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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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FORM 10-K

☒ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 1998

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1- 9761

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**ARTHUR J. GALLAGHER & CO.**

(Exact name of registrant as specified in its charter)

**DELAWARE 36- 2151613**

(State or other jurisdiction of (I.R.S. Employer Identification incorporation or organization) Number)

Two Pierce Place 60143- 3141

Itasca, Illinois (Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code (630) 773- 3800

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Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$1.00 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S- K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10- K or any amendment to this Form 10- K. ☐

The aggregate market value of the voting stock held by non- affiliates of the registrant, computed by reference to the last reported price at which the stock was sold on February 28, 1999 was \$804,286,000.

The number of outstanding shares of the registrant's Common Stock, \$1.00 par value, as of February 28, 1999 was 18,100,066.

Portions of documents incorporated by Part of Form 10- K into which document reference into this report is incorporated

**ARTHUR J. GALLAGHER & CO. PART III**

Proxy Statement dated March 30, 1999

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PART I

Item 1. Business.

Arthur J. Gallagher & Co. (the "Registrant") and its subsidiaries (the Registrant and its subsidiaries are collectively referred to as the "Company" unless the context otherwise requires) are engaged in providing insurance brokerage, risk management, employee benefit and other related services to clients in the United States and abroad. The Company's principal activity is the negotiation and placement of insurance for its clients. The Company also specializes in furnishing risk management services. Risk management involves assisting clients in analyzing risks and determining whether proper protection is best obtained through the purchase of insurance or through retention of all or a portion of those risks and the adoption of corporate risk management policies and cost- effective loss control and prevention programs. Risk management services also include claims management, loss control consulting and property appraisals and insurance related investigative services. The Company believes that its ability to deliver a comprehensively structured risk management and brokerage service is one of its major strengths.

The Company operates through a network of approximately 200 offices located throughout the United States and six countries abroad and through a network of correspondent brokers and consultants in more than 100 countries around the world. Some of these offices are fully staffed with sales, marketing, claims and other service personnel; others function as servicing offices for the brokerage and risk management service operations of the Company. The Company's international operations include a Lloyd's broker and affiliated companies in London, England and other facilities in Australia, Bermuda, Canada, Scotland and Papua New Guinea.

The Company was founded in 1927 and was reincorporated as a Delaware corporation in 1972. The Company's executive offices are located at Two Pierce Place, Itasca, Illinois 60143- 3141, and its telephone number is (630) 773- 3800.

The Company has identified three operating segments in addition to its corporate operations. Insurance Brokerage Services encompasses operations that, for commission or fee compensation, place or arrange to place insurance directly related to the clients' funding of risk. This segment also provides consulting, for fee compensation, related to clients' risk financing programs. Risk Management Services includes the Company's third party administration, loss control and risk management consulting, workers' compensation investigations and insurance property appraisal operations. Third party administration is principally claims management services for the Company's clients. Financial Services includes the Company's investment operations and certain non- recurring events. Corporate consists primarily of unallocated administrative costs and the provision for income taxes which is not allocated to the Company's operating segments.

#### Insurance Brokerage Services

The Company places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the United States and abroad. The Company acts as an agent in soliciting, negotiating and effecting contracts of insurance through insurance companies worldwide, and also as a broker in procuring contracts of insurance on behalf of insureds. Specific coverages include all forms of property and casualty, marine, employee benefits, pension and life insurance products.

The Company places surplus lines coverages, which are coverages not available from insurance companies licensed by the states in which the risks are located, for various specialized risks. The Company also places reinsurance coverages for its clients.

The Company's Gallagher Benefit Services ("GBS") division specializes in the management of employee benefit programs through fully insured and self- insured programs. GBS provides services in connection with the design, financing, implementation, administration and communication of compensation and employee benefit programs (including pension and profit- sharing plans, group life, health, accident and disability insurance programs and tax deferral plans), and provides other professional services in connection therewith. The services provided by GBS are supported by an on- line data processing system provided by an outside vendor.

#### Risk Management Services

Through its wholly- owned subsidiary, Gallagher Bassett Services, Inc. ("Gallagher Bassett"), the Company provides a variety of professional consulting services to assist clients in analyzing risks and in determining whether proper protection is best obtained through the purchase of insurance or through retention of all or a portion of those risks and the adoption of risk management policies and cost- effective loss control and prevention programs. A full range of risk management services is offered including claims management, risk control consulting services, information management, property appraisals and insurance related investigative services on a totally integrated or select, stand- alone basis. Gallagher Bassett provides these services for the Company's clients through a network of over 100 offices throughout the United States, Canada, England, Scotland, Australia and Papua New Guinea.

The Company believes that its risk management services are an important factor in securing new brokerage business and retaining brokerage clients. The Company also markets these services directly to the client on an unbundled basis independent of brokerage services in order to capitalize on the interest in self- insurance created by market conditions. These services include consulting on a wide range of risk management needs such as toxic waste disposal, handling of dangerous cargo, workers' compensation, medical cost containment, substance abuse, employment- related background investigations, loss prevention, property appraisals and liability reserve reviews.

In connection with its risk management services, the Company provides self- insurance programs for large institutions, risk sharing pools and associations, and large commercial and industrial customers. Self- insurance, as administered by the Company, is a program in which the client assumes a manageable portion of its insurance risks, usually (although not always) placing the less predictable and larger loss exposures with an excess carrier. The Company's offices are staffed to provide services relating to claims, property appraisals, loss control consulting and computerized record keeping in administering the clients' programs.

#### Financial Services

Financial Services is responsible for all of the Company's investment operations and certain non- recurring events. The Company's comprehensive and diversified investment portfolio includes investment strategies, marketable securities, tax advantaged investments, equity investments, real estate partnerships and notes receivable from investees. Tax advantaged investments represent amounts invested by the Company in limited partnerships that operate qualified affordable housing or alternative energy projects. The Company receives tax benefits in the form of tax deductions for operating losses and tax credits from these investments. Investments in real estate partnerships primarily represent an investment in a limited partnership that owns 10,000 acres of land to be developed near Orlando, Florida. Notes receivable from investees represent secured loans made by the Company to several of its equity and limited partnership investments. Financial Services is primarily responsible for the management of the Company's own investments but is expanding these investment management services in conjunction with the insurance products the Company markets to its clients. These investments and the associated returns are for the benefit of the Company.

#### International Operations

The Company's international operations are principally comprised of a Lloyd's broker and a risk management services company in London, a risk management services company in Australia and Papua New Guinea, and an insurance brokerage operation and a rent- a- captive facility in Bermuda.

Arthur J. Gallagher (UK) Limited, a wholly- owned Lloyd's brokerage subsidiary of the Company based in London, provides brokerage and other services to clientele primarily located outside of the United Kingdom ("U.K."). The principal activity of Arthur J. Gallagher (UK) Limited is to negotiate and place insurance and reinsurance with Lloyd's underwriters and insurance companies worldwide. Its brokerage services encompass four major categories: aviation, marine, reinsurance (treaty and facultative) and property and casualty (risks predominantly located in North America).

Although Arthur J. Gallagher (UK) Limited is located in London, the thrust of its business development has been with non- U.K. brokers, agents and insurers rather than domestic U.K. retail business. Its clients are

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primarily insurance and reinsurance companies, underwriters at Lloyd's, the Company and its non- U.K. subsidiaries, other independent agents and brokers and major business corporations requiring direct insurance and reinsurance placement.

Wyatt Gallagher Bassett Pty Ltd ("Wyatt GB") is a 50% owned subsidiary of Gallagher Bassett that is headquartered in Brisbane, Australia with facilities located throughout Australia and Papua New Guinea. Wyatt GB is principally engaged in providing claims adjusting and risk management services.

Arthur J. Gallagher & Co. (Bermuda) Limited provides clients with direct access to the risk- taking capacity of Bermuda-based insurers for both direct and reinsurance placements. It also acts as a wholesaler to the Company's marketing efforts by accessing foreign insurance and reinsurance companies in the placing of U.S. and foreign risks. In addition, it provides services relating to the formation and management of offshore captive insurance companies.

The Company has helped to develop Artex Insurance Company Ltd., a partially owned, Bermuda- based insurance company that operates a "rent- a- captive" facility. Rent- a- captives enable clients to receive the benefits of owning a captive insurance company without the disadvantages of ownership. Captive insurance companies are created to insure risk and capture underwriting profit and investment income, which is then returned to the insured.

Gallagher Bassett International Ltd. (UK) ("GBI"), a subsidiary of Gallagher Bassett, provides risk management services for foreign operations, as well as U.S. operations that are foreign- controlled. Headquartered in London with offices throughout England and Scotland, GBI works with insurance companies, reinsurance companies, overseas brokers, and risk managers of overseas organizations. Services are offered on an unbundled basis wherever applicable and include consulting, claims management, information management, loss control and property valuations.

The Company also has facilities in Canada that are not material to the Company's consolidated operations. Additional information relating to the Company's foreign operations is contained in Notes 12 and 14 to the Consolidated Financial Statements.

#### Markets and Marketing

A substantial portion of the commission and fee business of the Company is derived from institutions, not- for- profit organizations, municipal and other governmental entities and associations. In addition, the Company's clients include large United States and multinational corporations engaged in a broad range of commercial and industrial businesses. The Company also places insurance for individuals. The Company services its clients through its network of approximately

200 offices in the United States and six countries abroad. No material part of the Company's business is dependent upon a single customer or on a few customers, the loss of any one or more of which would have a materially adverse effect on the Company. In 1998, the largest single customer represented approximately 1% of total revenues.

The Company believes that its ability to deliver comprehensively structured risk management and brokerage services, including the placement of reinsurance, is one of its major strengths. The Company also believes that its risk management business enhances and attracts other brokerage business due to the nature and strength of business relationships which it forms with clients when providing a variety of risk management services on an on- going basis.

The Company requires its employees serving in a sales or marketing capacity, including certain executive officers of the Company, to enter into agreements with the Company restricting disclosure of confidential information and solicitation of clients and prospects of the Company upon their termination of employment. The confidentiality and non- solicitation provisions of such agreements terminate in the event of a hostile change in control of the Company, as defined therein.

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#### Competition

The Company believes it is the fourth largest insurance broker worldwide in terms of total revenues. The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals throughout the world who actively compete with the Company in every area of its business. Three competing firms are significantly larger and have many times the commission and/or fee revenues of the Company. There are firms in a particular region or locality which are as large or larger than the particular local office of the Company. The Company believes that the primary factors determining its competitive position with other organizations in its industry are the overall cost and the quality of services rendered.

The Company is also in competition with certain insurance companies which write insurance directly for their customers. Government benefits relating to health, disability, and retirement are also alternatives to private insurance and hence indirectly compete with the business of the Company. To date, such direct writing and government benefits have had, in the opinion of the Company, relatively little effect on its business and operations, but the Company can make no prediction as to their effect in the future.

#### Regulation

In every state and foreign jurisdiction in which the Company does business, the Company or an employee is required to be licensed or receive regulatory approval in order for the Company to conduct business. In addition to licensing requirements applicable to the Company, most jurisdictions require that individuals who engage in brokerage and certain insurance service activities be personally licensed.

The Company's operations depend on its continued good standing under the licenses and approvals pursuant to which it operates. Licensing laws and regulations vary from jurisdiction to jurisdiction. In all jurisdictions the applicable licensing laws and regulations are subject to amendment or interpretation by regulatory authorities, and generally such authorities are vested with relatively broad and general discretion as to the granting, renewing and revoking of licenses and approvals.

#### Commissions and Fees

The two major sources of operating revenues are commissions from brokerage and risk management operations and service fees from risk management operations. Information with respect to these two major sources as well as investment income and other revenue, including non- recurring gains, are as follows (in thousands):

	Years Ended December 31,					
	1998		1997*		1996*	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commissions.....	\$313,131	58	\$285,189	57	\$276,736	58
Fees.....	209,017	39	182,147	36	172,965	37
Investment income and other.....	18,507	3	24,169	5	24,052	5
Non-recurring gains.....	--	--	8,993	2	--	--
	\$540,655	100	\$500,498	100	\$473,753	100

\*Restated for poolings of interests

The primary source of the Company's compensation for its brokerage services is commissions paid by insurance companies which are usually based on a percentage of the premium paid by the insured. Commission rates are dependent on a number of factors including the type of insurance, the particular insurance company and the capacity in which the Company acts. In some cases the Company is compensated for brokerage or advisory services directly by a fee from a client, particularly when insurers do not pay commissions. The Company may

also receive contingent commissions which are generally based on the profit the insurance company makes on the overall volume of business placed by the Company in a given period of time. Occasionally, the Company shares commissions with other brokers who have participated with the Company in placing insurance or servicing insureds.

The Company's compensation for risk management services is in the form of fees and commissions. The Company typically negotiates fees in advance with its risk management clients on an annual basis based on the estimated value of the services to be performed. In some cases the Company receives a fee for acting in the capacity of advisor and administrator with respect to employee benefit programs and receives commissions in connection with the placement of insurance under such programs.

See Note 14 to the Consolidated Financial Statements for revenue information by operating segment for 1998, 1997 and 1996.

The Company's revenues vary significantly from quarter to quarter as a result of the timing of policy inception dates which traditionally are heaviest in the third quarter, whereas expenses are fairly uniform throughout the year. See Note 13 to the Consolidated Financial Statements for unaudited quarterly operating results for 1998 and 1997.

#### Acquisitions

From January 1, 1994 through December 31, 1998, the Company has acquired forty- two insurance service businesses and disposed of seven insurance service businesses. See Note 2 to the Consolidated Financial Statements for further information concerning acquisitions in 1998 and 1997.

The following acquisitions have occurred since December 31, 1998:

On February 28, 1999, a wholly owned subsidiary of the Company acquired substantially all of the assets of Goodman Insurance Agency, Inc., a California corporation engaged in the insurance brokerage and services business in exchange for 157,385 shares of the Company's Common Stock. This acquisition was accounted for as a pooling of interests. The principal entered into a three- year employment agreement with the Company.

On February 28, 1999, a wholly owned subsidiary of the Company acquired substantially all of the assets of Dodson-Bateman & Company, a Texas corporation engaged in the insurance brokerage and services business in exchange for 147,480 shares of the Company's Common Stock. This acquisition was accounted for as a pooling of interests. Two principals and one key employee entered into three- year employment agreements with the Company.

On February 28, 1999, a wholly owned subsidiary of the Company acquired substantially all of the assets of Associated Risk Managers of California, Insurance Producers, a California corporation engaged in the insurance brokerage and services business in exchange for 99,054 shares of the Company's Common Stock. This acquisition was accounted for as a pooling of interests. One principal entered into a three- year employment agreement with the Company.

The Company believes that the net effect of these acquisitions has been and will be to expand significantly the volume of general services rendered by the Company and the geographical areas in which the Company renders such services and not to change substantially the nature of the services performed by the Company.

The Company is considering and intends to consider from time to time acquisitions and divestitures on terms it deems advantageous. The Company has had preliminary discussions with a number of candidates for possible future acquisitions and has executed a non- binding letter of intent with one candidate. No assurances can be given that any additional acquisitions or divestitures will be consummated or, if consummated, will be advantageous to the Company.

#### Employees

As of December 31, 1998, the Company and its subsidiaries employed approximately 4,300 employees, none of whom is represented by a labor union. The Company continuously reviews benefits and other matters of interest to its employees. The Company considers its relations with its employees to be satisfactory.

## **Item 2. Properties.**

The Company's executive offices and certain subsidiary and branch facilities are located at Two Pierce Place, Itasca, Illinois, where the Company leases approximately 200,000 square feet of space. The lease commitment on the above mentioned property expires February 28, 2006. The Company operates virtually all of its branch and service offices in leased premises. Certain of these leases for office space have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain escalation clauses related to increases in the cost of living in future years. See Note 11 to the Consolidated Financial Statements for information with respect to the Company's lease commitments at December 31, 1998.

## **Item 3. Legal Proceedings.**

The Company is engaged in various legal actions incident to the nature of its business. Management is of the opinion that none of the litigation will have a material effect on the Company's consolidated financial position or results of operations.

## **Item 4. Submission of Matters to a Vote of Security Holders.**

No matters were submitted to a vote of security holders during the Company's fourth fiscal quarter ended December 31, 1998.

#### Item 4A. Executive Officers of the Registrant.

The executive officers of the Company are as follows:

Name	Age	Position and Year First Elected
J. Patrick Gallagher, Jr.....	47	President since 1990, Chief Executive Officer since 1995
Michael J. Cloherty.....	51	Vice President--Finance 1981-1996, Executive Vice President since 1996
James J. Braniff III.....	59	Vice President since 1995
Peter J. Durkalski.....	48	Vice President since 1990
James W. Durkin, Jr.....	49	Vice President since 1985
David E. McGurn, Jr.....	45	Vice President since 1993

Each such person has been principally employed by the Company in management capacities for more than the past five years. All executive officers are elected annually and serve at the pleasure of the Board of Directors.

### PART II

#### Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters.

The Company's common stock is listed on the New York Stock Exchange, trading under the symbol "AJG." The following table sets forth information as to the price range of the Company's common stock for the two- year period January 1, 1997 through December 31, 1998 and the dividends declared per share for such period. The table reflects the range of high and low sales prices per share as reported on the Consolidated Transaction Reporting System for securities listed on the New York Stock Exchange.

Quarterly Periods	High	Low	Dividends Declared Per Share
1998			
First.....	\$46 1/8	\$33 9/16	\$.35
Second.....	46 9/16	41 7/8	.35
Third.....	45 25/32	36 5/8	.35
Fourth.....	46 3/4	34 7/8	.35
1997			
First.....	\$33 1/2	\$29 3/4	\$.31
Second.....	37 3/4	30 3/8	.31
Third.....	37 5/8	34 1/4	.31
Fourth.....	38 1/4	34 3/8	.31

As of February 28, 1999, there were approximately 650 holders of record of the Company's common stock.

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#### Item 6. Selected Financial Data.

**ARTHUR J. GALLAGHER & CO.**

GROWTH RECORD: 1989- 1998(a)

(in thousands, except per share and employee data)	Average Annual Growth	-----		
	-----	1998	1997	1996
Revenue Data				
Commissions.....		\$313,131	\$285,189	\$276,736
Fees.....		209,017	182,147	172,965
Investment income and other (e).....		18,507	33,162	24,052
Total revenues.....		\$540,655	\$500,498	\$473,753
Dollar growth.....		\$ 40,157	\$ 26,745	\$ 17,624
Percent growth.....	9%	8%	6%	4%
Pretax Earnings Data				
Pretax earnings.....		\$ 84,529	\$ 82,622	\$ 67,002
Dollar growth.....		\$ 1,907	\$ 15,620	\$ (1,936)
Percent growth.....	12%	2%	23%	(3%)
Pretax earnings as a percentage of revenues.....		16%	17%	14%
Net Earnings Data				
Net earnings.....		\$ 56,501	\$ 54,900	\$ 44,227
Dollar growth.....		\$ 1,601	\$ 10,673	\$ 1,216
Percent growth.....	11%	3%	24%	3%
Net earnings as a percentage of revenues.....		10%	11%	9%
Net Earnings Per Share Data				
Shares outstanding at year end.....		17,645	16,883	16,749
Net earnings per share (b).....		\$ 3.10	\$ 3.17	\$ 2.54
Percent growth.....	11%	(2%)	25%	5%
Employee Data				
Number at year end.....		4,288	3,975	4,104
Number growth.....		313	(129)	35
Percent growth.....	5%	8%	(3%)	1%
Total revenue per employee (c).....		\$ 126	\$ 126	\$ 115
Net earnings per employee (c).....		\$ 13	\$ 14	\$ 11
Common Stock Dividend Data				
Dividends declared per share (d).....		\$ 1.40	\$ 1.24	\$ 1.16
Total dividends declared.....		\$ 24,218	\$ 20,408	\$ 18,399
Percent of net earnings.....		43%	37%	42%
Balance Sheet Data				
Total assets.....		\$746,010	\$652,080	\$602,067
Long-term debt less current portion....		--	--	1,130
Total stockholders' equity.....		\$202,468	\$165,580	\$134,566
Return On Beginning Stockholders' Equity.		34%	41%	35%

#### Notes:

(a) The financial information for all periods prior to 1998 has been restated for four 1998 acquisitions accounted for using the pooling of interests method.

(b) Based on the weighted average number of common and common equivalent shares outstanding during the year.

(c) Based on the number of employees at year end.

(d) Based on the total dividends declared on a share of common stock outstanding during the entire year.

(e) Includes non- recurring gains.

Years Ended December 31,

1995	1994	1993	1992	1991	1990	1989
\$270,437	\$251,344	\$226,394	\$209,287	\$200,171	\$193,097	\$174,231
163,137	144,516	131,957	114,545	95,468	80,255	66,499
22,555	14,136	20,983	17,191	14,565	20,293	19,822
\$456,129	\$409,996	\$379,334	\$341,023	\$310,204	\$293,645	\$260,552
\$ 46,133	\$ 30,662	\$ 38,311	\$ 30,819	\$ 16,559	\$ 33,093	\$ 24,405
11%	8%	11%	10%	6%	13%	10%

\$ 68,938	\$ 59,542	\$ 54,218	\$ 40,534	\$ 32,990	\$ 36,057	\$ 35,981
\$ 9,396	\$ 5,324	\$ 13,684	\$ 7,544	\$ (3,067)	\$ 76	\$ 6,542
16%	10%	34%	23%	(9%)	--%	22%
15%	15%	14%	12%	11%	12%	14%
\$ 43,011	\$ 37,712	\$ 32,104	\$ 25,353	\$ 22,480	\$ 24,424	\$ 24,113
\$ 5,299	\$ 5,608	\$ 6,751	\$ 2,873	\$ (1,944)	\$ 311	\$ 2,835
14%	17%	27%	13%	(8%)	1%	13%
9%	9%	8%	7%	7%	8%	9%
16,821	16,527	17,432	16,907	17,213	17,247	17,442
\$ 2.43	\$ 2.14	\$ 1.76	\$ 1.43	\$ 1.25	\$ 1.36	\$ 1.33
14%	22%	23%	14%	(8%)	2%	15%
4,069	3,730	3,562	3,304	3,104	2,979	2,801
339	168	258	200	125	178	139
9%	5%	8%	6%	4%	6%	5%
\$ 112	\$ 110	\$ 106	\$ 103	\$ 100	\$ 99	\$ 93
\$ 11	\$ 10	\$ 9	\$ 8	\$ 7	\$ 8	\$ 9
\$ 1.00	\$ .88	\$ .72	\$ .64	\$ .64	\$ .60	\$ .52
\$ 15,270	\$ 13,209	\$ 10,808	\$ 8,767	\$ 8,439	\$ 6,999	\$ 5,905
36%	35%	34%	35%	38%	29%	24%
\$577,067	\$525,288	\$553,753	\$497,565	\$478,189	\$470,678	\$423,601
2,260	3,390	28,166	23,888	24,432	24,723	24,775
\$125,884	\$105,344	\$127,239	\$100,040	\$ 95,088	\$ 94,278	\$ 86,614
41%	30%	32%	27%	24%	28%	31%

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.  
General

Fluctuations in premiums charged by insurance companies have a material effect on the insurance brokerage industry. Commission revenues are based on a percentage of the premiums paid by insureds and generally follow premium levels. For more than a decade, lower premium rates have prevailed among property/casualty insurance carriers resulting in heavy competition for market share. This "soft market" (i.e., lower premium rates) has generally resulted in flat or reduced renewal commissions.

In recent years insured losses have reached into the billions of dollars. Substantial mergers, both domestically and internationally, have resulted in fewer insurance companies. Increased underwriting losses and reduced competition tend to raise premium rates. In spite of these forces, there have been mitigating factors including a favorable equity market, increased underwriting capital (more supply of insurance product) and economies of scale after consolidations, all of which tend to lower premium rates. The net result is that property/casualty premium rates have remained low. Management believes these conditions in the insurance marketplace will continue and overall premium pricing will remain under pressure and not improve in 1999.

Historically, increased property replacement costs due to inflation and increasingly large litigation awards have caused some clients to seek higher levels of insurance coverage. These factors generally have the effect of generating higher premiums to clients and higher commissions to the Company. In recent years, lower rates of inflation along with increased underwriting capital have resulted in a highly competitive insurance marketplace and flat to lower premiums. In general, the downward trend in premium rates has had a greater effect on the Company's revenues than inflation.

Although the property/casualty insurance pricing environment has resulted in some "risk" buyers returning to first-dollar coverage, management believes the overall trend will continue to move toward the alternative insurance market, which would tend to have a favorable effect on our Risk Management Services segment. The Company anticipates that new sales in the areas of risk management, claims management, insurance captive and self-insurance services will continue to be a major factor in the Company's fee revenue growth during 1999.

The Company continues to look to the future and to explore not only the core segments of Insurance Brokerage and Risk Management Services, but also expansion within the alternative insurance markets and financial and related investment services. Management believes these areas continue to hold opportunities for diversification and profitable growth.

Results of Operations- - Consolidated

The Company's results of operations for periods prior to 1998 have been restated for four acquisitions as if they had operated as part of the Company prior to their joining the Company. The Company continues to search for merger partners which complement existing operations, provide entry into new markets, add new products and enhance local sales and



service capabilities. For the effect of these restatements, in the aggregate, on year- to- year comparisons, see Note 2 to the Consolidated Financial Statements.

Commission revenues increased by \$27.9 million or 10% in 1998. This increase is the result of new business production of \$54.1 million, significantly offset by lost business of \$35.2 million, with the balance coming from net increases on renewals and contingent commissions. Commission revenues increased by \$8.5 million or 3% in 1997. This increase is the result of new business production partially offset by lost business.

Fee revenues increased by \$26.9 million or 15% in 1998. This increase, generated primarily from the Risk Management Services segment, resulted from strong new business production of \$39.0 million and favorable retention rates on existing business. Fee revenues increased by \$9.2 million or 5% in 1997. This increase, also generated primarily from Risk Management Services, resulted from new business production partially offset by lost business.

Investment income and other decreased by \$5.7 million or 23% in 1998. This decrease is due primarily to lower returns on funds invested with outside fund managers which were adversely affected by volatility in global

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equity markets during 1998. In addition, the Company liquidated a portion of its investment portfolio, thereby reducing the aggregate value of these portfolios by \$24.0 million during 1998. Investment income and other was virtually unchanged in 1997 from the same period in 1996.

In 1997, the Company recognized non- recurring pretax gains of \$7.2 million on the sale of underperforming or geographically undesirable operations and \$1.8 million on a real estate transaction. There were no material non- recurring pretax gains recorded in either 1998 or 1996.

Salaries and employee benefits increased by \$27.1 million or 11% in 1998 due primarily to an 8% increase in employee head count, salary increases, the annualized effect of prior year new hires along with a corresponding increase in employee benefit expenses, and a \$4.8 million non- recurring gain recognized in 1997 from the settlement of a defined benefit pension plan at one of the Company's United Kingdom subsidiaries. Salaries and employee benefits increased by \$4.8 million or 2% in 1997 due to salary increases and the annualized effect of prior year new hires substantially offset by a 3% reduction in employee head count in 1997, the non- recurring pension gain mentioned above and a wage freeze for certain management employees in 1997.

Other operating expenses increased by \$11.2 million or 7% in 1998. This increase is due primarily to increases associated with travel, entertainment and temporary personnel costs for new business, technology upgrades, office consolidation expenses and commissions paid to sub- brokers. Other operating expenses increased by \$6.4 million or 4% in 1997. This increase is due primarily to higher business insurance costs, additional rent and utility expenses resulting from leasing new office space, expanding and upgrading existing office facilities and the costs associated with closing certain underperforming operations.

The Company's effective income tax rates of 33.2%, 33.6% and 34.0% in 1998, 1997 and 1996, respectively, are less than the statutory federal income tax rate of 35% due primarily to the effect of tax benefits generated by certain investments which are substantially offset by state and foreign taxes. See Note 12 to the Consolidated Financial Statements.

The Company's foreign operations recorded earnings before income taxes of \$5.4 million, \$6.6 million and \$5.2 million in 1998, 1997 and 1996, respectively. The decrease in 1998 is due to the non- recurring gains recognized in 1997 associated with the pension and real estate transactions mentioned above, substantially offset by growth in operating results generated by new business. The 1997 increase is due to the non- recurring gains associated with the pension and real estate transactions mentioned above. See Notes 12 and 14 to the Consolidated Financial Statements.

The Company's revenues vary from quarter to quarter generally as a result of the timing of policy inception dates which traditionally are heaviest in the third quarter. Expenses, on the other hand, are fairly uniform throughout the year. See Note 13 to the Consolidated Financial Statements.

#### Results of Operations- - Segment Information

In 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosure about Segments of an Enterprise and Related Information." SFAS 131 establishes standards for the way that public business enterprises report information about operating segments and related disclosures. The following discussion describes and compares the results of operations and geographic data between 1998, 1997 and 1996 with respect to the way the Company views its operating segments.

Insurance Brokerage Services includes the Company's retail, reinsurance and wholesale brokerage operations. Total revenues in 1998 were \$362.5 million, a 9% increase over 1997. This increase is due primarily to new business production and the positive effect of acquisitions, significantly offset by lost business. U.S. revenues of \$330.2 million were up 9% over 1997. Revenues in 1998 from foreign operations, principally in the United Kingdom were up 8% or \$2.3 million over 1997 due mainly to new business partially offset by lost business. Earnings before income taxes in 1998 increased 19% over 1997 as a result of increased revenues. Total revenues in 1997 were \$333.8 million, an increase of 4% over 1996. This increase again is due to new business production partially offset by lost business. U.S. revenues of \$303.8 million

were up 4% over 1996. Revenues in

1997 from foreign operations, primarily in the United Kingdom, were virtually flat with 1996. Earnings before income taxes of \$57.4 million in 1997 increased 9% over 1996 due mainly to increased revenues.

Risk Management Services includes the Company's third party claims administration operations which are principally engaged in providing claims management services for the Company's clients. Total revenues in 1998 were \$168.8 million or 18% over 1997 due to strong new business production and favorable retention rates on existing business. U.S. revenues of \$156.8 million in 1998 were up 15% over 1997 due primarily to new business. In 1998, foreign revenues of \$12.0 million, principally from the United Kingdom and Australia, increased 107% over 1997 due mainly to new business and significant revenues from Australian operations for claim work performed as a result of a pervasive and extended power outage in New Zealand. Earnings before income taxes in 1998 increased 50% over 1997 due primarily to large revenue increases. Total revenues in 1997 were \$142.7 million or 3% over 1996 due to new business production partially offset by lost business. In 1997, U.S. revenues increased 1% over 1996 due primarily to new business partially offset by lost business. Earnings before income taxes in 1997 decreased 18% from 1996 due primarily to lost business partially offset by new business.

Financial Services is responsible for investments and certain non- recurring events. The Company's comprehensive investment portfolio includes investment strategies held as trading, marketable securities held as available for sale, tax advantaged investments, investments on the equity method of accounting, real estate partnerships and notes receivable from investees. Revenues in 1998 were \$9.3 million or \$14.7 million less than revenues in 1997 and earnings before income taxes decreased \$16.9 million or 76% from 1997. These decreases relate to \$9.0 million and \$13.8 million of non-recurring gains in revenues and earnings before taxes, respectively, recognized in 1997 and less favorable returns on funds invested with outside fund managers due to equity market conditions in 1998. Revenues in 1997 increased 80% over 1996 and earnings before income taxes in 1997 increased 166% over 1996 due primarily to the non- recurring gains mentioned above and favorable returns on funds invested with outside fund managers. Financial Services' revenues are generated principally in the U.S.

Corporate consists of unallocated administrative costs and the provision for income taxes which is not allocated to the Company's operating entities. Revenues are not recorded in this segment and all costs are generated in the U.S. See Note 14 to the Consolidated Financial Statements.

#### Financial Condition and Liquidity

The insurance brokerage industry is not capital intensive. The Company has historically been profitable, and cash flows from operations and short- term borrowings under various credit agreements have been sufficient to fund operating, investment and capital expenditure needs of the Company. Cash generated from operating activities was \$56.4 million, \$67.0 million and \$45.6 million in 1998, 1997 and 1996, respectively. Because of the variability related to the timing of premiums and fees receivable and premiums payable, net cash flows from operations vary substantially from year to year. Funds restricted as to the Company's use, primarily premiums held as fiduciary funds, have not been included in determining the Company's overall liquidity.

The Company maintains a \$20.0 million unsecured revolving credit agreement (the "Credit Agreement") requiring repayment of any loans under the agreement no later than June 30, 2001. During 1998, the Company borrowed and repaid \$15.0 million of short- term borrowings under the Credit Agreement. These borrowings were primarily used on a short-term basis to finance a portion of the Company's expanded investment activity. As of December 31, 1998, there were no borrowings outstanding under this agreement. During 1997, the Company made no borrowings under this agreement. The Credit Agreement requires the maintenance of certain financial covenants. The Company is currently in compliance with these covenants. The Company also had two term loan agreements. In 1998, the Company retired the remaining loan balances on these term loan agreements.

The Company also has line of credit facilities of \$27.5 million which expire on April 30, 1999. Periodically, the Company will make short- term borrowings under these credit facilities to meet short- term cash flow needs. During 1998 and 1997, the Company borrowed \$60.0 million and \$30.9 million and repaid \$60.0 million and \$25.9 million of short- term borrowings, respectively, under these facilities. As of December 31, 1998 and 1997,

\$15.0 million was outstanding under these facilities. These borrowings were primarily used on a short- term basis to finance a portion of the Company's expanded investment activity.

At December 31, 1997, the Company had commitments to invest \$26.0 million in several of its equity and tax advantaged investments. In addition, the Company had contingently committed to invest an additional \$3.0 million in 1998 related to a line of credit arrangement with one of its equity investments. As of December 31, 1998, approximately \$29.0 million had been invested under these arrangements, which were funded primarily from the \$24.0 million of proceeds from the

sales and maturities of trading and marketable securities investments. At December 31, 1998, the Company has committed to invest an additional \$7.5 million related to two letter of credit arrangements with one of its equity investments and to unconditionally guarantee \$30.0 million of debt that will be incurred by another of its equity investments. In addition, the Company has guaranteed an aggregate \$8.7 million of funds through letters of credit or other arrangements related to several investments and insurance programs of the Company.

The Company paid \$23.2 million in cash dividends on its common stock in 1998. The Company's dividend policy is determined by the Board of Directors and payments are fixed after considering the Company's available cash from earnings and its known or anticipated cash needs. In each quarter of 1998, the Company's Board of Directors declared a dividend of \$.35 per share which was \$.04 or 13% greater than each quarterly dividend in 1997. In January 1999, the Company announced a first quarter dividend of \$.40 per share, a 14% increase over the first quarter dividend in 1998. Net capital expenditures were \$14.0 million, \$11.4 million and \$10.4 million in 1998, 1997 and 1996, respectively. In 1999, the Company expects to make expenditures for capital improvements of approximately \$14.5 million. Capital expenditures by the Company are related primarily to office moves and expansions and updating computer systems and equipment.

In 1988, the Company adopted a plan which has been extended through June 30, 1999 to repurchase its common stock. Under the plan, the Company repurchased 215,000 shares at a cost of \$8.7 million, 522,000 shares at a cost of \$17.1 million and 645,000 shares at a cost of \$21.3 million in 1998, 1997 and 1996, respectively. The repurchased shares are held for reissuance in connection with exercises of options under the Company's stock option plans. Under the provisions of the plan, the Company is authorized to repurchase approximately 535,000 additional shares through June 30, 1999. The Company is under no commitment or obligation to repurchase any particular amount of common stock and at its discretion may suspend the repurchase plan at any time.

Effective with changes in the United States federal income tax laws in 1997, the Company no longer provides for U.S. income taxes on the undistributed earnings of its foreign subsidiaries which are considered permanently invested outside the United States. At December 31, 1998, the Company had \$21.8 million of undistributed earnings from its foreign subsidiaries which is a decrease of \$5.4 million from the undistributed earnings at December 31, 1997. This decrease is due primarily to \$7.7 million of aggregate dividend payments received by the Company from two of its foreign subsidiaries partially offset by the 1998 net earnings of its foreign subsidiaries. These dividend payments are subject to United States federal income tax which have been provided for by the Company. See Note 12 to the Consolidated Financial Statements. Although not considered available for domestic needs, the undistributed earnings generated by certain foreign subsidiaries referred to above may be used to finance foreign operations and acquisitions.

#### Year 2000 Compliance

Computer programs that have time sensitive software may recognize the date "00" as the Year 1900, rather than the Year 2000 which could result in system failures or miscalculations causing disruptions of operations. With respect to this issue, the Company has completed an assessment of its computer systems and software and has substantially completed the necessary modifications or replacements of its existing software so that its computer systems will function properly in the Year 2000 and beyond. Testing and live use have taken place and will continue into 1999. Any additional modifications found necessary will be made at that time. No contingency plans are deemed necessary.

The Company has evaluated the impact on operations of the Year 2000 on non- information technology systems and has determined that any potential impact would not be material to the Company's operations.

Generally, system modifications and replacements and the associated costs were contemplated with normal enhancements and improvements being made in conjunction with updating financial reporting and operating systems. To date, the cost of compliance has not been material and is not expected to be material in the future.

The Company also has an ongoing program to review the status of Year 2000 compliance efforts of its business partners and vendors. While the Company believes it is taking the appropriate steps to assure the Company's Year 2000 compliance, it is also dependent on business partner, vendor and client compliance to some extent. Consequently, any Year 2000 compliance problems that may be experienced by the Company's business partners, vendors or clients could have a material adverse effect on the Company's future financial condition and future operating results. No assurance can be given that the Company's and these other entities' efforts will completely address the Year 2000 issue.

#### Market Risk Exposure

The Company is exposed to various market risks, including changes in interest rates and foreign currency exchange rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest and foreign currency exchange rates and equity prices. The Company does not enter into derivatives or other similar financial instruments for trading or speculative purposes. The following analysis presents the hypothetical loss in fair value of the financial instruments held by the Company at December 31, 1998 that are sensitive to changes in interest rates and equity prices. The range of changes in interest rates used in the analysis reflects the Company's view of changes that are

reasonably possible over a one year period. This discussion of market risks related to the Company's consolidated balance sheet includes estimates of future economic environments caused by changes in market risks. The effect of actual changes in these risk factors may differ materially from the Company's estimates. In the ordinary course of business, the Company also faces risks that are either nonfinancial or nonquantifiable, including credit risk and legal risk. These risks are not included in the following analysis.

The Company has a comprehensive and diversified investment portfolio. The Company's invested assets are held as cash and cash equivalents, investment strategies held as trading and marketable securities held as available for sale.

Accordingly, these assets are subject to various market risk exposures such as interest rate risk and equity price risk. The fair value of the Company's cash and cash equivalents investment portfolio at December 31, 1998 approximated its carrying value due to its short- term duration. Market risk was estimated as the potential decrease in fair value resulting from a hypothetical one percentage point increase in interest rates for the instruments contained in the cash and cash equivalents investment portfolio and the resulting fair value was not materially different from the December 31, 1998 carrying value.

At December 31, 1998, the fair value of the Company's investment strategies portfolio was \$57.4 million. From an investment management perspective, this portfolio, which is managed by several outside fund managers, consists of two different components: an equity portfolio of \$7.3 million and an alternative investment strategies portfolio of \$50.1 million. The equity portfolio is subject to equity price risk. This portfolio, which is not hedged, consists of common stocks and is primarily managed to produce realized gains for the Company. The estimated potential loss in fair value of this equity component at December 31, 1998 resulting from a hypothetical decrease in prices quoted by stock exchanges of 10% would be approximately \$730,000. The Company's alternative investment strategies portfolio is also subject to equity pricing risk. However, these investments are actively managed in order to minimize the Company's exposure to equity pricing risk. The objective of this portfolio is to maximize the overall return to the Company, while minimizing the downward price risk in order to preserve the investment's underlying principal balance. The outside fund managers for these alternative investment

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strategies hedge their strategies by "selling short" common equity securities in order to mitigate the effects of changes in equity prices thereby making any such fluctuations immaterial. Accordingly, hypothetical changes in equity prices would not cause the resulting fair value to be materially different from the December 31, 1998 carrying value for this portfolio.

At December 31, 1998, the fair value of the Company's marketable securities portfolio was \$20.1 million, which was \$1.3 million less than its aggregate amortized cost. The overall objective of this portfolio is to provide the Company with a stable after tax yield. This portfolio, which is not hedged, primarily consists of dividend yielding preferred stocks.

Accordingly, this portfolio is more sensitive to interest rate risk than it is to equity pricing risk. The estimated potential loss in fair value resulting from a hypothetical one percentage point increase in short- term interest rates at December 31, 1998 would be approximately \$2.1 million.

At December 31, 1998, the fair value of the Company's borrowings under the line of credit facilities approximated the carrying value due to their short- term duration and variable interest rates. Market risk was estimated as the potential increase in the fair value resulting from a hypothetical one percentage point decrease in the Company's weighted average short- term borrowing rate at December 31, 1998 and the resulting fair value was not materially different from the year end carrying value.

The Company is subject to foreign currency exchange rate risk primarily due to the fact that its United Kingdom based subsidiaries incur expenses denominated in British pounds while receiving their revenues in U.S. dollars. The Company does not hedge this foreign currency exchange rate risk. The foreign currency gains (losses) related to this market risk are recorded in earnings before income taxes as they are incurred. Assuming a hypothetical adverse change of 10% in the average foreign currency exchange rate for 1998 (a weakening of the U.S. dollar), earnings before income taxes would decrease by approximately \$2.0 million. The Company is also subject to foreign currency exchange rate risk associated with the translation of its foreign subsidiaries into U.S. dollars. However, it is management's opinion that this foreign currency exchange risk is not material to the Company's consolidated operating results or financial position. The Company manages the balance sheets of its foreign subsidiaries such that foreign liabilities are matched with equal foreign assets thereby maintaining a "balanced book" which minimizes the effects of currency fluctuations.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

This annual report contains forward- looking statements. Forward- looking statements made by or on behalf of the Company are subject to risks and uncertainties, including but not limited to the following: the Company's commission revenues are highly dependent on premiums charged by insurers, which are subject to fluctuation; the property/casualty insurance industry continues to experience a prolonged soft market (low premium rates) thereby reducing commissions; lower interest rates will reduce the Company's income earned on invested funds; the insurance brokerage and service businesses are extremely competitive with three competitors being substantially larger than the Company; the alternative

insurance market continues to grow which could unfavorably impact commission and favorably impact fee revenue; the Company's revenues vary significantly from period to period as a result of the timing of policy inception dates and the net effect of new and lost business production; the general level of economic activity can have a substantial impact on the Company's renewal business; the Company's operating results and financial position may be adversely impacted by exposure to various market risks such as interest rate, equity pricing and foreign exchange rates; and the Company's Year 2000 compliance efforts depend upon compliance efforts of the Company's business partners, vendors and clients. The Company's ability to grow 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. Accordingly, actual results may differ materially from those set forth in the forward- looking statements. Attention is also directed to other risk factors set forth in documents filed by the Company with the Securities and Exchange Commission.

## Item 8. Financial Statements and Supplementary Data.

### INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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## ARTHUR J. GALLAGHER & CO.

### CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended December 31,		
	1998	1997	1996
	(in thousands, except per share data)		
Operating Results			
Revenues:			
Commissions.....	\$313,131	\$285,189	\$276,736
Fees.....	209,017	182,147	172,965
Investment income and other.....	18,507	24,169	24,052
Non-recurring gains.....	--	8,993	--
Total revenues.....	540,655	500,498	473,753
Expenses:			
Salaries and employee benefits.....	281,509	254,424	249,674
Other operating expenses.....	174,617	163,452	157,077
Total expenses.....	456,126	417,876	406,751
Earnings before income taxes.....	84,529	82,622	67,002
Provision for income taxes.....	28,028	27,722	22,775
Net earnings.....	\$ 56,501	\$ 54,900	\$ 44,227
Net earnings per common share.....	\$ 3.25	\$ 3.28	\$ 2.64
Net earnings per common and common equivalent share.....	3.10	3.17	2.54
Dividends declared per common share.....	1.40	1.24	1.16

See notes to consolidated financial statements.

**ARTHUR J. GALLAGHER & CO.****CONSOLIDATED BALANCE SHEET**

	December 31,	
	1998	1997
	(in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 61,518	\$ 72,021
Restricted cash.....	86,622	81,160
Premiums and fees receivable.....	288,276	220,972
Investment strategies--trading.....	57,368	62,681
Other.....	37,172	40,655
Total current assets.....	530,956	477,489
Marketable securities--available for sale.....	20,089	39,203
Deferred income taxes and other noncurrent assets.....	151,033	96,748
Fixed assets.....	98,262	88,029
Accumulated depreciation and amortization.....	(66,801)	(59,784)
Net fixed assets.....	31,461	28,245
Intangible assets--net.....	12,471	10,395
	\$746,010	\$652,080

&lt;CAPTION&gt;

## LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Premiums payable to insurance companies.....	\$372,626	\$318,007
Accrued salaries and bonuses.....	21,940	18,585
Accounts payable and other accrued liabilities.....	90,336	90,731
Unearned fees.....	13,616	11,778
Income taxes payable.....	12,621	10,799
Other.....	19,517	23,260
Total current liabilities.....	530,656	473,160
Other noncurrent liabilities.....	12,886	13,340
Stockholders' equity:		
Common stock--issued and outstanding 17,645 shares in 1998 and 16,883 shares in 1997.....	17,645	16,883
Capital in excess of par value.....	13,219	4,696
Retained earnings.....	172,381	142,343
Accumulated other comprehensive earnings (loss).....	(777)	1,658
Total stockholders' equity.....	202,468	165,580
	\$746,010	\$652,080

See notes to consolidated financial statements.

**ARTHUR J. GALLAGHER & CO.****CONSOLIDATED STATEMENT OF CASH FLOWS**

	Years Ended December 31,		
	1998	1997	1996
	(in thousands)		
Cash flows from operating activities:			
Net earnings.....	\$ 56,501	\$ 54,900	\$ 44,227
Adjustments to reconcile net earnings to net cash provided by operating activities:			

Net gain on investments and other.....	(4,144)	(13,931)	(3,928)
Depreciation and amortization.....	11,728	11,240	10,712
(Increase) decrease in restricted cash.....	(5,462)	6,064	8,164
(Increase) decrease in premiums receivable...	(58,782)	15,790	(5,775)
Increase (decrease) in premiums payable.....	54,619	(11,570)	3,280
Decrease (increase) in trading investments-- net.....	6,963	(6,217)	(4,128)
Decrease (increase) in other current assets..	5,583	(6,490)	(8,000)
Increase in accrued salaries and bonuses.....	3,355	3,512	1,326
(Decrease) increase in accounts payable and other accrued liabilities.....	(1,428)	19,675	8,404
Increase (decrease) in income taxes payable..	1,822	5,760	(5,575)
Net change in deferred income taxes.....	(5,474)	(9,604)	(2,502)
Other.....	(8,914)	(2,163)	(650)
Net cash provided by operating activities..	56,367	66,966	45,555
Cash flows from investing activities:			
Purchases of marketable securities.....	(33,331)	(30,170)	(23,679)
Proceeds from sales of marketable securities...	47,665	30,368	28,747
Proceeds from maturities of marketable securities.....	2,600	1,645	1,958
Net additions to fixed assets.....	(13,994)	(11,381)	(10,363)
Other.....	(52,146)	(25,698)	(16,969)
Net cash used by investing activities.....	(49,206)	(35,236)	(20,306)
Cash flows from financing activities:			
Proceeds from issuance of common stock.....	13,655	10,964	7,966
Tax benefit from issuance of common stock.....	4,273	2,429	1,955
Repurchases of common stock.....	(8,651)	(17,126)	(21,290)
Dividends paid.....	(23,185)	(19,990)	(17,530)
Retirement of long-term debt.....	(1,130)	(1,130)	(1,130)
Borrowings on line of credit facilities.....	75,000	30,900	10,000
Repayments on line of credit facilities.....	(75,000)	(25,900)	--
Equity transactions of pooled companies prior to dates of acquisition.....	(2,626)	(613)	(6,807)
Net cash used by financing activities.....	(17,664)	(20,466)	(26,836)
Net (decrease) increase in cash and cash equivalents.....			
	(10,503)	11,264	(1,587)
Cash and cash equivalents at beginning of year...	72,021	60,757	62,344
Cash and cash equivalents at end of year.....	\$61,518	\$ 72,021	\$ 60,757
Supplemental disclosures of cash flow information:			
Interest paid.....	\$ 1,289	\$ 1,018	\$ 885
Income taxes paid.....	20,337	24,158	25,874

See notes to consolidated financial statements.

## ARTHUR J. GALLAGHER & CO.

### CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Capital In Excess Of		Accumulated Other Comprehensive Earnings (Loss)	Total Stockholders' Equity
	Shares	Amount	Par Value	Retained Earnings		
			(in thousands)			
Balance at December 31, 1995 as previously reported.....	16,529	\$16,529	\$ --	\$109,616	\$ 34	\$ 126,179
Acquisition of pooled companies.....	292	292	267	(854)	--	(295)
Balance at December 31, 1995.....	16,821	16,821	267	108,762	34	125,884
Net earnings.....	--	--	--	44,227	--	44,227
Net change in						

unrealized gain (loss) on available for sale securities.....	--	--	--	--	855	855
Comprehensive earnings						45,082
Cash dividends declared on common stock.....	--	--	--	(18,399)	--	(18,399)
Common stock issued under stock option plans.....	398	398	7,568	--	--	7,966
Tax benefit from issuance of common stock.....	--	--	1,955	--	--	1,955
Common stock repurchases.....	(645)	(645)	(7,383)	(13,262)	--	(21,290)
Common stock issued in three pooling acquisitions.....	175	175	--	--	--	175
Equity transactions of pooled companies prior to dates of acquisition.....	--	--	--	(6,807)	--	(6,807)
Balance at December 31, 1996.....	16,749	16,749	2,407	114,521	889	134,566
Net earnings.....	--	--	--	54,900	--	54,900
Net change in unrealized gain (loss) on available for sale securities.....	--	--	--	--	769	769
Comprehensive earnings						55,669
Cash dividends declared on common stock.....	--	--	--	(20,408)	--	(20,408)
Common stock issued under stock option plans.....	557	557	10,407	--	--	10,964
Tax benefit from issuance of common stock.....	--	--	2,429	--	--	2,429
Common stock repurchases.....	(522)	(522)	(10,627)	(5,977)	--	(17,126)
Common stock issued in two pooling acquisitions.....	99	99	--	--	--	99
Equity transactions of pooled companies prior to dates of acquisition.....	--	--	80	(693)	--	(613)
Balance at December 31, 1997.....	16,883	16,883	4,696	142,343	1,658	165,580
Net earnings.....	--	--	--	56,501	--	56,501
Net change in unrealized gain (loss) on available for sale securities.....	--	--	--	--	(2,435)	(2,435)
Comprehensive earnings						54,066
Cash dividends declared on common stock.....	--	--	--	(24,218)	--	(24,218)
Common stock issued under stock option plans.....	588	588	13,067	--	--	13,655
Tax benefit from issuance of common stock.....	--	--	4,273	--	--	4,273
Common stock repurchases.....	(215)	(215)	(8,436)	--	--	(8,651)
Common stock issued in nine pooling acquisitions.....	389	389	--	--	--	389
Equity transactions of pooled companies prior to dates of						



acquisition.....	--	--	(381)	(2,245)	--	(2,626)
Balance at December 31,						
1998.....	17,645	\$17,645	\$ 13,219	\$172,381	\$ (777)	\$ 202,468

See notes to consolidated financial statements.

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## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Summary of Significant Accounting Policies

##### Nature of operations

Arthur J. Gallagher & Co. (the Company) provides insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional and governmental organizations. Commission revenue is principally generated through the negotiation and placement of insurance for its clients. Fee revenue is generated by providing other risk management services including claims management, information management, risk control services and appraisals in either the property/casualty market or human resource/employee benefit market. The Company operates through approximately 200 offices throughout the United States and six countries abroad.

##### Basis of presentation

The accompanying consolidated financial statements include the accounts of the Company and all of its majority owned subsidiaries. Investments in partially owned entities in which ownership is 20% to 50% are accounted for using the equity method. Accordingly, the Company's share of the net earnings of these entities is included in consolidated net earnings. Investments in partially owned entities in which ownership is less than 20% are carried at cost. All material intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior years' financial statements in order to conform to the current year presentation.

##### Use of estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

##### Revenue recognition

Commission income is generally recognized as of the effective date of insurance policies except for commissions on installment premiums which are recognized periodically as billed. Contingent commissions are generally recognized when received. Fee income is recognized ratably as services are rendered. The income effects of subsequent premium and fee adjustments are recorded when the adjustments become known. Premiums and fees receivable are net of allowance for doubtful accounts of \$1,500,000 and \$860,000 at December 31, 1998 and 1997, respectively.

##### Comprehensive earnings

As of January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130 (SFAS 130), "Reporting Comprehensive Income." SFAS 130 establishes new rules for the reporting and display of comprehensive earnings and its components; however, the adoption of SFAS 130 had no impact on the Company's consolidated net earnings or total stockholders' equity. SFAS 130 requires unrealized gains or losses on the Company's available for sale securities, which prior to adoption were reported separately in stockholders' equity, to be included in other comprehensive earnings. Prior year consolidated financial statements have been reclassified to conform to the requirements of SFAS 130.

##### Earnings per share

Earnings per share are computed based on the weighted average number of common and common equivalent shares outstanding during the respective period. Common equivalent shares include incremental shares from dilutive stock options, which are calculated from the date of grant under the treasury stock method using the average market price for the period.

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## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

## 1. Summary of Significant Accounting Policies- - (Continued)

### Segment information

As of December 31, 1998, the Company adopted Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosure about Segments of an Enterprise and Related Information," which superseded Statement of Financial Accounting Standards No. 14, "Financial Reporting for Segments of a Business Enterprise." SFAS 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to stockholders. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The adoption of SFAS 131 had no impact on the Company's consolidated operating results or financial position, but did affect the disclosure of segment information. Prior year segment information has been reclassified to conform to the requirements of SFAS 131. See Note 14 to the consolidated financial statements.

### Consolidated statement of cash flows

Short- term investments, consisting principally of commercial paper and certificates of deposit which have a maturity of ninety days or less at date of purchase, are considered cash equivalents.

### Premium trust funds

Premiums collected from insureds but not yet remitted to insurance carriers are restricted as to use by laws in certain states and foreign jurisdictions in which the Company's subsidiaries operate. Additionally, the Company's United Kingdom subsidiaries are required by Lloyd's of London to meet certain liquidity requirements.

### Investments

Investment strategies are considered trading securities and consist primarily of limited partnerships which invest in common stocks. Securities designated as trading are carried at fair value in the accompanying consolidated balance sheet, with unrealized gains and losses included in the consolidated statement of earnings. The fair value of investment strategies is determined by reference to the fair values of the underlying common stocks which are based on quoted market prices. Marketable securities are considered available for sale and consist primarily of preferred and common stocks. Securities designated as available for sale are carried at fair value in the accompanying consolidated balance sheet, with unrealized gains and losses, less related deferred income taxes, excluded from net earnings and reported as accumulated other comprehensive earnings. Gains and losses are recognized in net earnings when realized using the specific identification method. The fair value for marketable securities is based on quoted market prices.

### Fixed assets

Fixed assets are carried at cost in the accompanying consolidated balance sheet. Furniture and equipment with a cost of \$86,862,000 and \$78,839,000 at December 31, 1998 and 1997, respectively, are depreciated using the straight- line method over the estimated useful lives of the assets. Leasehold improvements with a cost of \$11,400,000 and \$9,190,000 at December 31, 1998 and 1997, respectively, are amortized using the straight- line method over the shorter of the estimated useful lives of the assets or the lease terms.

## **ARTHUR J. GALLAGHER & CO.**

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

## 1. Summary of Significant Accounting Policies- - (Continued)

### Intangible assets

Intangible assets consist of the excess of cost over the value of net tangible assets of acquired businesses, non- compete agreements and expiration lists. The excess of cost over the value of net tangible assets is amortized over twenty to forty years using the straight- line method. Non- compete agreements and expiration lists are amortized principally over ten years using the straight- line method. Accumulated amortization at December 31, 1998 and 1997 was \$4,618,000 and \$6,487,000, respectively.

### Stock based compensation

The Company primarily grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock option grants in accordance with Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," and, accordingly, recognizes no compensation expense for these stock options granted to employees.

### Effect of new pronouncement

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities," which is effective for fiscal years beginning after June 15, 1999. Because of the Company's minimal use of derivatives, management does not anticipate that the adoption of SFAS 133 will have a significant effect on the Company's consolidated operating results or financial position.

## 2. Business Combinations

In 1998, the Company acquired substantially all of the net assets of twelve insurance brokerage firms and one benefits consulting company in exchange for 681,000 shares of its common stock. In 1997, the Company acquired substantially all of the net assets of one insurance brokerage firm and two benefits consulting companies in exchange for 263,000 shares of its common stock. These acquisitions were accounted for as poolings of interests and, except for nine of the 1998 acquisitions and two of the 1997 acquisitions whose results were not significant, the consolidated financial statements for all periods prior to the acquisition dates have been restated to include the operations of these companies.

The following summarizes the restatement of the 1997 and 1996 consolidated financial statements to reflect the operations of the 1998 acquisitions (in thousands, except per share data):

	As Previously Reported	Attributable to Pooled Companies	As Restated
1997			
Total revenues.....	\$488,028	\$ 12,470	\$500,498
Net earnings.....	53,316	1,584	54,900
Net earnings per common share.....	3.24	.04	3.28
Net earnings per common and common equivalent share.....	3.13	.04	3.17
1996			
Total revenues.....	\$462,022	\$ 11,731	\$473,753
Net earnings.....	43,144	1,083	44,227
Net earnings per common share.....	2.62	.02	2.64
Net earnings per common and common equivalent share.....	2.52	.02	2.54

In 1998, the Company acquired the net assets of three insurance brokerage firms in exchange for cash and notes payable. These acquisitions were accounted for as purchases. In 1997, the Company acquired a majority equity interest in a risk management company which was also accounted for as a purchase. The Company paid cash in this transaction. These purchase transactions were not material to either the 1998 or 1997 consolidated financial statements.

## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

## 3. Investments

The following is a summary of available for sale marketable securities (in thousands):

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 1998				
Preferred stocks.....	\$ 14,487	\$ 529	\$ 646	\$14,370
Common stocks.....	4,735	57	1,218	3,574
Fixed maturities.....	2,161	71	87	2,145
	\$ 21,383	\$ 657	\$ 1,951	\$20,089
December 31, 1997				
Preferred stocks.....	\$ 20,776	\$ 1,264	\$ 162	\$21,878
Common stocks.....	12,139	2,420	766	13,793
Fixed maturities.....	3,525	161	154	3,532
	\$ 36,440	\$ 3,845	\$ 1,082	\$39,203

The gross realized gains on sales of marketable securities totaled \$3,054,000, \$2,257,000 and \$1,652,000 for 1998, 1997 and 1996, respectively. The gross realized losses totaled \$1,179,000, \$346,000 and \$881,000 for 1998, 1997 and 1996, respectively.

The cost or amortized cost and fair value of fixed maturities at December 31, 1998, by contractual maturity, are as follows (in thousands):

	Cost or Amortized Cost	Fair Value
Due in 1999.....	\$ --	\$ --
Due in 2000 through 2003.....	1,540	1,524
Due in 2004 through 2008.....	152	152
Due in 2009 and thereafter.....	469	469
	\$ 2,161	\$ 2,145

The expected maturities may differ from contractual maturities in the foregoing table because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following is a summary of deferred income taxes and other noncurrent assets (in thousands):

	December 31,	
	1998	1997
Tax advantaged investments.....	\$ 51,400	\$34,413
Investments on equity method of accounting.....	20,017	15,736
Real estate partnerships.....	10,732	405
Notes receivable from investees.....	30,855	12,545
Noncurrent deferred income taxes.....	21,669	19,349
Other investments.....	9,466	8,656
Other.....	6,894	5,644
	\$151,033	\$96,748

### 3. Investments- - (Continued)

Tax advantaged investments represent amounts invested by the Company in limited partnerships that operate qualified affordable housing or alternative energy projects. The Company receives tax benefits in the form of tax deductions for operating losses and tax credits from these investments. The tax advantaged investments are primarily accounted for using the effective yield method and are carried at amortized cost in the consolidated balance sheet. Under the effective yield method, the Company recognizes the tax credits as they are allocated by the partnerships, which are included, net of amortization of the investment, as a component of the provision for income taxes. During 1998 and 1997, the Company received tax benefits related to \$20,159,000 and \$21,934,000 of the aggregate amount invested in the tax advantaged investments at December 31, 1998 and 1997, respectively. Investments in real estate partnerships primarily represent an investment in a limited partnership that owns 10,000 acres of land to be developed near Orlando, Florida. Investments in real estate partnerships are carried at cost in the consolidated balance sheet, which approximated fair value at December 31, 1998. Notes receivable from investees represent secured loans made by the Company to several of its equity and limited partnership investments. Interest rates on the loans at December 31, 1998 ranged from 6% to 9.75%. The carrying value of these loans at December 31, 1998 approximated fair value.

Significant components of investment income and other, including non- recurring gains, are as follows (in thousands):

	Years Ended December 31,		
	1998	1997	1996
Interest.....	\$11,112	\$13,993	\$15,817
Dividends.....	2,809	3,814	4,229
Net realized and unrealized gains.....	4,144	4,938	3,928
Other income.....	1,206	1,155	189
Income (loss) from equity investments.....	(764)	269	(111)
Non-recurring gains.....	--	8,993	--
Total investment income and other.....	\$18,507	\$33,162	\$24,052

The net change in unrealized gain (loss) on investment strategies included

in the above table amounted to (\$611,000) in 1998, (\$1,813,000) in 1997 and \$3,905,000 in 1996. In 1997, the Company sold several underperforming or geographically undesirable operations and recorded aggregate gains on these sales of \$7,203,000. The gains on these sales of operations have been included in non-recurring gains in the foregoing table. The net assets sold and the operating results included in the consolidated statement of earnings related to these operations were not material to the consolidated financial statements. Also in 1997, the Company recorded a gain on a real estate transaction of \$1,790,000, which has also been included in non-recurring gains in the foregoing table.

The components of other comprehensive earnings, including the related income tax effects, consist of the following (in thousands):

<CAPTION>

	Years Ended December 31,		
	1998	1997	1996
Change in unrealized gain (loss) on available for sale securities during the year, net of income taxes of (\$844), \$872 and \$830, respectively.....	\$(1,267)	\$ 1,308	\$ 1,245
Reclassification adjustment for gains realized in net earnings during the year, net of income taxes of (\$778), (\$360) and (\$259), respectively.....	(1,168)	(539)	(390)
Net change in unrealized gain (loss) on available for sale securities during the year, net of income taxes of (\$1,622), \$512 and \$571, respectively.....	\$(2,435)	\$ 769	\$ 855

## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 4. Securities Sold Under Agreements to Repurchase

At December 31, 1998, securities sold under agreements to repurchase the identical securities are collateralized by government backed small business administration loans and government securities with a carrying value of \$21,714,000 and a fair value of \$21,817,000. The securities collateralizing the agreements were held by two primary dealers. At December 31, 1997, these securities had a carrying value of \$22,121,000 and a fair value of \$22,360,000.

#### 5. Credit and Debt Agreements

The Company maintains a \$20,000,000 variable rate (based on LIBOR plus .4%) unsecured revolving credit agreement which expires on June 30, 2001. As of December 31, 1998 and 1997, there were no borrowings outstanding under this agreement. Terms of the revolving credit agreement include various covenants which require the Company to maintain specified levels of tangible net worth and restrict the amount of payments on certain expenditures.

The Company also has line of credit facilities of \$27,500,000 which expire on April 30, 1999. Short- term borrowings under these facilities totaled \$15,000,000 at December 31, 1998 and 1997. The weighted average interest rate on the short-term borrowings were 5.9% and 6.5% during 1998 and 1997, respectively.

At December 31, 1997, the Company had two unsecured term loan agreements with outstanding balances of \$630,000 and \$500,000 and stated interest rates of 6.64% and 6.30%, respectively. In 1998, the Company retired the remaining balances on these term loan agreements.

#### 6. Capital Stock and Stockholders' Rights Plan

##### Capital Stock

The table below summarizes certain information about the Company's capital stock at December 31, 1998 and 1997 (in thousands, except per share data):

Class	Par Value	Authorized Shares
Preferred stock.....	No par	1,000
Common stock.....	\$ 1.00	100,000

## Stockholders' Rights Plan

Non- voting Rights, authorized by the Board of Directors on March 10, 1987 and approved by stockholders on May 12, 1987, are outstanding on each share of outstanding common stock. Under certain conditions, each Right may be exercised to purchase one share of common stock at an exercise price of \$100. The Rights become exercisable and transferable after a public announcement that a person or group has acquired 20% or more of the common stock or after commencement or public announcement of a tender offer for 30% or more of the common stock. If the Company is acquired in a merger or business combination, each Right exercised gives the holder the right to purchase \$200 of market value of common stock of the surviving company for the \$100 exercise price. The Rights Plan was amended in 1996 to extend the expiration of the Rights to May 12, 2007. The Rights may be redeemed by the Company at five cents per Right at any time prior to the public announcement of the acquisition of 20% of the common stock. At December 31, 1998 and 1997, 25,000,000 shares of common stock were reserved for potential exercise of the Rights.

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## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 7. Earnings Per Share

The following table sets forth the computation of net earnings per common share and net earnings per common and common equivalent share (in thousands, except per share data):

	Years Ended December 31,		
	1998	1997	1996
Net earnings.....	\$ 56,501	\$ 54,900	\$ 44,227
Weighted average number of common shares outstanding.....	17,402	16,746	16,739
Dilutive effect of stock options using the treasury stock method.....	804	584	681
Weighted average number of common and common equivalent shares outstanding.....	18,206	17,330	17,420
Net earnings per common share.....	\$ 3.25	\$ 3.28	\$ 2.64
Net earnings per common and common equivalent share.....	3.10	3.17	2.54

Options to purchase 20,000, 644,000 and 1,313,000 shares of common stock were outstanding during 1998, 1997 and 1996, respectively, but were not included in the computation of the dilutive effect of stock options. These options were excluded from the computation because the options' exercise prices were greater than the average market price of the common shares and, therefore, would be antidilutive.

#### 8. Stock Option Plans

The Company has incentive and nonqualified stock option plans for officers and key employees of the Company and its subsidiaries. The options are primarily granted at the fair value of the underlying shares at the date of grant. Options granted under the nonqualified plan primarily become exercisable at the rate of 10% per year beginning the calendar year after the date of grant or earlier in the event of death, disability or retirement. Options expire ten years from the date of grant, or earlier in the event of termination of the employee.

In addition, the Company has a non- employee directors' stock option plan which currently authorizes 200,000 shares for grant, with Discretionary Options granted at the direction of the Option Committee and Retainer Options granted in lieu of the directors' annual retainer. Discretionary Options shall be exercisable at such rates as shall be determined by the Committee on the date of grant. Retainer Options shall be cumulatively exercisable at the rate of 25% of the total Retainer Option at the end of each full fiscal quarter succeeding the date of grant. The excess of fair value at the date of grant over the option price for these nonqualified stock options is considered compensation and is charged against earnings ratably over the vesting period.

The Company also has an incentive stock option plan for its officers and key employees resident in the United Kingdom. The United Kingdom plan is essentially the same as the Company's domestic employee stock option plans, with certain modifications to comply with United Kingdom law and to provide potentially favorable tax treatment for grantees resident in the United Kingdom.

In 1998, all of the aforementioned stock option plans were modified to provide for the immediate vesting of all outstanding stock option grants in the event of a change in control of the Company. A change in control of the Company is

defined as the acquisition by a person (or entity) of the beneficial ownership of 50% or more of the Company's common stock; the cessation, for any reason, of a majority of directors of the Company to serve as directors during any two year period; or the approval by the stockholders of the Company of the sale of substantially all of the assets of the Company.

ARTHUR J. GALLAGHER & CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

8. Stock Option Plans- - (Continued)

The Company accounts for stock option grants in accordance with APB 25 and, accordingly, recognizes no compensation expense for stock options that are granted to employees at the fair value of the underlying shares at the date of grant. Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock- Based Compensation," requires disclosure of pro forma information regarding net earnings and net earnings per share, using pricing models to estimate the fair value of stock option grants. Had compensation expense for the Company's stock option plans been determined based on the estimated fair value at the date of grant consistent with the methodology prescribed under SFAS 123, approximate net earnings and net earnings per share would have been as follows (in thousands, except per share data):

	Years Ended December 31,		
	1998	1997	1996
Pro forma net earnings.....	\$ 55,449	\$ 54,009	\$ 43,583
Pro forma net earnings per common share.....	3.19	3.23	2.60
Pro forma net earnings per common and common equivalent share.....	3.08	3.15	2.53

For purposes of the pro forma disclosures, the estimated fair values of the stock option grants are amortized to expense over the options' expected lives. The fair value of stock options at the date of grant was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

<CAPTION>

	Years Ended December 31,		
	1998	1997	1996
Dividend yield.....	3.1%	3.0%	2.9%
Risk-free interest rate.....	4.9%	5.7%	6.3%
Volatility.....	24.1%	23.9%	24.1%
Expected life (years).....	8.0	8.0	8.0

The Black- Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee and director stock options have characteristics significantly different from those of traded options, and because changes in the selective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee and director stock options.

The pro forma disclosures above only include the effect of options granted subsequent to January 1, 1995. Accordingly, the effects of applying the SFAS 123 pro forma disclosures to future periods may not be indicative of future effects.

ARTHUR J. GALLAGHER & CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

8. Stock Option Plans- - (Continued)

The following is a summary of all of the Company's stock option activity and related information (in thousands, except exercise price data):

	Years Ended December 31,					
	1998		1997		1996	
	Shares	Weighted	Shares	Weighted	Shares	Weighted
	Under	Average	Under	Average	Under	Average
	Option	Exercise	Option	Exercise	Option	Exercise
		Price		Price		Price
Beginning balance.....	4,327	\$28.26	4,910	\$27.18	4,770	\$25.87
Granted.....	761	37.91	149	33.18	714	32.05
Exercised.....	(588)	23.20	(557)	19.69	(398)	20.02
Canceled.....	(39)	32.83	(175)	29.44	(176)	28.44
Ending balance.....	4,461	\$30.52	4,327	\$28.26	4,910	\$27.18
Exercisable at end of						
year.....	1,743		1,780		1,728	

Options with respect to 1,328,000 shares were available for grant at December 31, 1998.

Other information regarding stock options outstanding and exercisable at December 31, 1998 is summarized as follows (in thousands, except exercise price data):

Options Outstanding			Options Exercisable		
Weighted			Weighted		
Average			Average		
Remaining			Weighted		
Contractual			Average		
Life			Exercise		
Range of Exercise Prices	Number	Exercise	Number	Exercise	Exercise
-----	Outstanding	(in years)	Exercisable	Price	Price
\$ 7.13 - \$22.38.....	1,078	2.25	703	\$20.70	\$20.59
22.81 - 31.88.....	1,262	6.44	434	30.50	30.05
32.00 - 34.38.....	1,170	5.33	534	33.87	33.74
34.75 - 44.06.....	897	9.18	72	37.08	36.10
45.13 - 45.38.....	54	9.91	--	45.35	--
\$ 7.13 - \$45.38.....	4,461	5.73	1,743	\$30.52	\$27.62

## 9. Retirement Plans

The Company has a noncontributory defined benefit pension plan which covers substantially all domestic employees who have attained a specified age and one year of employment. Benefits under the plan are based on years of service and salary history. Plan assets consist primarily of common stocks and bonds invested under the terms of a group annuity contract managed by a life insurance company.

The Company accounts for the defined benefit pension plan in accordance with Statement of Financial Accounting Standards No. 87 (SFAS 87), "Employers' Accounting for Pensions." The difference between the present value of the pension benefit obligation at the date of adoption of SFAS 87 and the fair value of plan assets at that date is being amortized on a straight- line basis over the average remaining service period of employees expected to receive benefits.

## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

## 9. Retirement Plans- - (Continued)

A reconciliation of the beginning and ending balances of the pension benefit obligation and fair value of plan assets and the funded status of the plan is as follows (in thousands):

	Years Ended December 31,	
	1998	1997
Change in pension benefit obligation:		
Pension benefit obligation at beginning of		
year.....	\$ 63,747	\$ 52,931
Service cost.....	7,355	7,046
Interest cost.....	4,560	3,985



Actuarial (gain) loss.....	(9,141)	657
Benefits paid.....	(1,206)	(872)
Pension benefit obligation at end of year....	65,315	63,747
Change in plan assets:		
Fair value of plan assets at beginning of year.....	45,560	39,045
Actual return on plan assets.....	5,832	5,802
Company contributions.....	4,868	1,585
Benefits paid.....	(1,206)	(872)
Fair value of plan assets at end of year....	55,054	45,560
Funded status of the plan (underfunded).....	(10,261)	(18,187)
Unrecognized net actuarial gain.....	(13,433)	(2,628)
Unrecognized prior service cost.....	1,102	1,212
Unrecognized transition obligation.....	443	499
Accrued pension benefit cost..... \$	(22,149)	\$ (19,104)

The components of the net periodic pension benefit cost for the plan consists of the following (in thousands):

<CAPTION>

	Years Ended December 31,		
	1998	1997	1996
Service cost--benefits earned during the year.....	\$ 7,355	\$ 7,046	\$ 5,790
Interest cost on benefit obligation..	4,560	3,985	3,322
Expected return on plan assets.....	(4,168)	(3,550)	(3,057)
Amortization of prior service cost...	110	110	110
Amortization of transition obligation.....	56	56	56
Other.....	26	26	52
Net periodic pension benefit cost....	\$ 7,939	\$ 7,673	\$ 6,273

The following assumptions were used in determining the plan's pension benefit obligation for 1998, 1997 and 1996:

Discount rate.....	7.5%
Rate of increase in future compensation levels.....	6.5%
Expected long-term rate of return on assets.....	9.0%

The Company has a contributory savings and thrift plan covering the majority of its employees. Company contributions are at the discretion of the Company's Board of Directors and may not exceed the maximum

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ARTHUR J. GALLAGHER & CO.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

#### 9. Retirement Plans- - (Continued)

amount deductible for federal income tax purposes. The Company contributed \$2,823,000, \$2,760,000 and \$3,220,000 in 1998, 1997 and 1996, respectively. The Company also has a foreign defined contribution plan which provides for basic contributions by the Company and voluntary contributions by employees which are matched 100% by the Company, up to a maximum of 5% of salary, as defined. Net expense (income) for foreign retirement plans amounted to \$3,128,000 in 1998, (\$2,922,000) in 1997 and \$1,485,000 in 1996.

In 1997, the Company settled a foreign defined benefit plan and enrolled the participants into a foreign defined contribution plan. At the time of the settlement of the foreign plan, there was a surplus of plan assets in excess of benefit obligations. Previously vested benefits of the plan participants were settled by the purchase of annuity policies with a life insurance company. As a result of the defined benefit plan settlement, the Company recognized a \$4,830,000 gain in 1997 which was recorded as a reduction of salaries and employee benefits expense.

#### 10. Postretirement Benefits Other Than Pensions

In 1992, the Company amended its health benefits plan to eliminate retiree coverage, except for retirees at the time of the amendment and those employees who had already attained a specified age and length of service. The retiree health plan is contributory, with contributions adjusted annually and is funded on a pay- as- you- go basis.

A reconciliation of the beginning and ending balances of the postretirement benefit obligation and the funded status of the plan is as follows (in thousands):

Years Ended December 31,

	1998	1997
Change in postretirement benefit obligation:		
Postretirement benefit obligation at beginning of year.....	\$ 11,280	\$ 10,112
Service cost.....	--	--
Interest cost.....	803	763
Actuarial (gain) loss.....	(346)	793
Benefits paid.....	(460)	(388)
Postretirement benefit obligation at end of year...	11,277	11,280
Fair value of plan assets at beginning and end of year.....	--	--
Funded status of the plan (underfunded).....	(11,277)	(11,280)
Unrecognized net actuarial gain.....	(1,075)	(729)
Unrecognized prior service cost.....	--	--
Unrecognized transition obligation.....	7,164	7,676
Accrued postretirement benefit cost.....	\$ (5,188)	\$ (4,333)

## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 10. Postretirement Benefits Other Than Pensions- - (Continued)

The components of the net periodic postretirement benefit cost include the following (in thousands):

	Years Ended December 31,		
	1998	1997	1996
Service cost--benefits earned during the year.....	\$ --	\$ --	\$ --
Interest cost on benefit obligation.....	803	763	717
Amortization of transition obligation.....	512	512	512
Amortization of gain.....	--	(89)	(209)
Net periodic postretirement benefit cost.....	\$ 1,315	\$ 1,186	\$ 1,020

The discount rate used to measure the postretirement benefit obligation was 7.5% at December 31, 1998 and 1997. The transition obligation is being amortized over a 20 year period. For measurement purposes, an 8.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 1999. This rate was assumed to gradually scale down to 4.5% for 2009 and remain at that level thereafter. The assumed health care cost trend rate has a significant effect on the amounts reported and disclosed herein. A one percentage point change in the assumed health care cost trend rate would have the following effects (in thousands):

	One Percentage Point	
	Increase	(Decrease)
Effect on the net periodic postretirement benefit cost in 1998.....	\$ 96	\$ (342)
Effect on the postretirement benefit obligation at December 31, 1998.....	1,377	(4,900)

#### 11. Commitments and Contingencies

The Company is engaged in various legal actions incident to the nature of its business. Management is of the opinion that none of the litigation will have a material effect on the Company's consolidated financial position or operating results. The Company generally operates in leased premises. Certain office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain escalation clauses related to increases in the cost of living in future years.

Minimum aggregate rental commitments at December 31, 1998 under noncancelable operating leases having an initial term of more than one year are as follows (in thousands):

	Total
1999.....	\$ 27,757
2000.....	22,729
2001.....	18,719
2002.....	15,462
2003.....	11,733
Subsequent years.....	34,337
	\$130,737

Total rent expense, including rent relating to cancelable leases and leases with initial terms of less than one year, amounted to \$32,057,000 in 1998, \$30,724,000 in 1997 and \$28,796,000 in 1996.

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## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 11. Commitments and Contingencies- - (Continued)

At December 31, 1998, the Company has contingently committed to invest an additional \$7,500,000 in 1999 related to two letter of credit arrangements with one of its equity investments. At December 31, 1998, the Company has agreed to unconditionally guarantee \$30,000,000 of debt that will be incurred by one of the Company's equity investments in 1999. In addition, the Company has guaranteed an aggregate \$8,700,000 of funds through letters of credit or other arrangements related to several investment and insurance programs of the Company.

#### 12. Income Taxes

Significant components of earnings before income taxes and the provision for income taxes are as follows (in thousands):

	Years Ended December 31,		
	1998	1997	1996
Earnings before income taxes:			
Domestic.....	\$79,087	\$ 75,987	\$61,838
Foreign.....	5,442	6,635	5,164
	\$84,529	\$ 82,622	\$67,002
Provision for income taxes:			
Federal:			
Current.....	\$27,314	\$ 30,514	\$19,953
Deferred.....	(7,049)	(10,284)	(3,737)
	20,265	20,230	16,216
State and local:			
Current.....	7,081	6,306	5,340
Deferred.....	(1,007)	(1,469)	(415)
	6,074	4,837	4,925
Foreign:			
Current.....	2,629	1,318	729
Deferred.....	(940)	1,337	905
	1,689	2,655	1,634
Total provision for income taxes.....	\$28,028	\$ 27,722	\$22,775

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## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 12. Income Taxes- - (Continued)

A reconciliation of the provision for income taxes with the U.S. federal income tax rate is as follows (in thousands):

	Years Ended December 31,			
	1998	1997	1996	
	% of	% of	% of	
	Pretax	Pretax	Pretax	
Amount	Income	Income	Income	Amount

Federal statutory rate.....	\$29,585	35.0	\$28,918	35.0	\$23,451	35.0
State income taxes--net of federal.....	3,731	4.4	2,925	3.6	3,151	4.7
Pre-acquisition earnings of pooled companies taxed to previous owners.....	(509)	(0.6)	(84)	(0.1)	(468)	(0.7)
Foreign taxes.....	349	0.4	592	0.7	208	0.3
General business credits....	(4,866)	(5.8)	(2,697)	(3.3)	(2,242)	(3.3)
Other--net.....	(262)	(0.2)	(1,932)	(2.3)	(1,325)	(2.0)
Provision for income taxes..	\$28,028	33.2	\$27,722	33.6	\$22,775	34.0

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows (in thousands):

	December 31,	
	1998	1997
Deferred tax liabilities:		
Leveraged leases.....	\$ 444	\$ 444
Unrealized investment gain.....	--	1,105
Other.....	2,104	1,124
Deferred tax liabilities.....	2,548	2,673
Deferred tax assets:		
Accrued and unfunded compensation and employee benefits.....	20,706	15,138
Accrued liabilities.....	13,305	13,938
Unrealized investment loss.....	517	--
Other.....	1,968	2,079
Total deferred tax assets.....	36,496	31,155
Valuation allowance for deferred tax assets.....	--	--
Deferred tax assets.....	36,496	31,155
Net deferred tax assets.....	\$33,948	\$28,482

During the period from 1994 to 1996, the Company provided for U.S. income taxes on the undistributed earnings of its foreign subsidiaries. Due to changes in the U.S. federal income tax laws effective in 1997, the Company no longer provides for U.S. income taxes on the undistributed earnings (\$21,800,000 at December 31, 1998) of certain foreign subsidiaries which are considered permanently invested outside of the U.S. The amount of unrecognized deferred tax liability on these undistributed earnings is \$6,100,000 at December 31, 1998.

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## ARTHUR J. GALLAGHER & CO.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 13. Quarterly Operating Results (unaudited)

Quarterly operating results for 1998 and 1997 were as follows (in thousands, except per share data):

	1st	2nd	3rd	4th
1998				
Total revenues.....	\$123,702	\$124,417	\$143,538	\$148,998
Earnings before income taxes.....	17,215	14,788	29,132	23,394
Net earnings.....	11,494	9,892	19,859	15,256
Net earnings per common share.....	.68	.57	1.13	.87
Net earnings per common and common equivalent share.....	.65	.54	1.08	.83
1997				
Total revenues.....	\$114,594	\$119,695	\$133,518	\$132,691
Earnings before income taxes.....	14,457	19,840	28,587	19,738
Net earnings.....	9,631	13,185	18,958	13,126
Net earnings per common share.....	.57	.79	1.13	.78
Net earnings per common and common equivalent share.....	.56	.77	1.09	.75

#### 14. Segment Information

The Company has identified three operating segments in addition to its corporate operations. Insurance Brokerage Services encompasses operations that, for commission or fee compensation, place or arrange to place insurance directly related to the clients' funding of risk. This segment also provides consulting, for fee compensation, related to clients' risk financing programs. Risk Management Services includes the Company's third party administration, loss control and risk management consulting, workers' compensation investigations and insurance property appraisal operations. Third party administration is principally claims management services for the Company's clients. Financial Services includes alternative investment strategies and tax advantaged investments. It manages the Company's own investment portfolio while expanding these services in conjunction with the insurance products the Company markets. Corporate consists primarily of unallocated administrative costs and the provision for income taxes which is not allocated to the Company's operating segments.

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### ARTHUR J. GALLAGHER & CO.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS- - (Continued)

#### 14. Segment Information- - (Continued)

Allocations of investment income and certain expenses are based on assumptions and estimates, and reported operating results by segment would change if different methods were applied. Certain assets are not individually identifiable by segment and, accordingly, have been allocated based on formulas. Financial information relating to the Company's operating segments for 1998, 1997 and 1996 is as follows (in thousands):

	Insurance Brokerage Services	Risk Management Services	Financial Services	Corporate	Total
Year Ended December 31, 1998					
Revenues:					
Commissions.....	\$312,664	\$ 467	\$ --	\$ --	\$313,131
Fees.....	41,640	167,377	--	--	209,017
Investment income and other.....	8,179	1,000	9,328	--	18,507
Total revenues.....	\$362,483	\$ 168,844	\$ 9,328	\$ --	\$540,655
Earnings before income taxes.....	\$ 68,268	\$ 15,427	\$ 5,270	\$ (4,436)	\$ 84,529
Provision for income taxes..	--	--	--	28,028	28,028
Net earnings.....	\$ 68,268	\$ 15,427	\$ 5,270	\$ (32,464)	\$ 56,501
Income (loss) from equity investments.....	\$ 215	\$ --	\$ (979)	\$ --	\$ (764)
Depreciation and amortization expense.....	7,660	3,732	--	336	11,728
Interest expense.....	136	88	11	1,054	1,289
Net foreign exchange gain (loss).....	(176)	126	--	2	(48)
Revenues:					
United States.....	\$330,153	\$ 156,836	\$ 8,902	\$ --	\$495,891
Foreign, principally United Kingdom.....	32,330	12,008	426	--	44,764
Total revenues.....	\$362,483	\$ 168,844	\$ 9,328	\$ --	\$540,655
<CAPTION>					
At December 31, 1998					
Identifiable assets:					
United States.....	\$301,471	\$ 40,774	\$195,302	\$ 40,006	\$577,553
Foreign, principally United Kingdom.....	156,701	7,373	4,383	--	168,457
Total identifiable assets.....	\$458,172	\$ 48,147	\$199,685	\$ 40,006	\$746,010
Identifiable assets related to equity					

investments..... \$ (120) \$ -- \$ 20,137 \$ -- \$ 20,017

**ARTHUR J. GALLAGHER & CO.**

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

**14. Segment Information- - (Continued)**

	Insurance Brokerage Services	Risk Management Services	Financial Services	Corporate	Total
Year Ended December 31, 1997					
Revenues:					
Commissions.....	\$284,808	\$ 381	\$ --	\$ --	\$285,189
Fees.....	40,744	141,403	--	--	182,147
Investment income and other...	8,253	912	15,004	--	24,169
Non-recurring gains.....	--	--	8,993	--	8,993
Total revenues.....	\$333,805	\$ 142,696	\$ 23,997	\$ --	\$500,498
Earnings before income taxes....	\$ 57,384	\$ 10,273	\$ 22,129	\$ (7,164)	\$ 82,622
Provision for income taxes.....	--	--	--	27,722	27,722
Net earnings.....	\$ 57,384	\$ 10,273	\$ 22,129	\$ (34,886)	\$ 54,900
Income (loss) from equity					
investments.....	\$ (154)	\$ --	\$ 423	\$ --	\$ 269
Depreciation and amortization					
expense.....	7,486	3,425	--	329	11,240
Interest expense.....	178	69	561	210	1,018
Net foreign exchange gain					
(loss).....	75	1	--	--	76
Revenues:					
United States.....	\$303,824	\$ 136,899	\$ 21,609	\$ --	\$462,332
Foreign, principally United Kingdom.....	29,981	5,797	2,388	--	38,166
Total revenues.....	\$333,805	\$ 142,696	\$ 23,997	\$ --	\$500,498
<CAPTION>					
At December 31, 1997					
Identifiable assets:					
United States.....	\$245,817	\$ 34,084	\$168,907	\$ 44,928	\$493,736
Foreign, principally United Kingdom.....	148,967	5,054	4,323	--	158,344
Total identifiable assets....	\$394,784	\$ 39,138	\$173,230	\$ 44,928	\$652,080
Identifiable assets related to					
equity investments.....	\$ (627)	\$ --	\$ 16,363	\$ --	\$ 15,736
<CAPTION>					
Year Ended December 31, 1996					
Revenues:					
Commissions.....	\$276,295	\$ 441	\$ --	\$ --	\$276,736
Fees.....	36,458	136,507	--	--	172,965
Investment income and other...	9,742	943	13,367	--	24,052
Total revenues.....	\$322,495	\$ 137,891	\$ 13,367	\$ --	\$473,753
Earnings before income taxes....	\$ 52,705	\$ 12,494	\$ 8,317	\$ (6,514)	\$ 67,002
Provision for income taxes.....	--	--	--	22,775	22,775
Net earnings.....	\$ 52,705	\$ 12,494	\$ 8,317	\$ (29,289)	\$ 44,227
Income (loss) from equity					
investments.....	\$ (204)	\$ --	\$ 93	\$ --	\$ (111)
Depreciation and amortization					
expense.....	7,270	3,080	--	362	10,712
Interest expense.....	485	5	362	33	885
Net foreign exchange gain					
(loss).....	(267)	72	--	14	(181)
Revenues:					
United States.....	\$292,538	\$ 135,044	\$ 12,925	\$ --	\$440,507
Foreign, principally United					

Kingdom.....	29,957	2,847	442	--	33,246
Total revenues.....	\$322,495	\$ 137,891	\$ 13,367	\$ --	\$473,753
<CAPTION>					
At December 31, 1996					
Identifiable assets:					
United States.....	\$290,663	\$ 36,595	\$117,352	\$ 21,163	\$465,773
Foreign, principally United					
Kingdom.....	129,727	2,926	3,641	--	136,294
Total identifiable assets...	\$420,390	\$ 39,521	\$120,993	\$ 21,163	\$602,067
Identifiable assets related to					
equity investments.....	\$ (473)	\$ --	\$ 6,065	\$ --	\$ 5,592

## MANAGEMENT'S REPORT

The Management of Arthur J. Gallagher & Co. is responsible for the preparation and integrity of the consolidated financial statements and the related financial comments appearing in this annual report. The consolidated financial statements were prepared in accordance with generally accepted accounting principles and include certain amounts based on management's best estimates and judgments. Other financial information presented in this annual report is consistent with the consolidated financial statements.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded and that transactions are executed as authorized and are recorded and reported properly. This system of controls is based on written policies and procedures, appropriate divisions of responsibility and authority, careful selection and training of personnel and the utilization of an internal audit function. Policies and procedures prescribe that the Company and all employees are to maintain the highest ethical standards and that business practices throughout the world are to be conducted in a manner which is above reproach.

Ernst & Young LLP, independent auditors, has audited the Company's consolidated financial statements and their report is presented herein.

The Board of Directors has an Audit Committee composed entirely of outside directors. Ernst & Young LLP has direct access to the Audit Committee and periodically meets with the Committee to discuss accounting, auditing and financial reporting matters.

Arthur J. Gallagher & Co.

Itasca, Illinois  
January 19, 1999

/s/ J. Patrick Gallagher, Jr.  
J. Patrick Gallagher, Jr.  
President and Chief Executive  
Officer

/s/ Michael J. Cloherty

Michael J. Cloherty  
Executive Vice President and  
Chief Financial Officer

## REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders  
Arthur J. Gallagher & Co.

We have audited the accompanying consolidated balance sheet of Arthur J. Gallagher & Co. as of December 31, 1998 and 1997, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material

misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arthur J. Gallagher & Co. at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ Ernst & Young LLP

Ernst & Young LLP

Chicago, Illinois  
January 19, 1999

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

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#### PART III

Item 10. Directors and Executive Officers of the Registrant.

Information regarding directors and nominees for directors of the Company is included under the caption entitled "Election of Directors" in the Proxy Statement dated March 30, 1999 and is incorporated herein by reference.

#### **Item 11. Executive Compensation.**

Information regarding executive compensation of the Company's directors and executive officers is included in the Proxy Statement dated March 30, 1999 under the caption entitled "Compensation of Executive Officers and Directors," and is incorporated herein by reference; provided, however, the report of the Compensation Committee on executive compensation and the stock performance graph shall not be deemed to be incorporated herein by reference.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management.**

Information regarding beneficial ownership of the Common Stock by certain beneficial owners and by management of the Company is included under the caption entitled "Principal Holders of Securities" in the Proxy Statement dated March 30, 1999 and is incorporated herein by reference.

#### **Item 13. Certain Relationships and Related Transactions.**

Not applicable.

#### PART IV

#### **Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.**

(a) The following documents are filed as a part of this report: 1. Consolidated Financial Statements of Arthur J. Gallagher & Co. consisting of:

(a) Consolidated Statement of Earnings for each of the three years in the period ended December 31, 1998.

(b) Consolidated Balance Sheet as of December 31, 1998 and 1997.

(c) Consolidated Statement of Cash Flows for each of the three years in the period ended December 31, 1998.

(d) Consolidated Statement of Stockholders' Equity for each of the three years in the period ended December 31, 1998.

(e) Notes to Consolidated Financial Statements.

(f) Report of Independent Auditors.

2. Consolidated Financial Statement Schedules consisting of:

(a) Schedule II- - Valuation and Qualifying Accounts.

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or the Notes thereto.



### 3. Exhibits:

- 3.1 Restated Certificate of Incorporation of the Company (incorporated by reference to the same exhibit number to Company's Form 10-Q Quarterly Report for the quarterly period ended June 30, 1996, File No. 1-9761).

- 3.2 By-Laws of the Company (incorporated by reference to the same exhibit number to Company's Form S-1 Registration Statement No. 33-10447).
- 3.3 Rights Agreement between the Company and Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago) (incorporated by reference to Exhibits 1 and 2 to Company's Form 8-A Registration Statement filed May 12, 1987, File No. 0-13480).
- 3.4 Assignment and Assumption Agreement of Rights Agreement by and among Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago), Harris Trust and Savings Bank and the Company (incorporated by reference to the same exhibit number to Company's Form S-8 Registration Statement No. 33-38031).
- 3.5 Amendment No. 1 to Exhibit 3.3 (incorporated by reference to the same exhibit number to Company's Form 10-Q Quarterly Report for the quarterly period ended June 30, 1996, File No. 1-9761).
- 4.1 Instruments defining the rights of security holders (relevant portions contained in the Restated Certificate of Incorporation and By-Laws of the Company and the Rights Agreement in Exhibits 3.1, 3.2, and 3.3, respectively, hereby incorporated by reference).
- 4.4 Credit Agreement dated February 16, 1993 (incorporated by reference to the same exhibit number to the Company's Form 10-K Annual Report for 1992, File No. 1-9761).
- \*\*10.1 Arthur J. Gallagher & Co. Incentive Stock Option Plan and related form of stock option agreement (incorporated by reference to the same exhibit number to Company's Form S-1 Registration Statement No. 2-89195).
- \*\*10.1.1 Amendment No. 1 to Exhibit No. 10.1 (incorporated by reference to Exhibit No. 10.3 to Company's Form S-8 Registration Statement No. 33-604).
- \*\*10.1.2 Amendment No. 2 to Exhibit No. 10.1 (incorporated by reference to Exhibit No. 10.3.1 to Company's Form S-8 Registration Statement No. 33-14625).
- \*\*10.25 Arthur J. Gallagher & Co. United Kingdom Incentive Stock Option Plan, Amended and restated as of January 22, 1998 and approved by the Inland Revenue on June 12, 1998 (incorporated by reference to the same exhibit number to the Company's Form 10-Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1-9761).
- \*\*10.26 Arthur J. Gallagher & Co. 1988 Incentive Stock Option Plan, Amended and restated as of May 19, 1998 (incorporated by reference to the same exhibit number to the Company's Form 10-Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1-9761).
- \*\*10.27 Arthur J. Gallagher & Co. 1988 Nonqualified Stock Option Plan, Amended and restated as of January 22, 1998 (incorporated by reference to the same exhibit number to the Company's Form 10-Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1-9761).
- \*\*10.28 Arthur J. Gallagher & Co. 1989 Non-Employee Directors' Stock Option Plan, Amended and restated as of January 22, 1998 (incorporated by reference to the same exhibit number to the Company's Form 10-Q Quarterly Report for the quarterly period

- ended June 30, 1998, File No. 1-9761).
- 10.5 Lease Agreement between Arthur J. Gallagher & Co. and Itasca Center III Limited Partnership, a Texas limited partnership, dated July 26, 1989 (incorporated by reference to the same exhibit number to Company's Form 10-K Annual Report for 1989, File No. 1-9761).
- 10.7 Letter dated December 31, 1983 from Arthur J. Gallagher & Co. to Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago) regarding Common Stock Purchase Financing Program including exhibits thereto and related letters (incorporated by reference to the same exhibit number to Company's Form S-1 Registration Statement No. 2-89195).

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- 10.71 Amendment to Exhibit No. 10.7 dated September 11, 1985 (incorporated by reference to the same exhibit number to Company's Form 10-K Annual Report for 1985, File No. 0-13480).
- \*\*10.10 Board of Directors' Resolution from meeting on January 26, 1984 relating to consulting and retirement benefits for certain directors (incorporated by reference to the same exhibit number to Company's Form S-1 Registration Statement No. 2-89195).
- \*\*10.11 Form of Indemnity Agreement between the Company and each of its directors and corporate officers (incorporated by reference to Attachment A to the Company's Proxy Statement dated April 10, 1987 for its Annual Meeting of Stockholders, File No. 0-13480).
- \*\*10.13 Arthur J. Gallagher & Co. Stock Option Agreements dated May 10, 1988 between the Company and each of Robert H. B. Baldwin, Jack M. Greenberg and James R. Wimmer (incorporated by reference to the same exhibit number to Company's Form 10-K Annual Report for 1988, File No. 1-9761).
- \*10.14 Form of Change in Control Agreement between the Company and each of its Executive Officers.
- \*21.0 Subsidiaries of the Company, including state or other jurisdiction of incorporation or organization and the names under which each does business.
- \*23.1 Consent of Ernst & Young LLP, as independent auditors.
- \*24.0 Powers of Attorney.
- \*27.0 Financial Data Schedule.

All other exhibits are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

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\*Filed as exhibits to this Form 10- K with the Securities and Exchange Commission.

\*\*Such exhibit is a management contract or compensatory plan or arrangement required to be filed as an exhibit to this form pursuant to item 601 of Regulation S- K.

(b) Reports on Form 8- K  
Not applicable

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### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on the 26th day of March, 1999.

Arthur J. Gallagher & Co.  
/s/ J. Patrick Gallagher, Jr.

By \_\_\_\_\_

J. Patrick Gallagher, Jr.  
President and Chief Executive  
Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 26th day of March, 1999 by the following persons on behalf of the Registrant in the capacities indicated.

Name	Title
*Robert E. Gallagher	Chairman and Director
Robert E. Gallagher /s/ J. Patrick Gallagher, Jr.	President and Director (Chief Executive Officer)
J. Patrick Gallagher, Jr. /s/ Michael J. Cloherty	Executive Vice President and Director (Chief Financial Officer)
Michael J. Cloherty /s/ Jack H. Lazzaro	Vice President--Finance (Chief Accounting Officer)
Jack H. Lazzaro *T. Kimball Brooker	Director
T. Kimball Brooker *Peter J. Durkalski	Director
Peter J. Durkalski *Jack M. Greenberg	Director
Jack M. Greenberg *Frank M. Heffernan, Jr.	Director
Frank M. Heffernan, Jr. *Philip A. Marineau	Director
Philip A. Marineau *Walter F. McClure	Director
Walter F. McClure *James R. Wimmer	Director
James R. Wimmer	

/s/ John C. Rosengren

\*By: \_\_\_\_\_

John C. Rosengren, Attorney-in-Fact

SCHEDULE II

ARTHUR J. GALLAGHER & CO.  
VALUATION AND QUALIFYING ACCOUNTS  
(in thousands)

	Balance at Beginning of Year	Additions Charged to Expense	Adjustments	Balance at End of Year
Year ended December 31, 1998				
Allowance for doubtful accounts...	\$ 860	\$ 241	\$ 399 (1)	\$ 1,500
Accumulated amortization of goodwill.....	3,377	285	(43) (2)	3,619
Accumulated amortization of non-compete agreements and expiration				

lists.....	3,110	665	(2,776) (3)	999
Year ended December 31, 1997				
Allowance for doubtful accounts...	\$ 889	\$ 636	\$ (665) (1)	\$ 860
Accumulated amortization of goodwill.....	3,419	237	(279) (2)	3,377
Accumulated amortization of non-compete agreements and expiration lists.....	3,314	816	(1,020) (3)	3,110
Year ended December 31, 1996				
Allowance for doubtful accounts...	\$ 729	\$2,111	\$ (1,951) (1)	\$ 889
Accumulated amortization of goodwill.....	4,006	361	(948) (2)	3,419
Accumulated amortization of non-compete agreements and expiration lists.....	4,189	759	(1,634) (3)	3,314

(1) Bad debt write- offs net of recoveries.

(2) Reversal of fully amortized goodwill.

(3) Reversal of fully amortized non- compete agreements and expiration lists.

#### EXHIBIT 10.14

##### "CHANGE IN CONTROL" AGREEMENT

THIS AGREEMENT is made between Arthur J. Gallagher & Co., a Delaware corporation (the "Company"), and \_\_\_\_\_ (the "Executive"), dated this 7th day of October, 1998.

WITNESSETH THAT:

WHEREAS, the Company wishes to attract and retain well- qualified executive personnel and to assure both itself and the Executive of continuity of management in the event of any actual or threatened change in control of the Company;

NOW, THEREFORE, it is hereby agreed by and between the parties as follows:

1. Change in Control. A "change in control of the Company" shall be deemed to have occurred if: (a) any person or group, as defined in Sections 13(d) and 14(d)(2) of the Securities Exchange Act of 1934, as amended, is or becomes the beneficial owner, directly or indirectly of securities of the Company representing 50 percent or more of the combined voting power of the Company's outstanding securities then entitled to vote for the election of directors; or (b) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board of Directors and any new directors whose election by the Board or nomination for election by the Company's Stockholders was approved by at least two- thirds of the directors then still in office who either were directors at the beginning of the period or whose election was previously so approved cease for any reason to constitute at least a majority thereof; or (c) the Stockholders of the Company shall approve the sale of all or substantially all of the assets of the Company or any merger, consolidation, issuance of securities or purchase of assets, the result of which would be the occurrence of any event described in clause (a) or (b) above.

2. Termination. "Termination" shall mean either (a) termination by the Company of the employment of the Executive with the Company for any reason other than death, physical or mental incapacity, or cause (as defined below) within 24 months following a Change in Control of the Company, or (b) resignation of the Executive within 24 months following a Change in Control of the Company upon the occurrence of any of the following events:

- (i) a material change in the nature or scope of the Executive's authorities, powers, functions, or duties;
- (ii) a reduction in Executive's total compensation;
- (iii) any relocation of Executive's principal place of employment more than 35 miles from Executive's location immediately prior to the change in control;

(iv) the breach by the Company of any other provision of this Agreement; or

(v) a good faith determination by the Executive that, as a result of a change in control of the Company Executive's position is materially affected so that Executive is unable to exercise the authorities,

powers, functions or duties attached to Executive's position.

"Cause" means gross misconduct or willful and material breach of this Agreement by the Executive. No act, or failure to act, on the Executive's part shall be deemed "willful" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that the action or omission was in the best interest of the Company.

3. Severance and Benefit Payments.

a. In the event of termination of the Executive as defined in Section 2 hereof, the Company shall pay the Executive a lump- sum severance allowance equal to salary and bonus payments for a 24 calendar month period calculated on the basis of a salary rate which shall not be less than Executive's annual salary immediately prior to termination,

or if greater, not less than Executive's annual salary immediately prior to the change in control of the Company and an annual bonus amount which shall not be less than the Executive's annual bonus immediately prior to termination, or if greater, not less than

Executive's bonus immediately prior to the change of control of the Company. The lump- sum severance allowance shall not be adjusted on a present value basis.

b. The amount of the severance allowance payment described in this Section 3 shall be determined and such payment shall be made as soon as it is reasonably practicable but in no event later than 7 days

after the date of such termination.

c. The severance allowance payment to be provided pursuant to this Section 3 shall be in addition to, and shall not be reduced by, any other amounts or benefits provided by separate agreement with the

Executive, or plan or arrangement of the Company or its subsidiaries, unless specifically stipulated in an agreement which constitutes an amendment to this Agreement.

d. In the event of termination of Executive as defined in Section 2 hereof, with respect to each welfare benefit plan, including, without limitation, medical, dental, life and disability insurance plans, for the period beginning on Executive's termination and ending on the earlier of (i) two years following Executive's termination, or (ii)

the date Executive becomes covered by a welfare benefit plan or

program maintained by an entity other than the Company which provides coverage or benefits at least equal, in all respects, to such welfare benefit plan, Executive shall continue to participate in such welfare benefit plan on the same basis and at the same cost to Executive as was the case immediately prior to the Change in Control (or, if more favorable to Executive, as was the case at any time thereafter), or, if any benefit or coverage cannot be provided under a welfare benefit plan because of applicable law or contractual provisions, the Company

shall provide Executive with substantially similar benefits and coverage for such period. Immediately following the expiration of the

continuation period required by the preceding sentence, Executive

shall be entitled to continued group health benefit plan coverage (so-

called "COBRA coverage") in accordance with Section 4980B of the

Internal Revenue Code of 1986, as amended, (the "Code"), it being

intended that COBRA coverage shall be consecutive to the benefits and

coverage provided for in the preceding sentence. Executive's

eligibility for, and premium contribution level, under each welfare benefit plan and any similar or successor plans or programs maintained or contributed to by the Company, shall be determined by adding two

years to Executive's age and years of service at Executive's

termination.

(e) In the event of the termination of Executive as defined in Section 2 hereof, the Company shall pay to Executive any unpaid salary or other compensation of any kind earned with respect to any period prior to Executive's termination (including a proportionate share of any bonus

for a part of a year in which termination as defined in Section 2

hereof occurs) and a lump sum cash payment for accumulated but unused vacation earned through Executive's termination.

#### 4. Make- Whole Payments.

a. Anything in this Agreement to the contrary notwithstanding, in the event that any payment or distribution by or on behalf of the Company

to or for the benefit of Executive (whether paid or payable or

distributed to distributable pursuant to the terms of this Agreement or otherwise, but determined without regard to any additional payments required under this Section 4) (the "Payments") is determined to be an "excess parachute payment" pursuant to Section 280G of the Code or any successor or substitute provision of the Code, with the effect that

Executive is liable for the payment of the excise tax described in

Code Section 4999 or any successor or substitute provision of the

Code, or any interest or penalties are incurred by Executive with

respect to such Payments (such excise tax, together with any such

interest and penalties, are hereinafter collectively referred to as

the "Excise Tax"), then Executive shall be entitled to receive an

additional payment (the "Gross- Up Payment") in an amount such that

after payment by Executive of all taxes imposed upon the Gross- Up

Payment, including, without limitation, federal, state, local or other income taxes, FICA taxes, and additional Excise Tax (and any interest and penalties imposed with respect to such taxes), Executive retains a portion of the Gross- Up Payment equal to the Excise Tax imposed upon the Payments.

b. Subject to the provisions of Section 4(c), all determinations required to be made under this Section 4, including whether and when a Gross- Up Payment is required and the amount of such Gross- Up Payment and the assumptions to be utilized in arriving at such determination, shall be

made by the public accounting firm that serves as the Company's

auditors (the "Accounting Firm"), which shall provide detailed

supporting calculations both to the company and Executive within 15 business days of the receipt of notice from the Company or Executive that there have been Payments, or such earlier time as is requested by

the Company. In the event that the Accounting Firm is serving as

accountant or auditor for the individual, entity or group effecting the Change in Control, Executive shall designate another nationally

recognized accounting firm to make the determinations required

hereunder (which accounting firm shall then be referred to as the

Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross- Up Payment, as determined pursuant to this Section 4, shall be paid by the Company to

Executive within five days after the receipt by the Company and

Executive of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable by Executive, it shall furnish Executive with a written opinion that failure to report the Excise Tax on Executive's applicable federal income tax return would not result in the imposition of a negligence or similar penalty. Any determination by the Accounting Firm shall be binding upon the Company

and Executive, except as provided in paragraph (c) below.

c. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that

the Internal Revenue Service or another agency will claim that a

greater Excise Tax is due, and thus a greater amount of Gross- Up

Payment should have been made by the Company than that determined

pursuant to paragraph (b) above (an "Underpayment"). In the event that Executive is required to make a payment of any such Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred, if any, and such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive. Executive shall

notify the Company in writing of any claim by the Internal Revenue

Service or other agency that, if successful, would require the payment

by the company of the Gross- Up Payment or an Underpayment.

5. Mitigation and Set Off. The Executive shall not be required to mitigate the amount of any payment provided for in this Agreement by seeking other employment or otherwise. The Company shall not be entitled to set off against the amounts payable to the Executive under this Agreement any amounts owed to the Company by the Executive, any amounts earned by the Executive in other employment after termination of Executive's employment with the Company, or any amounts which might have been earned by the Executive in other employment had Executive sought such other employment.

6. Other Agreements. The Company and Executive are parties to an Executive Agreement which both parties hereby reconfirm and acknowledge. Such Executive Agreement is not in any way modified, superseded or amended by the execution and delivery of this Agreement.

7. Arbitration of All Disputes. Any controversy or claim arising out of or relating to this Agreement or the breach thereof, except with respect to Section 4, shall be settled by arbitration in the City of Chicago in accordance with the laws of the State of Illinois by three arbitrators appointed by the parties. If the parties cannot agree on the appointment, one arbitrator shall be appointed by the Company and one by the Executive, and the third shall be appointed by the first two arbitrators. If the first two arbitrators cannot agree on the appointment of a third arbitrator, then the third arbitrator shall be appointed by the Chief Judge of the United States Court of Appeals for the Seventh Circuit. The arbitration shall be conducted in accordance with the rules of the American Arbitration Association, except with respect to the selection of arbitrators which shall be as provided in this Section 7. Judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof. In the event that it shall be necessary or desirable for the Executive to retain legal counsel or incur other costs and expenses in connection with enforcement of Executive's rights under this Agreement, Executive shall be entitled to recover from the Company Executive's reasonable attorneys' fees and costs and expenses in connection with enforcement of Executive's rights (including the enforcement of any arbitration award in court). Payment shall be made to the Executive by the Company at the time these attorneys' fees and costs and expenses are incurred by the Executive. If, however, the arbitrators should later determine that under the circumstances the Executive could have had no reasonable expectation of prevailing on the merits at the time Executive initiated the arbitration based on the information then available to Executive, Executive shall repay any such payments to the Company in accordance with the order of the arbitrators. Any award of the arbitrators shall include interest at a rate or rates considered just under the circumstances by the arbitrators.

8. Notices. Any notices, requests, demands, and other communications provided for by this Agreement shall be sufficient if in writing and if sent by registered or certified mail to the

Executive at the last address Executive has filed in writing with the Company or, in the case of the Company, at its principal executive offices.

9. Non- Alienation. The Executive shall not have any right to pledge, hypothecate, anticipate or in any way create a lien upon any amounts provided under this Agreement; and no benefits payable hereunder shall be assignable in anticipation of payment either by voluntary or involuntary acts, or by operation of law. Nothing in this paragraph shall limit the Executive's rights or powers which Executive's executor or administrator would otherwise have.

10. Governing Law. The Agreement shall be construed and enforced according to the Employee Retirement Income Security Act of 1974 ("ERISA"), and the laws of the State of Illinois, other than its laws respecting choice of law, to the extent not pre- empted by ERISA.

11. Amendment. This Agreement may be amended or canceled by mutual agreement of the parties in writing without the consent of any other person and, so long as the Executive lives, no person, other than the parties hereto, shall have any rights under or interest in this Agreement or the subject matter hereof.

12. Term. This Agreement shall terminate when the Executive has left the employ of the Company for any reason prior to a Change in Control of the Company.

13. Successors to the Company. Except as otherwise provided herein, this Agreement shall be binding upon and inure to the benefit of the Company and any successor of the Company.
14. Severability. In the event that any provision or portion of this Agreement shall be determined to be invalid or unenforceable for any reason, the remaining provisions of this Agreement shall be unaffected thereby and shall remain in full force and effect.

IN WITNESS WHEREOF, the Executive has hereunto set Executive's hand and, pursuant to proper authorization, the Company has caused these presents to be executed in its name on its behalf by an appropriate corporate officer, and its corporate seal to be hereunto affixed and attested by its Secretary or Assistant Secretary, all as of the day and year first above written.

THE EXECUTIVE  
ARTHUR J. GALLAGHER & CO.

SEAL  
Attest:  
\_\_\_\_\_

EXHIBIT 21.0

SUBSIDIARIES OF THE COMPANY

In the following list of subsidiaries of the Company, those companies which are indented represent subsidiaries of the corporation under which they are indented. Except for directors' qualifying shares, 100% of the voting stock of each of the subsidiaries listed below, other than those indicated by footnote, is owned of record or beneficially by its indicated parent.(1)

Name	State or Other Jurisdiction of Incorporation
Arthur J. Gallagher & Co. (Registrant).....	Delaware
Arthur J. Gallagher & Co. (Illinois).....	Illinois
Arthur J. Gallagher & Co. of Oklahoma, Inc.....	Oklahoma
Arthur J. Gallagher Risk Management Services, Inc.....	Illinois
Arthur J. Gallagher & Co. of Michigan, Inc.....	Michigan
Arthur J. Gallagher & Co. of Wisconsin, Inc.....	Wisconsin
Arthur J. Gallagher & Co. of Pennsylvania, Inc.....	Pennsylvania
Gallagher Captive Services, Inc.....	Delaware
Arthur J. Gallagher & Co.--Chicago Metro.....	Illinois
Arthur J. Gallagher & Co. (St. Louis).....	Delaware
Gallagher Holt, Inc.....	Texas
Arthur J. Gallagher Inc.....	Texas
Gallagher Braniff, Inc.....	Texas
Arthur J. Gallagher & Co. (Florida).....	Florida
Arthur J. Gallagher & Co. of New York, Inc.....	New York
Arthur J. Gallagher & Co. Ohio Agency, Inc.....	Ohio
Risk Placement Services, Inc.....	Illinois
Arthur J. Gallagher & Co.--Greenville.....	South Carolina
Arthur J. Gallagher and Co. of Massachusetts, Inc.....	Massachusetts
Gallagher Insurance Advisors, Inc.....	Massachusetts
Arthur J. Gallagher & Co. of Rhode Island, Inc.....	Rhode Island
Arthur J. Gallagher International, Inc.....	Delaware



Arthur J. Gallagher & Co. (Bermuda) Limited.....	Bermuda
Arthur J. Gallagher Intermediaries (Bermuda) Limited.....	Bermuda
Arthur J. Gallagher Management (Bermuda) Limited.....	Bermuda
Gallagher Captive Services (Cayman) Limited.....	Cayman Islands
Scholastic Risk Services Limited.....	Bermuda
Artex Insurance Company Ltd(2).....	Bermuda
Artex Underwriting Managers Ltd.....	Bermuda
Arthur J. Gallagher & Co.--Little Rock.....	Arkansas
Arthur J. Gallagher & Co. of Georgia, Inc.....	Georgia
Gallagher Plumer Holdings Limited.....	England
Arthur J. Gallagher (UK) Limited.....	England
Risk Management Partners Ltd.(3).....	England
John Plumer & Company Limited.....	England
John Plumer & Partners Limited.....	England
John Plumer & Partners Marine Limited.....	England
Arthur J. Gallagher Aviation Limited.....	England
AJG Twenty Limited.....	England
AJG Twenty One Limited.....	England
AJG Twenty Two Limited.....	England
AJG Twenty Three Limited.....	England
Arthur J. Gallagher & Partners (UK) Limited.....	England
Morgan, Read & Coleman (Holdings) Limited.....	England
Gallagher, Read & Coleman Limited.....	England
Morgan, Read & Coleman (Sweden) AB.....	Sweden
Morgan Insurance Services Limited.....	England

Name	State or Other Jurisdiction of Incorporation
Gallagher Bassett Services, Inc.....	Delaware
Gallagher Bassett of New York, Inc.....	New York
Gallagher Bassett International Ltd.....	Delaware
Gallagher Bassett International Ltd. (UK).....	England
Gallagher Bassett Canada Inc.....	Canada
Gallagher Benefit Administrators, Inc.....	Illinois
Gallagher Bassett Investigative Services, Inc.....	Delaware
Wyatt Gallagher Bassett Pty Ltd(3).....	Australia
Gallagher Bassett Australia Pty Ltd.....	Australia
Wyatt Emerson Pty Ltd.....	Australia
Wyatt Group (PNG) Pty Ltd.....	New Guinea
Gallagher Bassett International S.A.....	France
Arthur J. Gallagher & Co. Insurance Brokers of California, Inc.....	California
Charity First Insurance Services, Inc.....	California
Arthur J. Gallagher & Co. of Connecticut, Inc.....	Connecticut
Arthur J. Gallagher Intermediaries, Inc.....	New York
LHC of Illinois, Inc.....	Illinois
Arthur J. Gallagher & Co.--Denver.....	Colorado
Arthur J. Gallagher & Co. of Washington, Inc.....	Washington
Gallagher Louisiana, Inc.....	Louisiana
Arthur J. Gallagher of Louisiana, Inc.....	Louisiana
Arthur J. Gallagher & Co. of Mississippi, Inc.....	Mississippi
Gallagher ABOW, Inc.....	Michigan
Arthur J. Gallagher & Co.--Kansas City, Inc.....	Missouri
Gallagher Benefit Services of Kansas City, Inc.....	Delaware
IMC Insurance Management Corporation.....	Missouri
IMC Services Corporation.....	Missouri
GBS Retirement Services, Inc.....	New York
Arthur J. Gallagher & Co. of New Jersey, Inc.....	New Jersey
Arthur J. Gallagher & Co. Ohio Life Agency, Inc.....	Ohio
Gallagher Pipino, Inc.....	Ohio
Gallagher Benefit Services of Texas, Inc.....	Texas
Arthur J. Gallagher & Co. of Minnesota, Inc.....	Minnesota
Gallagher Alliance Insurance Services, Inc.....	Arizona
AJG Financial Services, Inc.....	Delaware
AJG Capital, Inc.(4).....	Illinois
AJG Investments, Inc.....	Delaware

Gallagher Benefit Services of Colorado, Inc.....	Colorado
Lamberson Koster & Company.....	California
Arthur J. Gallagher & Co. of Tennessee, Inc.....	Tennessee
Arthur J. Gallagher & Co. of Kentucky, Inc.....	Kentucky
AJG Premium Finance, Inc.....	Illinois
Risk Management Products Canada Inc.(3).....	Canada
Gallagher Benefit Services of New York, Inc.....	New York
Gallagher Benefit Services of the Carolinas, Inc.....	North Carolina

- (1) The Company conducts some of its operations under the following names: Gallagher Benefit Services; Gallagher Bassett Information Services; Gallagher Risk Management Services; Pacific Atlantic Administrators; The Boston Insurance Center; Gallagher Heffernan; Broussard, Bush & Hurst; Henley, Williams & Associates; Gallagher Steel Agency; Bryce Insurance; CMC Claims Management Corporation; The Planning Corporation; Environmental Claims Management Incorporated; Gallagher Byerly, Inc.; Innovative Risk Services, Inc.; and International Special Risk Services, Inc. (2) 76% of the Common Stock of this subsidiary is owned by two third parties. (3) 50% of the Common Stock of each of these subsidiaries is owned by an unrelated party.
- (4) 10% of the Common Stock of this subsidiary is owned by an unrelated party.

#### EXHIBIT 23.1

##### CONSENT OF INDEPENDENT AUDITORS

Our audits included the consolidated financial statement schedule of Arthur J. Gallagher & Co. listed in Item 14(a). This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, with respect to which the date is January 19, 1999, the consolidated financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We consent to the incorporation by reference in the Registration Statements (Form S- 8, No. 33- 604 and Form S- 8, No. 33- 14625) pertaining to the Arthur J. Gallagher & Co. Incentive and United Kingdom Incentive Plans, in the Registration Statements (Form S- 8, No. 33- 24251, Form S- 8, No. 33- 38031 and Form S- 8, No. 333- 57155) pertaining to the Arthur J. Gallagher & Co. 1988 Incentive and 1988 Nonqualified Stock Option Plans, in the Registration Statement (Form S- 8, No. 33- 30816) pertaining to the Arthur J. Gallagher & Co. Non- Employee Directors' Stock Option Plan, in the Registration Statements (Form S- 8, No. 33- 64614 and Form S- 8, No. 33- 80648) pertaining to the Arthur J. Gallagher & Co. 1988 Incentive, 1988 Nonqualified, and Non- Employee Directors' Stock Option Plans, in the Registration Statement (Form S- 8, No. 333- 06359) pertaining to the Arthur J. Gallagher & Co. 1988 Nonqualified and Non- Employee Directors' Stock Option Plans, and in the related Prospectuses, of our report dated January 19, 1999 with respect to the consolidated financial statements included herein, and our report included in the preceding paragraph with respect to the consolidated financial statement schedule included in this Annual Report (Form 10- K) of Arthur J. Gallagher & Co.

/s/ Ernst & Young LLP

Ernst & Young LLP

Chicago, Illinois  
March 26, 1999

#### EXHIBIT 24.0

##### POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ FRANK M. HEFFERNAN, JR.

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**FRANK M. HEFFERNAN, JR.**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ T. KIMBALL BROOKER

---

**T. KIMBALL BROOKER**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ ROBERT E. GALLAGHER

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**ROBERT E. GALLAGHER**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ JACK M. GREENBERG

---

**JACK M. GREENBERG**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name,

place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ PHILIP A. MARINEAU

---

**PHILIP A. MARINEAU**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ WALTER F. McCLURE

---

**WALTER F. McCLURE**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ JAMES R. WIMMER

---

**JAMES R. WIMMER**

EXHIBIT 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney- in- fact and agent, with full power of substitution and resubstitution, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 1998 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 18th day of March, 1999.

/s/ PETER J. DURKALSKI

**PETER J. DURKALSKI**

<ARTICLE> 5

<LEGEND> This schedule contains summary financial information extracted from the Arthur J. Gallagher & Co. Consolidated Financial Statements included in the Form 10-K Annual Report for the fiscal year ended December 31, 1998 and is qualified in its entirety by reference to such financial statements.

</LEGEND>

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