

HILB ROGAL & HOBBS CO  
Form 10-Q  
November 07, 2005  
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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

### QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005

Commission File Number 0-15981

## HILB ROGAL & HOBBS COMPANY

(Exact name of registrant as specified in its charter)

Virginia  
(State or other jurisdiction of  
incorporation or organization)

54-1194795  
(I.R.S. Employer  
Identification No.)

4951 Lake Brook Drive, Suite 500

Glen Allen, Virginia  
(Address of principal executive offices)

23060  
(Zip Code)

(804) 747-6500

(Registrant's telephone number, including area code)

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding at October 31, 2005</u>
Common Stock, no par value	35,808,454

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**HILB ROGAL & HOBBS COMPANY**

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**Table of Contents****HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES****STATEMENT OF CONSOLIDATED INCOME****(UNAUDITED)****PART I FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS.**

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
<i>(in thousands, except per share amounts)</i>				
<b>REVENUES</b>				
Commissions and fees	\$ 161,119	\$ 151,622	\$ 499,808	\$ 453,692
Investment income	1,633	788	4,221	2,099
Other	1,739	1,290	5,834	3,891
	<u>164,491</u>	<u>153,700</u>	<u>509,863</u>	<u>459,682</u>
<b>OPERATING EXPENSES</b>				
Compensation and employee benefits	90,742	81,474	274,597	244,344
Other operating expenses	29,893	28,313	95,423	80,290
Depreciation	2,122	2,136	6,402	6,465
Amortization of intangibles	4,783	3,444	14,197	9,125
Interest expense	4,300	2,546	12,097	7,460
Regulatory charge and related costs	42,320		42,320	
Severance charge			1,303	
Integration costs		176	764	1,803
	<u>174,160</u>	<u>118,089</u>	<u>447,103</u>	<u>349,487</u>
<b>INCOME BEFORE INCOME TAXES</b>	<u>(9,669)</u>	<u>35,611</u>	<u>62,760</u>	<u>110,195</u>
Income tax expense (benefit)	(2,821)	14,262	26,083	44,108
<b>NET INCOME (LOSS)</b>	<u>\$ (6,848)</u>	<u>\$ 21,349</u>	<u>\$ 36,677</u>	<u>\$ 66,087</u>
<b>Net Income (Loss) Per Share:</b>				
Basic	\$ (0.19)	\$ 0.60	\$ 1.03	\$ 1.85
Assuming Dilution	\$ (0.19)	\$ 0.58	\$ 1.01	\$ 1.81

See notes to consolidated financial statements.



**Table of Contents****HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEET**

<i>(in thousands)</i>	<b>September 30, 2005</b>	<b>December 31, 2004</b>
	<b>(UNAUDITED)</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents, including \$54,629 and \$55,909, respectively, of restricted funds	\$ 219,788	\$ 210,470
Receivables:		
Premiums and commissions, less allowance for doubtful accounts of \$5,163 and \$4,630, respectively	203,983	211,299
Other	35,929	29,122
	<u>239,912</u>	<u>240,421</u>
Prepaid expenses and other current assets	35,706	24,586
	<u>239,912</u>	<u>240,421</u>
<b>TOTAL CURRENT ASSETS</b>	<b>495,406</b>	<b>475,477</b>
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>25,374</b>	<b>24,024</b>
<b>GOODWILL</b>	<b>623,474</b>	<b>608,427</b>
<b>OTHER INTANGIBLE ASSETS</b>	<b>190,807</b>	<b>181,289</b>
Less accumulated amortization	45,814	31,774
	<u>768,467</u>	<u>757,942</u>
<b>OTHER ASSETS</b>	<b>26,381</b>	<b>20,556</b>
	<u>26,381</u>	<u>20,556</u>
	<b>\$ 1,315,628</b>	<b>\$ 1,277,999</b>
	<u>\$ 1,315,628</u>	<u>\$ 1,277,999</u>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Premiums payable to insurance companies	\$ 308,429	\$ 315,130
Accounts payable	12,925	13,417
Accrued expenses	66,138	46,371
Premium deposits and credits due customers	47,949	48,287
Current portion of long-term debt	12,540	16,248
	<u>447,981</u>	<u>439,453</u>
<b>TOTAL CURRENT LIABILITIES</b>	<b>447,981</b>	<b>439,453</b>
<b>LONG-TERM DEBT</b>	<b>260,471</b>	<b>265,384</b>
<b>DEFERRED INCOME TAXES</b>	<b>33,658</b>	<b>34,113</b>
<b>OTHER LONG-TERM LIABILITIES</b>	<b>49,008</b>	<b>31,893</b>
<b>SHAREHOLDERS EQUITY</b>		
Common Stock, no par value; authorized 100,000 shares; outstanding 35,774 and 35,886 shares, respectively	226,635	233,785
Retained earnings	296,654	271,978
Accumulated other comprehensive income (loss)		
Unrealized gain (loss) on interest rate swaps, net of deferred tax (expense) benefit of \$(289) and \$120 respectively	434	(181)
Foreign currency translation adjustments	787	1,574

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	<u>524,510</u>	<u>507,156</u>
	<u>\$ 1,315,628</u>	<u>\$ 1,277,999</u>

See notes to consolidated financial statements.

**Table of Contents****HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES****STATEMENT OF CONSOLIDATED SHAREHOLDERS EQUITY****(UNAUDITED)**

	<b>Common Stock</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>
	<u>          </u>	<u>          </u>	<u>          </u>
<i>(in thousands, except per share amounts)</i>			
Balance at January 1, 2005	\$ 233,785	\$ 271,978	\$ 1,393
Issuance of 501 shares of Common Stock	12,835		
Repurchase of 613 shares of Common Stock	(21,848)		
Income tax benefit from exercise of stock options	1,863		
Payment of dividends (\$0.3350 per share)		(12,001)	
Derivative gain, net of tax			615
Foreign currency translation adjustments			(787)
Net income		36,677	
	<u>          </u>	<u>          </u>	<u>          </u>
Balance at September 30, 2005	\$ 226,635	\$ 296,654	\$ 1,221
	<u>          </u>	<u>          </u>	<u>          </u>
Balance at January 1, 2004	\$ 228,357	\$ 205,184	\$ 726
Issuance of 982 shares of Common Stock	17,987		
Repurchase of 503 shares of Common Stock	(17,300)		
Income tax benefit from exercise of stock options	7,299		
Payment of dividends (\$0.3025 per share)		(10,853)	
Derivative gain, net of tax			233
Foreign currency translation adjustments			(67)
Net income		66,087	
	<u>          </u>	<u>          </u>	<u>          </u>
Balance at September 30, 2004	\$ 236,343	\$ 260,418	\$ 892
	<u>          </u>	<u>          </u>	<u>          </u>

See notes to consolidated financial statements.



**Table of Contents****HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES****STATEMENT OF CONSOLIDATED CASH FLOWS****(UNAUDITED)**

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
<i>(in thousands)</i>		
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 36,677	\$ 66,087
Adjustments to reconcile net income to net cash provided by operating activities:		
Regulatory charge and related costs	42,320	
Severance charge	1,303	
Integration costs	764	1,803
Depreciation	6,402	6,465
Amortization of intangibles	14,197	9,125
Provision for losses on receivables	1,119	991
Provision for deferred income taxes	(3,561)	3,675
Gain on sale of assets	(2,791)	(560)
Income tax benefit from exercise of stock options	1,863	7,299
Changes in operating assets and liabilities net of effects from regulatory charge and related costs, severance charge, integration costs and insurance agency acquisitions and dispositions:		
Decrease in receivables	2,445	17,133
Increase in prepaid expenses	(8,628)	(9,261)
Decrease in premiums payable to insurance companies	(8,956)	(18,397)
Increase (decrease) in premium deposits and credits due customers	(337)	13,790
Decrease in accounts payable	(2,088)	(388)
Decrease in accrued expenses	(11,140)	(12,043)
Other operating activities	(71)	724
<b>Net Cash Provided by Operating Activities</b>	<b>69,518</b>	<b>86,443</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(7,365)	(6,570)
Purchase of insurance agencies, net of cash acquired	(19,281)	(45,128)
Proceeds from sale of assets	5,183	4,872
Other investing activities	536	(478)
<b>Net Cash Used in Investing Activities</b>	<b>(20,927)</b>	<b>(47,304)</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds from long-term debt		50,000
Principal payments on long-term debt	(9,475)	(5,419)
Debt issuance costs	(204)	(300)
Repurchase of Common Stock	(21,848)	(17,300)
Proceeds from issuance of Common Stock, net of tax payments for options exercised	4,255	(374)
Dividends	(12,001)	(10,853)
<b>Net Cash Provided by (Used in) by Financing Activities</b>	<b>(39,273)</b>	<b>15,754</b>

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Increase in cash and cash equivalents	9,318	54,893
Cash and cash equivalents at beginning of period	210,470	126,464
	<u>          </u>	<u>          </u>
Cash and cash equivalents at End of Period	\$ 219,788	\$ 181,357
	<u>          </u>	<u>          </u>

See notes to consolidated financial statements.

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**HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2005**

**(UNAUDITED)**

**NOTE A BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements of Hilb Rogal & Hobbs Company (the Company) have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States 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. Operating results for the nine-month period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2004.

**NOTE B ACCOUNTING FOR STOCK-BASED COMPENSATION**

The Company has three stock-based compensation plans. The Company continues to account for its stock options using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (Statement 123), as amended by Statement of Financial Accounting Standards No. 148, establishes accounting and disclosure requirements using a fair value based method of accounting for stock options.

In December 2004, the Financial Accounting Standards Board issued Financial Accounting Standards Board Statement No. 123 (revised 2004), Share-Based Payment (Statement 123R). Statement 123R revises Statement 123. The revised standard requires all companies to recognize compensation costs related to all share-based payments (including stock options) in their financial statements at fair value, thereby, upon adoption, eliminating the use of pro forma disclosures to report such amounts. In April 2005, the Securities and Exchange Commission issued a rule to amend the effective date of Statement 123R. Statement 123R is effective for a public company that is not a small business issuer at the beginning of the first fiscal year beginning after June 15, 2005.

Statement 123R permits public companies to account for the adoption of this revised standard using one of two methods: the modified-prospective method or the modified-retrospective method. The modified-prospective method requires a company to recognize compensation based upon fair value for only those share-based awards granted with an effective date subsequent to the company's date of

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adoption and share-based awards issued in prior periods that remain unvested at the date of adoption. The modified-retrospective method allows a company to restate, based upon pro forma amounts previously disclosed under the requirements of Statement 123, for either all prior periods presented or prior interim periods included in the year of adoption.

The Company intends to adopt Statement 123R no later than January 1, 2006, but has yet to determine which of the two methods described above will be utilized. The Company continues to evaluate the impact of this proposed statement on its financial position and results of operations.

**Table of Contents****HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****September 30, 2005****(UNAUDITED)**

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement 123 to stock-based compensation.

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<i>(in thousands, except per share amounts)</i>				
Net income (loss) as reported	\$ (6,848)	\$ 21,349	\$ 36,677	\$ 66,087
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1,519)	(1,447)	(4,223)	(4,103)
Pro forma net income (loss)	\$ (8,367)	\$ 19,902	\$ 32,454	\$ 61,984
Net income (loss) per share:				
Basic as reported	\$ (0.19)	\$ 0.60	\$ 1.03	\$ 1.85
Basic pro forma	\$ (0.23)	\$ 0.55	\$ 0.91	\$ 1.73
Assuming dilution as reported	\$ (0.19)	\$ 0.58	\$ 1.01	\$ 1.81
Assuming dilution pro forma	\$ (0.23)	\$ 0.55	\$ 0.89	\$ 1.70

**NOTE C INCOME TAXES**

Deferred taxes result from temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's effective rate varies from the statutory rate primarily due to state income taxes and certain non-deductible items in the regulatory charge.

**NOTE D ACQUISITIONS**

During the first nine months of 2005, the Company acquired certain assets and liabilities of four insurance agencies. These acquisitions, individually or in aggregate, were not material to the consolidated financial statements.

**NOTE E SALE OF ASSETS AND OTHER GAINS**

During the nine months ended September 30, 2005 and 2004, the Company sold certain insurance accounts and other assets resulting in gains of \$2.8 million and \$0.6 million, respectively. These amounts are included in other revenues in the Statement of Consolidated Income. Taxes related to these gains were \$1.3 million and \$0.2 million for the nine months ended September 30, 2005 and 2004, respectively. Revenues, expenses and assets related to these dispositions were not material to the consolidated financial statements.

**Table of Contents****HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****September 30, 2005****(UNAUDITED)****NOTE F NET INCOME (LOSS) PER SHARE**

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<i>(in thousands, except per share amounts)</i>				
Numerator for basic and diluted net income (loss) per share				
Net Income (Loss)	\$ (6,848)	\$ 21,349	\$ 36,677	\$ 66,087
Denominator				
Weighted average shares	35,446	35,562	35,495	35,525
Effect of guaranteed future shares to be issued in connection with agency acquisitions	224	310	260	268
Denominator for basic net income (loss) per share	35,670	35,872	35,755	35,793
Effect of dilutive securities:				
Employee stock options		352	288	437
Employee non-vested stock		130	137	123
Contingent stock acquisitions		166	114	127
Dilutive potential common shares		648	539	687
Denominator for diluted net income (loss) per share adjusted weighted average shares	35,670	36,520	36,294	36,480
Net Income (Loss) Per Share:				
Basic	\$ (0.19)	\$ 0.60	\$ 1.03	\$ 1.85
Assuming Dilution <sup>1</sup>	\$ (0.19)	\$ 0.58	\$ 1.01	\$ 1.81

<sup>1</sup> For the three months ended September 30, 2005, dilutive securities are not included in the calculation of diluted net loss per share as this would be antidilutive.

**NOTE G SEVERANCE CHARGE**

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In May 2005, Robert B. Lockhart, the Company's former President and Chief Operating Officer, resigned. In connection with Mr. Lockhart's resignation, the Company recorded a severance charge of \$1.3 million, and related income tax benefit of \$0.5 million, representing estimated payments due to Mr. Lockhart under the terms of his employment agreement.

### **NOTE H INTEGRATION COSTS**

The Company began the integration of Hobbs Group, LLC (Hobbs) with the rest of the Company subsequent to June 30, 2003 with the completion of the Hobbs earn-out. The Company recognized integration costs of \$0.8 million and \$1.8 million and related income tax benefit of \$0.3 million and \$0.7 million for the first nine months of 2005 and 2004, respectively. These amounts represent costs such as severance and other employee-related costs, facility and lease termination costs, and branding expenses.

### **NOTE I REGULATORY CHARGE AND RELATED MATTERS**

The Company and certain other companies in the insurance intermediary industry have been subject to investigations and inquiries by various governmental authorities regarding business practices and broker compensation arrangements. On August 31, 2005, the Company entered into an agreement (the Agreement) with the Attorney General of the State of Connecticut (the Attorney General) and the Insurance Commissioner of the State of



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**HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2005**

**(UNAUDITED)**

Connecticut (the Commissioner) to resolve all issues related to investigations conducted by the Attorney General and the Commissioner into certain insurance brokerage and insurance agency practices (the Investigations) and to settle an action commenced on August 31, 2005 by the Attorney General in the Connecticut Superior Court alleging violations of the Connecticut Unfair Trade Practices Act and the Connecticut Unfair Insurance Practices Act (the Action).

Following is a summary of the material terms of the Agreement:

1. The Company will pay \$30.0 million into a fund (the Fund) in two installments to be distributed to certain eligible U.S. policyholder clients (the Affected Policyholders). These payments are in full satisfaction of the Company's obligations under the Agreement and the Attorney General and the Commissioner have agreed not to impose any other financial obligation or liability on the Company related to the Investigations and/or the Action, except for the fine as provided for in the Stipulation and Consent Order with the Commissioner (see below for additional detail). The Company is not permitted to seek or accept, directly or indirectly, indemnification for payments made by the Company pursuant to the Agreement and the fine described below to the State of Connecticut Insurance Department. No portion of the payments by the Company for the Fund is considered a fine or penalty. The Company will make payments into the Fund as follows:

On or before February 1, 2006, the Company shall pay \$20.0 million into the Fund,

On or before August 1, 2007, the Company shall pay \$10.0 million into the Fund.

2. The Fund, plus interest, will be used to compensate the Affected Policyholders according to procedures set forth in the Agreement.
3. Affected Policyholders are a) all Company U.S. brokerage business clients on whose insurance placements, renewals, consultations or service the Company was eligible to receive Contingent Compensation (as defined in the Agreement) between January 1, 2001 and December 31, 2004 (the Broker Clients); b) all Company U.S. agency clients on whose insurance placements, renewals, consultations or service the Company was eligible to receive Contingent Compensation pursuant to a National Override Agreement between January 1, 2001 and December 31, 2004 (the National Override Clients); and c) all Company U.S. agency clients, other than National Override Clients, on whose insurance placements, renewals, consultations or service the Company was eligible to receive Contingent Compensation between January 1, 2001 and December 31, 2004 (the Agent Clients).

The Fund will be allocated \$19.5 million between Broker Clients and National Override Clients (the Broker/Override Fund) and \$10.5 million to Agent Clients (the Agency Fund), and an Affected Policyholder arising from an acquisition by the Company after December 31, 2000 shall be included only as of the date of acquisition by the Company.

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National Override Agreements, as defined in the Agreement, mean corporate-wide compensation agreements negotiated by the Company with those certain insurance companies on behalf of all of the Company's offices to receive commissions in lieu of standard contingent compensation arrangements with each office of the Company.

4. By August 21, 2006, the Company will send notice to each client setting forth the amount it will be paid from the Fund if it elects to participate. Clients will have until November 21, 2006 to make an election to receive distributions from the Fund.
5. The Company will make distributions from the Fund on January 15, 2007 and, if necessary, January 15, 2008 to participating clients that elected to receive a distribution.

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**HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2005**

**(UNAUDITED)**

6. In the event that any Affected Policyholder elects not to participate or otherwise does not respond (the Non-Participating Policyholders), that Affected Policyholder's allocated share may be used by the Company to satisfy any pending or other claims of policyholders relating to the matters covered by the Agreement. The funds attributable to Non-Participating Policyholders also may be used to reimburse the Company for any payments made to policyholders between September 1, 2005 and April 15, 2008 for claims related to this Agreement. In no event shall a distribution be made from the Fund to any Non-Participating Policyholder or as reimbursement to the Company for prior payments to any Non-Participating Policyholder until all participating clients have been paid the full aggregate amount due, nor shall total payments to any Non-Participating Policyholder exceed 80% of that Non-Participating Policyholder's original allocated share. If any funds remain in the Fund as of April 15, 2008, such funds will be distributed pro rata to the participating policyholders and clients. In no event shall any of the monies in or from the Fund be used to pay attorney fees.
  
7. Within 60 days of executing the Agreement, the Company will undertake the implementation of certain business reforms for both brokerage business and agency business. These reforms include:
  - to not accept or request contingent compensation on brokerage business,
  
  - to make enhanced disclosures to clients regarding compensation and customer rights,
  
  - to accept certain types of compensation only after disclosing such compensation to a client,
  
  - to adopt additional corporate governance practices.

In conjunction with executing the Agreement, the Company entered into a Stipulation and Consent Order with the Commissioner to resolve all issues relating to the Commissioner's investigation into the placement or attempted placement of professional liability insurance in Connecticut. Pursuant to the Stipulation and Consent Order, the Company paid an administrative fine of \$250,000 to the State of Connecticut Insurance Department. The cost of this fine is included in the 2005 third quarter regulatory charge of \$42.3 million.

In the 2005 third quarter, the Company recorded a \$42.3 million charge, and related income tax benefit of \$16.0 million, primarily relating to the Agreement with the Attorney General and the Commissioner. This charge includes the \$30.0 million national fund established by the Agreement; \$5.1 million of estimated legal and administrative costs to be incurred related to the Fund and complying with the Agreement's other provisions; and \$1.4 million of legal costs relating to the Agreement incurred in the 2005 third quarter. The regulatory charge also includes \$5.8 million of estimated costs for pending regulatory matters. These estimated costs represent the Company's best estimate of the probable outcomes of the various pending regulatory matters and include related legal and administrative costs incurred or expected to be incurred for these regulatory matters.

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The current liability portion of this charge as of September 30, 2005 is \$30.1 million and is included in accrued expenses. The remaining liability is included in other long-term liabilities.

These pending regulatory matters relate to subpoenas and/or inquiries made by state attorneys general and insurance departments into, among other things, the industry's commission payment practices. The Company has received subpoenas and/or requests for information from attorneys general and/or insurance departments in fourteen states. The Company may receive additional subpoenas and/or requests for information in the future from attorneys general and/or insurance departments of other states. The Company will continue to evaluate and monitor all such subpoenas and requests.

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**HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2005**

**(UNAUDITED)**

**NOTE J COMMITMENTS AND CONTINGENCIES**

*Industry Litigation*

The Company has been named as a defendant in certain legal proceedings against brokers and insurers relating to broker compensation arrangements and other business practices.

*MDL 1663 Class Action*

In August 2004, OptiCare Health Systems Inc. filed a putative class action in the U.S. District Court for the Southern District of New York (Case No. 04-CV-06954) against a number of the country's largest insurance brokers and several large commercial insurers. The Company was named as a defendant in the Opticare suit in November 2004. In December 2004, two other purported class actions were filed in the U.S. District Court for the Northern District of Illinois, Eastern Division, by Stephen Lewis (Case No. 04-C-7847) and Diane Preuss (Case No. 04-C-7853), respectively, against certain insurance brokers, including the Company, and several large commercial insurers. On February 17, 2005, the Judicial Panel on Multidistrict Litigation (the Panel) ordered that the Opticare suit, along with three other purported antitrust class actions filed in New York, New Jersey and Pennsylvania against industry participants, be centralized and transferred to the U.S. District Court for the District of New Jersey. In addition, by Conditional Transfer Order dated March 10, 2005, the Panel conditionally transferred the Lewis and Preuss cases to the U.S. District Court for the District of New Jersey. As a result of the Panel's transfer orders, the Opticare, Lewis and Preuss cases are proceeding on a consolidated basis with other purported class action suits styled as In re: Insurance Brokerage Antitrust Litigation (MDL 1663).

On August 1, 2005, the plaintiffs in MDL 1663 filed a First Consolidated Amended Commercial Class Action Complaint (the Commercial Complaint) in the United States District Court for the District of New Jersey (Civil No. 04-5184) against the Company and certain other insurance brokers and insurers. In the Commercial Complaint, the named plaintiffs purport to represent a class consisting of all persons who, between August 26, 1994 and the date on which class certification may occur, engaged the services of any one of the broker defendants or any of their subsidiaries or affiliates to obtain advice with respect to the procurement or renewal of insurance and who entered into or renewed a contract of insurance with one of the insurer defendants. The plaintiffs allege in the Commercial Complaint, among other things, that the broker defendants engaged in improper steering of clients to the insurer defendants for the purpose of obtaining undisclosed additional compensation in the form of contingent commissions from insurers; that the defendants were engaged in a bid-rigging scheme involving the submission of false and/or inflated bids from insurers to clients; that the broker defendants improperly placed their clients' insurance business with insurers through related wholesale entities where an intermediary was unnecessary for the purpose of generating additional commissions from insurers; that the broker defendants entered into unlawful tying arrangements to obtain reinsurance business from the defendant insurers; and that the defendants created centralized internal departments for the purpose of monitoring, facilitating and advancing the collection of contingent commissions, payments and other improper fees. The plaintiffs allege violations of federal and state antitrust laws, violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962(c) and (d), fraudulent misrepresentation, breach of fiduciary duty, aiding and abetting breach of

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fiduciary duty and unjust enrichment. The plaintiff seeks monetary relief, including treble damages, injunctive and declaratory relief, restitution, interest, attorneys' fees and expenses, costs and other relief. The Company has not yet filed a responsive pleading in this case but believes it has substantial defenses to these claims and intends to defend itself vigorously.

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**HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2005**

**(UNAUDITED)**

In addition, the plaintiffs in MDL 1663 also filed on August 1, 2005 a First Consolidated Amended Employee Benefits Class Action Complaint (the Employee Benefits Complaint) in the United States District Court for the District of New Jersey against the Company; Frank F. Haack & Associates, Inc.; O'Neill, Finnegan & Jordan Insurance Agency Inc.; and certain other insurance brokers and insurers. In the Employee Benefits Complaint (Civil Nos. 04-5184, et al.), the named plaintiffs purport to represent two separate classes consisting of ERISA and non-ERISA plan employees and employers, respectively, that have acquired insurance products from the defendants in connection with an employee benefit plan between August 26, 1994 and the date on which class certification may occur. The plaintiffs allege in the Employee Benefits Complaint, among other things, that the broker defendants secretly conspired with the insurer defendants to steer plaintiffs and members of the classes to the insurer defendants in exchange for undisclosed fees, including communication fees, enrollment fees, service fees, finders fees and/or administrative fees, contingent commissions and other payments, including broker bonuses, trips and entertainment, from the insurer defendants; that the defendants were engaged in a bid-rigging scheme involving the submission of false and/or inflated bids from insurers to clients; that the broker defendants improperly placed their clients' insurance business with insurers through related wholesale entities where an intermediary was unnecessary for the purpose of generating additional commissions from insurers; and that the defendants entered into unlawful tying arrangements under which the broker defendants would place primary insurance contracts with insurers on the condition that the insurers use the broker defendants for placing their reinsurance coverage with reinsurance carriers. The plaintiffs allege violations of federal and state antitrust laws, violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962(c) and (d), fraudulent misrepresentation, breach of fiduciary duty, aiding and abetting breach of fiduciary duty and unjust enrichment. The plaintiff seeks monetary relief, including treble and punitive damages, injunctive and declaratory relief, restitution, interest, attorneys' fees and expenses, costs and other relief. The Company has not yet filed a responsive pleading in this case but believes it has substantial defenses to these claims and intends to defend itself vigorously.

***Bensley Class Action***

In May 2005, Bensley Construction, Inc. filed a putative class action in the Superior Court of the Commonwealth of Massachusetts (Case No. ESCV2005-00277) against the Company and certain large commercial insurers and brokers. In the amended complaint, the plaintiff alleges, among other things, that the broker defendants entered into contingent commission agreements with the insurer defendants without disclosing the existence and/or terms of the agreements to clients to whom the defendants owed a fiduciary duty and that certain of the defendants engaged in a bid-rigging and customer allocation scheme to maximize their revenues under the contingent commission agreements. The plaintiff alleges breach of fiduciary duty, unjust enrichment, aiding and abetting breaches of fiduciary duty, breach of contract and breach of implied covenant of good faith and fair dealing. The plaintiff seeks monetary damages for each member of the class in an amount not to exceed \$74,999 per class member, costs and other relief. The defendants removed the case to federal court and filed a notice to transfer the case to the U.S. District Court for the District of New Jersey pursuant to the Panel order referred to above. The Company believes it has substantial defenses to these claims and intends to defend itself vigorously.

***Securities Class Action***

In June 2005, the Iron Workers Local 16 Pension Fund filed a putative class action complaint in the United States District Court for the Eastern District of Virginia (Case No. 1:05-CV-00735-GBL-TCB) against the Company and Andrew L. Rogal, Martin L. Vaughan, III, Timothy J.

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Korman, Carolyn Jones, Robert W. Blanton, Jr. and Robert B. Lockhart. The plaintiff alleged violations by each of the defendants of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and violations by the individual defendants of Section 20(a) of the Securities Exchange Act of 1934.



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**HILB ROGAL & HOBBS COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**September 30, 2005**

**(UNAUDITED)**

In September 2005, the Iron Workers Local 16 Pension Fund was appointed Lead Plaintiff. In October 2005, Lead Plaintiff filed an amended putative class action complaint against the Company and Andrew L. Rogal, Martin L. Vaughan, III, Carolyn Jones and Robert B. Lockhart. Each of the individual defendants is a current or former officer and/or director of the Company. In the amended complaint, the Lead Plaintiff alleges, among other things, that the defendants made false and misleading statements to the public in the Company's filings with the Securities and Exchange Commission, press releases and other public statements between August 11, 2000 and May 26, 2005 by failing to disclose that the Company's contingent and override commissions were designed to allow the Company to steer its flow of business to those insurance carriers that agreed to pay it such commissions; that the Company's business practices were in direct conflict of interest with its customers and were fraudulent and illegal; that the Company's business practices exposed the Company to the risk of legal proceedings, reputational damage, and other harms; and that the Company's financial results were materially inflated as a result of the recognition of improper commissions as revenues.

The amended complaint further alleges that the individual defendants were able to and did control the content of the Company's public statements as a result of their positions as officers and/or directors of the Company. The amended complaint alleges violations by each of the defendants of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and violations by the individual defendants of Section 20(a) of the Securities Exchange Act of 1934. The Lead Plaintiff seeks monetary damages, interest, costs, legal fees and other relief. The Company believes it has substantial defenses to these claims and intends to defend itself vigorously.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

On September 29, 2005, the Company's Board of Directors appointed F. Michael Crowley as President of the Company effective September 29, 2005. Previously, Mr. Crowley was Executive Vice President and National Director for Property and Casualty. Mr. Crowley succeeds Robert B. Lockhart, the Company's former President and Chief Operating Officer, who resigned from the Company in May 2005. On October 4, 2005, the Company filed a Current Report on Form 8-K with the Securities and Exchange Commission regarding Mr. Crowley's appointment.

On September 13, 2005, the Company's Board of Directors appointed Michael Dinkins as Executive Vice President and Chief Financial Officer of the Company effective October 1, 2005. Previously, Mr. Dinkins was Vice President-Global Control and Reengineering for Guidant Corporation. Mr. Dinkins succeeds Carolyn Jones, the Company's former Senior Vice President, Chief Financial Officer and Treasurer, who announced in April 2005 her intention to retire from her position. On September 13, 2005, the Company filed a Current Report on Form 8-K with the Securities and Exchange Commission regarding Mr. Dinkins' appointment.

***Results of Operations***

*Three Months Ended September 30, 2005*

Net income (loss) for the three months ended September 30, 2005 was \$(6.8) million, or \$(0.19) per share, compared with \$21.3 million, or \$0.58 per share, for the comparable period last year. Net loss for the 2005 quarter included a regulatory charge and related costs, net of tax, of \$26.3 million, or \$0.73 per share. This charge primarily relates to the Company's settlement with the Attorney General and the Insurance Commissioner of the State of Connecticut. The Connecticut settlement provides for a \$30 million national fund for distribution to HRH's U. S. clients who elect to participate in the fund. In addition, the charge includes amounts for the legal and administrative costs of complying with the settlement as well as estimated costs for related pending regulatory matters. For additional information regarding this charge, see Note I-Regulatory Charge and Related Matters of Notes to Consolidated Financial Statements. Net income for the 2004 quarter included integration costs, net of tax, of \$0.1 million, or \$0.01 per share. Integration costs relate to the continued integration of Hobbs Group, LLC. These represent costs such as severance and other employee-related costs, facility and lease termination costs, and branding expenses. In addition, non-operating gains, net of tax, were \$0.4 million and \$51 thousand for the three months ended September 30, 2005 and 2004, respectively.

Commissions and fees were \$161.1 million, an increase of 6.3%, from commissions and fees of \$151.6 million during the comparable period of the prior year. Approximately \$14.2 million of the commissions was derived from acquisitions of new insurance agencies in 2005 and 2004. This increase was offset by decreases of approximately \$3.2 million from the sale of certain offices and accounts in 2005 and 2004. Excluding the effect of acquisitions and divestitures, the change in commissions and fees was (1.0)%. This decrease principally reflects a continued decline in property and casualty premium rates, the termination of National Override Agreements and lower than normal retention rates primarily related to producer culling. National Override Agreements are defined in Note I Regulatory Charge and Related Matters of Notes to Consolidated Financial Statements.

Expenses for the quarter increased \$56.1 million, or 47.5%. The 2005 quarter includes a regulatory charge of \$42.3 million which is described above. Compensation and benefits and other operating expenses increased \$9.3 million and \$1.6 million, respectively. The increase in compensation and benefits can be attributed to acquisitions of insurance agencies and continued investment in new sales and service talent. Other operating expenses increased mainly due to acquisitions partially offset by lower legal and claims expenditures. Legal and claims expenditures decreased due to resolution of certain claims that were open during the 2004 third quarter.



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Depreciation expense was relatively comparable to the prior year. Amortization of intangibles increased approximately \$1.3 million due primarily to intangible assets acquired in 2005 and 2004 acquisitions. Interest expense increased \$1.8 million as average borrowings and interest rates increased between the quarters.

The Company's overall tax rates for the three months ended September 30, 2005 and 2004, respectively, were 29.2% and 40.0%. The overall tax rate decreased from 2004 primarily due to certain non-deductible items in the 2005 regulatory charge.

### *Nine Months Ended September 30, 2005*

Net income for the nine months ended September 30, 2005 decreased to \$36.7 million, or \$1.01 per share, from \$66.1 million, or \$1.81 per share, for the prior year period. Net income for the nine-month period ended September 30, 2005, included a regulatory charge, net of tax, of \$26.3 million, or \$0.73 per share; a severance charge, net of tax, of \$0.8 million, or \$0.02 per share; and integration costs, net of tax, of \$0.5 million, or \$0.01 per share. The regulatory charge and integration costs are consistent with those noted for the 2005 third quarter. The severance charge represents estimated payments due to the Company's former President and Chief Operating Officer under the terms of his employment agreement. In addition, non-operating gains, net of tax, were \$1.5 million or \$0.04 per share, and \$0.3 million, or \$0.01 per share, for the nine months ended September 30, 2005 and 2004, respectively.

Commissions and fees for the nine months ended September 30, 2005 increased 10.2% to \$499.8 million from \$453.7 million during the prior year period. Acquisitions of new insurance agencies in 2005 and 2004 contributed commissions of \$59.3 million. This increase was offset by decreases of \$8.1 million from the sale of certain offices and accounts in 2005 and 2004. Excluding the effect of acquisitions and divestitures, the change in commissions and fees was (1.1)%. This decrease principally reflects the same factors noted for the quarter.

Expenses for the nine months ended September 30, 2005 increased \$97.6 million, or 27.9%, from the prior year period. For the 2005 nine-month period, expenses include a regulatory charge of \$42.3 million and a severance charge of \$1.3 million which are described above. Integration costs decreased \$1.0 million from the prior year. Other increases from the prior year were \$30.3 million in compensation and benefits and \$15.1 million in other operating expenses. Compensation and benefits increased primarily due to acquisitions of insurance agencies and continued investment in new sales and service talent. Other operating expenses increased mainly due to increased legal, compliance and claims expenses and acquisitions. Legal, compliance and claims expenditures increased \$7.3 million due primarily to various regulatory inquiries and the protection of restrictive covenants in employment contracts as well as expenditures for compliance with Section 404 of the Sarbanes-Oxley Act. The \$7.3 million increase is net of \$4.2 million in insurance recoveries on contested claims.

Depreciation expense was comparable to the prior year. Amortization of intangibles increased approximately \$5.1 million due primarily to intangible assets acquired in 2005 and 2004 acquisitions. Interest expense increased \$4.6 million as average borrowings and interest rates increased compared to the same period in the prior year.

The Company's overall tax rates for the nine months ended September 30, 2005 and 2004, respectively, were 41.6% and 40.0%. The overall tax rate increased from 2004 primarily due to certain non-deductible items in the 2005 regulatory charge.

*Other*

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For the three months ended September 30, 2005, net income as a percentage of revenues declined from the three months ended June 30, 2005. This decline was primarily due to the regulatory charge recorded in the third quarter. In addition, commission income increased \$2.7 million or 1.7% between the two periods primarily as a result of the timing of new business and policy renewals partially offset by lower contingent commissions.

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The timing of contingent commissions, policy renewals and acquisitions may cause revenues, expenses and net income to vary significantly from quarter to quarter. As a result of the factors described above, operating results for the nine months ended September 30, 2005 should not be considered indicative of the results that may be expected for the entire year ending December 31, 2005.

### ***Liquidity and Capital Resources***

Net cash provided by operations totaled \$69.5 million and \$86.4 million for the nine months ended September 30, 2005 and 2004, respectively, and is primarily dependent upon the timing of the collection of insurance premiums from clients and payment of those premiums to the appropriate insurance underwriters.

The Company has historically generated sufficient funds internally to finance capital expenditures. Cash expenditures for the acquisition of property and equipment were \$7.4 million and \$6.6 million for the nine months ended September 30, 2005 and 2004, respectively. The purchase of insurance agencies utilized cash of \$19.3 million and \$45.1 million in the nine months ended September 30, 2005 and 2004, respectively. Cash expenditures for such insurance agency acquisitions have been primarily funded through operations and long-term borrowings. In addition, a portion of the purchase price in such acquisitions may be paid through the Company's Common Stock and/or deferred cash and Common Stock payments. The Company did not have any material capital expenditure commitments as of September 30, 2005.

Financing activities utilized cash of \$39.3 million and provided cash of \$15.8 million for the nine months ended September 30, 2005 and 2004, respectively, as the Company repurchased Common Stock and made dividend and debt payments. For 2004, these uses of cash were offset by 2004 borrowings against the Company's revolving credit facility to fund acquisitions. The Company has annually increased its dividend rate and anticipates the continuance of its dividend policy. The Company repurchased 612,800 shares of its Common Stock for \$21.8 million during the nine months ended September 30, 2005. The Company is currently authorized to purchase up to \$50.0 million annually of its Common Stock subject to market conditions and other factors.

As of September 30, 2005, the Company has a credit agreement with outstanding term loans of \$244.8 million, which are due in various amounts through 2011, and \$174.6 million available under a revolving credit facility with no outstanding borrowings. Borrowings under the credit agreement bear interest at variable rates based on LIBOR plus a negotiated spread. In September 2005, the Company amended the credit agreement to modify certain covenant requirements.

The Company has two interest rate swap agreements with a total notional amount of \$50.0 million. The Company uses these interest rate swaps to manage interest cost and cash flows associated with variable interest rates.

The Company had a current ratio (current assets to current liabilities) of 1.11 to 1.00 as of September 30, 2005. Shareholders' equity of \$524.5 million at September 30, 2005 is improved from \$507.2 million at December 31, 2004. The debt to equity ratio at September 30, 2005 of 0.50 to 1.00 has decreased from the ratio at December 31, 2004 of 0.52 to 1.00 due to net income and the issuance of Common Stock partially offset by share repurchases.

The Company believes that cash generated from operations, together with proceeds from borrowings, will provide sufficient funds to meet the Company's short and long-term funding needs.

*Market Risk*

The Company has variable rate debt, maintains certain investments and utilizes derivative financial instruments (on a limited basis) which are subject to market risk; however, the Company believes that exposure to market risk associated with these instruments is not material.

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***New Accounting Standards***

In December 2004, the Financial Accounting Standards Board issued Financial Accounting Standards Board Statement No. 123 (revised 2004), *Share-Based Payment* (Statement 123R). Statement 123R revises Statement 123. The revised standard requires all companies to recognize compensation costs related to all share-based payments (including stock options) in their financial statements at fair value, thereby, upon adoption, eliminating the use of pro forma disclosures to report such amounts. In April 2005, the Securities and Exchange Commission issued a rule to amend the effective date of Statement 123R. Statement 123R is effective for a public company that is not a small business issuer at the beginning of the first fiscal year beginning after June 15, 2005.

Statement 123R permits public companies to account for the adoption of this revised standard using one of two methods: the modified-prospective method or the modified-retrospective method. The modified-prospective method requires a company to recognize compensation based upon fair value for only those share-based awards granted with an effective date subsequent to the company's date of adoption and share-based awards issued in prior periods that remain unvested at the date of adoption. The modified-retrospective method allows a company to restate, based upon pro forma amounts previously disclosed under the requirements of Statement 123, for either all prior periods presented or prior interim periods included in the year of adoption.

The Company intends to adopt Statement 123R no later than January 1, 2006, but has yet to determine which of the two methods described above will be utilized. The Company continues to evaluate the impact of this proposed statement on its financial position and results of operations.

***Industry Regulatory Matters***

On August 31, 2005, the Company entered into an agreement with the Attorney General of the State of Connecticut (the Attorney General) and the Insurance Commissioner of the State of Connecticut (the Commissioner) to resolve all issues related to investigations conducted by the Attorney General and the Commissioner into certain insurance brokerage and insurance agency practices (the Investigations) and to settle an action commenced on August 31, 2005 by the Attorney General in the Connecticut Superior Court alleging violations of the Connecticut Unfair Trade Practices Act and the Connecticut Unfair Insurance Practices Act. For further information on this Agreement, see *Note I-Regulatory Charge and Related Matters* of Notes to Consolidated Financial Statements. Following is additional information regarding governmental investigations into the insurance intermediary industry's business practices and broker compensation arrangements.

On October 14, 2004, the Office of the Attorney General of the State of New York (NYAG) filed a lawsuit against Marsh & McLennan Companies, Inc. and its subsidiary Marsh Inc. (collectively Marsh), the world's largest insurance broker, alleging statutory and common law fraud, securities fraud, bid-rigging and other antitrust violations in the placement of insurance business. On March 4, 2005, the NYAG filed a lawsuit against Aon Corporation (Aon), the world's second largest insurance broker, alleging fraudulent business practices, common law fraud and securities fraud in connection with the conduct of its placement of insurance business. Marsh and Aon have each announced settlement agreements with the NYAG and certain state regulators. On April 8, 2005, Willis Group Holdings Limited, Willis North America Inc. and Willis of New York, Inc. (collectively Willis) entered into an agreement with the NYAG and the New York state insurance regulator to resolve issues related to investigations of business practices conducted by the NYAG and the state regulator. On May 18, 2005, Arthur J. Gallagher & Co. and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., (collectively Gallagher), entered into an Assurance of Voluntary Compliance with the Attorney General of the State of Illinois and the Illinois state insurance regulator to resolve issues related to investigations of business practices conducted by the Illinois regulators.



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Under the terms of the agreements, Marsh, Aon, Willis and Gallagher are required to establish settlement funds in the amounts of \$850 million, \$190 million, \$50 million and \$27 million, respectively, to compensate certain policyholder clients who retained Marsh, Aon, Willis or Gallagher to place insurance between specified inception or renewal dates, where such policies resulted in Marsh, Aon, Willis and Gallagher recording contingent or override commissions. The Marsh, Aon, Willis and Gallagher agreements also place restrictions on the future business

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practices of these companies. Marsh, Aon, Willis and Gallagher may no longer accept (i) any contingent compensation for certain services in placing, renewing, consulting on or servicing any insurance policy and (ii) any compensation other than a specific fee to be paid by the client, a specific percentage commission on premiums to be paid by the insurer set at the time of the purchase, renewal, placement or servicing of the policy, or both types of compensation. If Marsh, Aon or Willis receives any commission, it must disclose to the client that it intends to collect the commission and obtain the client's written consent prior to the binding of the policy.

A committee of the Company's Board of Directors has been authorized to perform an independent review of the Company's business practices in the areas that were the subjects of the NYAG's allegations against Marsh. This committee has engaged outside legal counsel to assist it in the review.

### ***Contingent and National Override Agreements Commissions***

As a result of the industry and regulatory developments described above, controversy continues to surround the longstanding insurance industry practice of contingent and override commissions paid to agents and brokers by underwriters. The Company has historically entered into contingent and override commission agreements with various underwriters. Contingent commissions are commissions paid by underwriters based on profitability of the business, premium growth, total premium volume or some combination of these factors. Revenue from contingent commissions is heavily weighted in the first and second quarters. Income from the National Override Agreements was typically volume-based and paid quarterly by underwriters in excess of the standard commission rates on specific classes of business.

For the nine months ended September 30, 2005 and 2004, the Company recognized contingent and National Override Agreements commissions of \$47.6 million and \$39.4 million, respectively. For the years ended December 31, 2004 and 2003, the Company recognized \$42.4 million and \$40.8 million, respectively, in contingent and National Override Agreements commissions. Of the 2005 nine month amount, 93% was from standard contingency agreements and 7% was from National Override Agreements. Of the 2004 annual amount, 81% was from standard contingency agreements and 19% was from National Override Agreements. The standard contingency agreements are maintained at the local office level. Effective for business written on or after January 1, 2005, these National Override Agreements reverted into standard local contingency arrangements with those underwriters on an office by office basis, which will be paid and recorded, if at all, annually beginning in early 2006. There can be no assurance that the loss of National Override Agreements commissions resulting from the reversion to standard local contingency arrangements will be offset by additional contingent commissions in future periods.

The departments of insurance of various states may adopt new regulations addressing contingent commission arrangements and disclosure of such arrangements with insureds. In addition, the National Association of Insurance Commissioners has proposed model legislation to implement new disclosure requirements relating to agent and broker compensation arrangements. The Company intends to monitor agent and broker compensation practices and, as warranted by market and regulatory developments, will review its compensation arrangements with underwriters. While it is not possible to predict the outcome of the governmental inquiries and investigations into the insurance industry's commission payment practices or the responses by the market and regulators, any material decrease in the Company's contingent commissions is likely to have an adverse effect on its results of operations.

In addition to state regulatory inquiries, the Company has been named as a defendant in four purported class actions brought against a number of brokers in the insurance industry and one purported securities class action. For information on industry litigation, see Note J Commitments and Contingencies of Notes to Consolidated Financial Statements.

### ***Forward-Looking Statements***

The Company cautions readers that the foregoing discussion and analysis includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by that Act. These forward-looking statements are believed by the Company to

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be reasonable based upon management's current knowledge and assumptions about future events, but are subject to the uncertainties generally inherent in any such forward-looking statement, including factors discussed above as well as other factors that may generally affect the Company's business, financial condition or operating results. Risk factors and uncertainties that might cause such a difference include, but are not limited to, the following: the Company's commission revenues are highly dependent on premium rates charged by insurance underwriters, which are subject to fluctuation based on the prevailing economic conditions and competitive factors that affect insurance underwriters; the level of contingent commissions is difficult to predict and any material decrease in the Company's collection of them is likely to have an adverse impact on operating results; the Company has eliminated National Override Agreements commissions effective for business written on or after January 1, 2005, and it is uncertain whether additional contingent commissions payable to the Company will offset the loss of such revenues; the Company's failure to recruit, retain, train and integrate quality producers may have an adverse effect on the Company; the Company may be subject to increasing costs arising from errors and omissions claims against the Company; the Company's growth has been enhanced through acquisitions, which may or may not be available on acceptable terms in the future and which, if consummated, may or may not be advantageous to the Company; the Company's failure to integrate an acquired insurance agency efficiently may have an adverse effect on the Company; the general level of economic activity can have a substantial impact on revenues that is difficult to predict; a strong economic period may not necessarily result in higher revenues if the volume of insurance business brought about by favorable economic conditions is offset by premium rates that have declined in response to increased competitive conditions; a decline in the Company's ability to obtain new financing and/or refinance current borrowings may adversely effect the Company's borrowing costs and financial flexibility; if the Company is unable to respond in a timely and cost-effective manner to rapid technological change in the insurance intermediary industry, there may be a resulting adverse effect on business and operating results; the Company is subject to governmental regulation which may adversely impact operating results and/or growth; the business practices and broker compensation arrangements of the Company and the insurance intermediary industry are subject to uncertainty due to investigations by various governmental authorities and related private litigation; costs incurred related to investigations, private litigation and class actions are uncertain and difficult to predict; and quarterly and annual variations in the Company's commissions and fees that result from the timing of policy renewals and the net effect of new and lost business production may have unexpected impacts on the Company's results of operations. For more details on factors that could affect expectations, see the Company's Annual Report on Form 10-K for the year ended December 31, 2004 and other reports from time to time filed with or furnished to the Securities and Exchange Commission.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

The Company believes that its exposure to market risk associated with transactions using variable rate debt, certain investments and derivative financial instruments is not material.

**Item 4. CONTROLS AND PROCEDURES.**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods required by the Securities and Exchange Commission. As of the end of the period covered by this report on Form 10-Q, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended). Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of the end of such period. Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. There have been no changes in the Company's internal control over financial reporting during the three months ended September 30, 2005, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS.**

The information on legal proceedings contained in Note J-Commitments and Contingencies of the Notes to Consolidated Financial Statements filed in Item 1 of Part I of this Form 10-Q is incorporated by reference.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

- c) No purchases of Common Stock occurred in the third quarter of 2005 under the publicly announced share-repurchase program (the 2004 Program).

The 2004 Program was announced by the Company on March 31, 2004 and provides for the Company to purchase up to \$50.0 million of its Common Stock annually. The repurchases may be made on the open market or in negotiated transactions, with the timing and amount of the transactions to be determined by the Company's management subject to market conditions and other factors.

Not included in the 2004 Program are purchases that were made on behalf of a trust maintained by the Company for the Executive Voluntary Deferral Plan and the Outside Directors Deferral Plan. Total number of shares purchased during the quarter relating to the plans was 7,140, at an average price per share of \$34.08.

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**Item 6. EXHIBITS.**

<b><u>Exhibit No.</u></b>	<b><u>Document</u></b>
10.1	First Amendment to Credit Agreement, dated September 29, 2005, among the Company, as Borrower; and Wachovia Bank, National Association, as administrative agent
10.2	Agreement between the Attorney General of the State of Connecticut and the Insurance Commissioner of the State of Connecticut and Hilb Rogal & Hobbs Company and its subsidiaries and affiliates dated August 31, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K dated August 31, 2005, File No. 0-15981)
10.3	Stipulation and Consent Order between the Insurance Commissioner of the State of Connecticut and Hilb Rogal & Hobbs Company and Hilb Rogal & Hobbs of Connecticut, LLC dated August 31, 2005 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K dated August 31, 2005, File No. 0-15981)
10.4	Hilb Rogal & Hobbs Company Restricted Stock Agreement between the Company and Michael Dinkins, dated October 1, 2005
10.5	Hilb Rogal & Hobbs Company Employee Non-Qualified Stock Option Agreement between the Company and Michael Dinkins, dated October 1, 2005
31.1	Certification Statement of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
31.2	Certification Statement of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
32.1	Certification Statement of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification Statement of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Hilb Rogal & Hobbs Company  
(Registrant)

Date November 4, 2005

By: /s/ **MARTIN L. VAUGHAN, III**  
**Martin L. Vaughan, III**  
**Chairman and Chief Executive Officer**  
**(Principal Executive Officer)**

Date November 4, 2005

By: /s/ **MICHAEL DINKINS**  
**Michael Dinkins**  
**Executive Vice President and**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

Date November 4, 2005

By: /s/ **ROBERT W. BLANTON, JR.**  
**Robert W. Blanton, Jr.**  
**Vice President and Controller**  
**(Chief Accounting Officer)**

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**HILB ROGAL & HOBBS COMPANY**

**EXHIBIT INDEX**

<b><u>Exhibit No.</u></b>	<b><u>Document</u></b>
10.1	First Amendment to Credit Agreement, dated September 29, 2005, among the Company, as Borrower; and Wachovia Bank, National Association, as administrative agent
10.2	Agreement between the Attorney General of the State of Connecticut and the Insurance Commissioner of the State of Connecticut and Hilb Rogal & Hobbs Company and its subsidiaries and affiliates dated August 31, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K dated August 31, 2005, File No. 0-15981)
10.3	Stipulation and Consent Order between the Insurance Commissioner of the State of Connecticut and Hilb Rogal & Hobbs Company and Hilb Rogal & Hobbs of Connecticut, LLC dated August 31, 2005 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K dated August 31, 2005, File No. 0-15981)
10.4	Hilb Rogal & Hobbs Company Restricted Stock Agreement between the Company and Michael Dinkins, dated October 1, 2005
10.5	Hilb Rogal & Hobbs Company Employee Non-Qualified Stock Option Agreement between the Company and Michael Dinkins, dated October 1, 2005
31.1	Certification Statement of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
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