, which is comprised of two units - Professional Programs, which provides professional liability and related package products for certain professionals delivered through nationwide networks of independent agents, and Special Programs, which markets targeted products and services designated for specific industries, trade groups, governmental entities and market niches; the Brokerage Division, which markets and sells excess and surplus commercial and personal lines insurance, and reinsurance, primarily through independent agents and brokers; and the Services Division, which provides insurance-related services, including third-party administration, consulting for the workers' compensation and managed healthcare services, and Medicare set-aside services and programs.

NOTE 2 • Basis of Financial Reporting

The accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("United States") for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These unaudited, condensed, consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

NOTE 3 • Net Income Per Share

Basic net income per share is computed by dividing net income available to shareholders by the weighted average number of shares outstanding for the period. Basic net income per share excludes dilution. Diluted net income per share reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted to common stock.

The following table sets forth the computation of basic net income per share and diluted net income per share:

(in thousands, except per share data)	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Net income	$ 44,431	$ 37,033	$ 94,457	$ 80,051
Weighted average number of common shares outstanding	139,511	138,312	139,447	138,318
Dilutive effect of stock options using the treasury stock method	1,495	1,164	1,468	1,130
Weighted average number of shares outstanding	141,006	139,476	140,915	139,448
Net income per share:				
Basic	$ 0.32	$ 0.27	$ 0.68	$ 0.58
Diluted	$ 0.32	$ 0.27	$ 0.67	$ 0.57

All share and per share amounts in the consolidated financial statements have been restated to give effect to the two-for-one common stock split effected by Brown & Brown on November 28, 2005. The stock split was effected as a stock dividend.

NOTE 4 • New Accounting Pronouncements

Stock-Based Compensation - The Company grants stock options and non-vested stock awards (previously referred to as "restricted stock") to its employees, officers and directors. Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R, *Share-Based Payment* ("SFAS 123R"), for its stock-based compensation plans. Among other things, SFAS 123R requires that compensation expense for all share-based awards be recognized in the financial statements based upon the grant-date fair value of those awards.

Prior to January 1, 2006, the Company accounted for stock-based compensation using the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25"), and related interpretations, and disclosure requirements established by SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transitions and Disclosures* ("SFAS 148").

Under APB No. 25, no compensation expense was recognized for either stock options issued under the Company's stock compensation plans or for stock purchased under the Company's 1990 Employee Stock Purchase Plan ("ESPP"). The pro forma effects on net income and earnings per share for stock options and ESPP awards were instead disclosed in a footnote to the financial statements. Compensation expense was previously recognized for awards of non-vested stock, based upon the market value of the common stock on the date of award, on a straight-line basis over the requisite service period with the effect of forfeitures recognized as they occurred.

The following table represents the pro forma information for the three and six months ended June 30, 2005 (as previously disclosed) under the Company's stock compensation plans had compensation cost for the stock options and common stock purchased under the ESPP been determined based on the fair value at the grant-date consistent with the method prescribed by SFAS No. 123R:

(in thousands, except per share data)		Periods Ended June 30, 2005	
		Three Months	**Six months**
Net income	As reported	$ 37,033	$ 80,051
Add: Total stock-based compensation included in net income, net of tax effect	As reported	483	1,028
Less: Total stock-based employee compensation expense determined under fair value method for all awards, net of tax effect	Pro forma	(1,139)	(2,337)
Net income	Pro forma	$ 36,377	$ 78,742
Basic earnings per share:	As reported	$ 0.27	$ 0.58
	Pro forma	$ 0.26	$ 0.57
Diluted earnings per share:	As reported	$ 0.27	$ 0.57
	Pro forma	$ 0.26	$ 0.56

The Company has adopted SFAS 123R using the modified-prospective transition method. Under this transition method, compensation cost recognized in the first and second quarters of 2006 includes:

- compensation cost for all share-based awards (expected to vest) granted prior to, but not yet vested as of January 1, 2006, based upon grant-date fair value estimated in accordance with the original provisions of SFAS 123; and

- compensation cost for all share-based awards (expected to vest) granted during the three and six months ended June 30, 2006 based upon grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Results for prior periods have not been restated.

Upon adoption of SFAS 123R, the Company continued to use the Black-Scholes valuation model for valuing all stock options and shares granted under the ESPP. Compensation for non-vested stock awards is measured at fair value on the grant-date based upon the number of shares expected to vest. Compensation cost for all awards will be recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period. The cumulative effect of changing from recognizing compensation expense for non-vested stock awards as forfeitures occurred to recognizing compensation expense for non-vested awards net of estimated forfeitures was not material.

The adoption of SFAS 123R had the following effect on the Company for the three- and six- months ended June 30, 2006:

(in thousands, except per share data)	Three Month Period	Six Month Period
Non-cash stock-based compensation	$ (12)	$ 872
Reduction (increase) in:		
Provision for income taxes	$ (4)	$ 336
Net income	$ (8)	$ 536
Basic earnings per share	$ –	$ –
Diluted earnings per share	$ –	$ –
Increase (decrease) in deferred tax assets	$ (4)	$ 336

In addition, prior to the adoption of SFAS 123R, the Company presented tax benefits resulting from the exercise of stock options as operating cash flows in the statement of cash flows. SFAS 123R requires that tax benefits associated with share-based payments be classified under financing activities in the statement of cash flows. Since no stock option shares were exercised that gave rise to excess tax deductions during the three or six months ended June 30, 2006, there is no effect of the adoption of SFAS 123R on the cash flow statement for the three or six months ended June 30, 2006.

See Note 5 for additional information regarding the Company's stock-based compensation plans and the assumptions used to calculate the fair value of stock-based awards.

NOTE 5 • Employee Stock-Based Compensation

Stock Option Awards

The Company uses the Black-Scholes option-pricing model to estimate the fair value of stock options on the grant-date under SFAS 123R, which is the same valuation technique previously used for pro forma disclosures under SFAS 123. The Company did not grant any options during the three or six months ended June 30, 2006, but did grant 12,000 shares during the six months ended June 30, 2005. The Company used the following weighted average assumptions for all options granted during the six months ended June 30, 2005:

Risk-free interest rate	4.5%
Expected life (in years)	6
Expected volatility	35%
Dividend yield	0.86%

The risk-free interest rate is based upon the US Treasury yield curve on the date of grant with a remaining term approximating the expected term of the option granted. The expected term of the options granted is derived from historical data; employees are divided into two groups based upon expected exercise behavior and are considered separately for valuation purposes. The expected volatility is based upon the historical volatility of the Company's common stock over the period of time equivalent to the expected term of the options granted. The dividend yield is based upon the Company's best estimate of future dividend yield.

A summary of stock option activity for the six-month period ended June 30, 2006 is as follows:

Stock Options	Shares Under option	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value *(in thousands)*
Outstanding at January 1, 2006	2,016,988	$10.83		
Granted	-	$ -		
Exercised	35,017	$ 7.35		
Forfeited	-	$ -		
Expired	-	$ -		
Outstanding at June 30, 2006	1,981,971	$10.89	5.4	36,335

Exercisable at June 30, 2006	1,273,263	$ 8.10	4.7	26,885

The weighted average grant-date fair value of stock options granted during the six-months ended June 30, 2005 was $8.51. The total intrinsic value of options exercised, determined as of the date of exercise, during the six months ended June 30, 2006 and 2005 was $818,000 and $850,000, respectively. Aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted market price of the Company's stock for in-the-money stock options at June 30, 2006.

Non-Vested Stock Awards ("Performance Stock Plan" or "PSP")

The Company uses a path-depended lattice model to estimate the fair value of PSP grants on the grant-date under SFAS 123R. A summary of PSP activity for the six months ended June 30, 2006 is as follows:

Stock Options		Weighted-Average Grant Date Fair Value	Granted Shares	Awarded Shares	Shares Not Yet Awarded
Outstanding at January 1, 2006	$	5.21	6,349,298	5,622,920	726,378
Granted	$	19.73	122,845	-	122,845
Awarded	$	11.50	-	253,672	(253,672)
Vested	$	10.89	(1,086)	(1,086)	-
Forfeited	$	5.32	(220,840)	(199,770)	(21,070)
Outstanding at June 30, 2006	$	5.51	6,250,217	5,675,736	574,481

The weighted average grant-date fair value of PSP grants for the six months ended June 30, 2006 and 2005 was $19.73 and $14.13, respectively. The total fair value of PSP grants that vested during each of the six months ended June 30, 2006 and 2005 was $35,000 and $-0-, respectively.

Employee Stock Purchase Plan ("ESPP")

The Company has a shareholder approved ESPP. Employees of the Company who regularly work more than 20 hours per week are eligible to participate in the plan. Participants, through payroll deductions, may subscribe to purchase Company stock up to 10% of their compensation, to a maximum of $25,000, during each annual subscription period at a cost of 85% of the lower of the stock price as of the beginning or ending of the stock subscription period. During the six months ended June 30, 2006 and 2005, 305,451 and 266,935 shares of common stock (from authorized but unissued shares), respectively, were subscribed to by employees participating in the Company's ESPP for proceeds of approximately $5,642,000 and $4,709,000, respectively.

As of June 30, 2006, there was approximately $17.2 million of unrecognized compensation expense related to all non-vested share-based compensation arrangements granted under the Company's stock compensation plans. That expense is expected to be recognized over a weighted-average period of 10.2 years.

NOTE 6 • Business Combinations

Acquisitions in 2006

For the six months ended June 30, 2006, Brown & Brown acquired the assets and assumed certain liabilities of 11 entities. The aggregate purchase price of these acquisitions was $101,507,000, including $87,023,000 of net cash payments, the issuance of $3,582,000 in notes payable and the assumption of $10,902,000 of liabilities. Substantially all of these acquisitions were acquired primarily to expand Brown & Brown's core businesses and to attract and obtain high-quality individuals. Acquisition purchase prices are based primarily on a multiple of average annual operating profits earned over a one- to three-year period within a minimum and maximum price range. The initial asset allocation of an acquisition is based on the minimum purchase price, and any subsequent earn-out payment is allocated to goodwill.

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All of these acquisitions have been accounted for as business combinations and are as follows:

(in thousands) Name	Business Segment	2006 Date of Acquisition	Net Cash Paid	Notes Payable	Recorded Purchase Price
Axiom Intermediaries, LLC	Brokerage	January 1	$ 60,292	$ -	$ 60,292
Other	Various	Various	26,731	3,582	30,313
Total			$ 87,023	$ 3,582	$ 90,605

The following table summarizes the estimated fair values of the aggregate assets and liabilities acquired as of the date of each acquisition:

(in thousands)	Axiom	Other	Total
Fiduciary cash	$ 9,598	$ -	$ 9,598
Other current assets	372	100	472
Fixed assets	435	361	796
Purchased customer accounts	14,022	16,161	30,183
Noncompete agreements	31	207	238
Goodwill	45,819	14,328	60,147
Other assets	73	-	73
Total assets acquired	70,350	31,157	101,507
Other current liabilities	(10,058)	(652)	(10,710)
Other liabilities	-	(192)	(192)
Total liabilities assumed	(10,058)	(844)	(10,902)
Net assets acquired	$ 60,292	$ 30,313	$ 90,605

The results of operations for the acquisitions completed during 2006 have been combined with those of the Company since their respective acquisitions dates. If the acquisitions had occurred as of January 1, 2005, the Company's results of operations would be as shown in the following table:

(UNAUDITED)	For the three months ended June 30,		For the six months ended June 30,	
(in thousands, except per share data)	2006	2005	2006	2005
Total revenues	$ 222,314	$ 203,859	$ 456,896	$ 414,788
Income before income taxes	71,479	63,089	154,284	136,452
Net income	44,751	38,638	95,623	83,395
Net income per share:				
Basic	$ 0.32	$ 0.28	$ 0.69	$ 0.60
Diluted	$ 0.32	$ 0.28	$ 0.68	$