

HALES & COMPANY
INVESTMENT BANKERS

The Value of Innovation

**Presented by John Kraska, Partner
Hales & Company**

September 2008

HALES & COMPANY
INVESTMENT BANKERS

Overview of Hales & Company

Overview of Hales & Company

Leading Advisor to the Insurance Industry

- ◆ **Hales & Company is one of the oldest and most experienced advisory and investment banking firms specializing in the insurance industry**
 - ▶ Focused on middle-market transactions of insurers, retail brokers, wholesale brokers, MGAs, TPAs, premium finance companies and other service related firms
 - ▶ Hales consistently ranks among the top advisors in insurance, having advised on over 200 completed transactions ranging from \$5 million to \$300 million in aggregate value since 1997
 - ▶ Offices in New York, Chicago, San Francisco, Seattle, Hartford, Harrisburg, Washington DC and Southern California.

- ◆ **Hales offers a broad scope of services in helping companies achieve their financial objectives**
 - ▶ Mergers and acquisitions advisory
 - ▶ Private placements of equity and debt capital
 - ▶ Valuations of both privately-held and public insurance entities
 - ▶ Due diligence reviews
 - ▶ Strategic consulting

Overview of Hales & Company

Leadership Position Among Advisors

Hales ranked No. 1 or No. 2 among advisors focused on the insurance broker sector from 2004 to present.

In 2007, Hales acquired WFG Capital Advisors further expanding its reach in the insurance brokerage sector.

Firm	Transaction Volume			
	2005	2006	2007	YTD
Hales & Company, Inc.	\$242.3	\$628.2	\$461.9	\$372.1
Mystic Capital Advisors Group LLC	7.0	116.4	39.5	250.0
Marsh Berry & Co. Inc.	150.4	14.7	29.8	68.8
Merrill Lynch & Co. Inc.	48.4	N/A	1,757.8	47.5
Reagan Consulting Inc.	41.2	104.8	34.4	N/A
Philo Smith & Co.	46.9	N/A	25.0	N/A

Overview of Hales & Company

Leadership Position Among Advisors



has been acquired by



2008

Hales advised Fullerton & Co., Inc.



has been acquired by

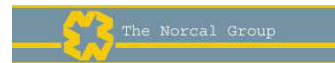


2008

Hales advised Wm. W. George & Associates, Inc.



has been acquired by



2008

Hales advised MIC Holding Company



has been acquired by



2008

Hales advised USI Holdings Corporation

Overview of Hales & Company

Leadership Position Among Advisors (cont'd)




has been acquired by




2008

Hales advised Beacon Risk Strategies




has been acquired by




2008

Hales advised Scheer's, Inc.




has been acquired by




2008

Hales advised Kelley & Swain, Inc.



has been acquired by



2008

Hales advised Healthcare Risk Solutions, LLC



has been acquired by



2008

Hales advised Employers Mutual, Inc.




has been acquired by



2008

Hales advised ESL, Inc.



has been acquired by



2008

Hales advised RSI



has been acquired by



2008

Hales advised ClearPoint

Overview of Hales & Company

Leadership Position Among Advisors (cont'd)



has been acquired by



2008

Hales advised Agency Marketing Services




has been acquired by




2008

Hales advised Kinloch Holdings, Inc.




has been acquired by




2008

Hales advised Minard-Ames Insurance Group



has been acquired by



2008

Hales advised USI Holdings Corporation




has been acquired by




2008

Hales advised Business Insurance Agency, Inc.




has been acquired by




2008

Hales advised Tennant Risk Services Insurance Agency, LLC



has been acquired by



2008

Hales advised The Commonwealth Consulting group



has been acquired by



2008

Hales advised Hub International Ltd.

The Value of Innovation

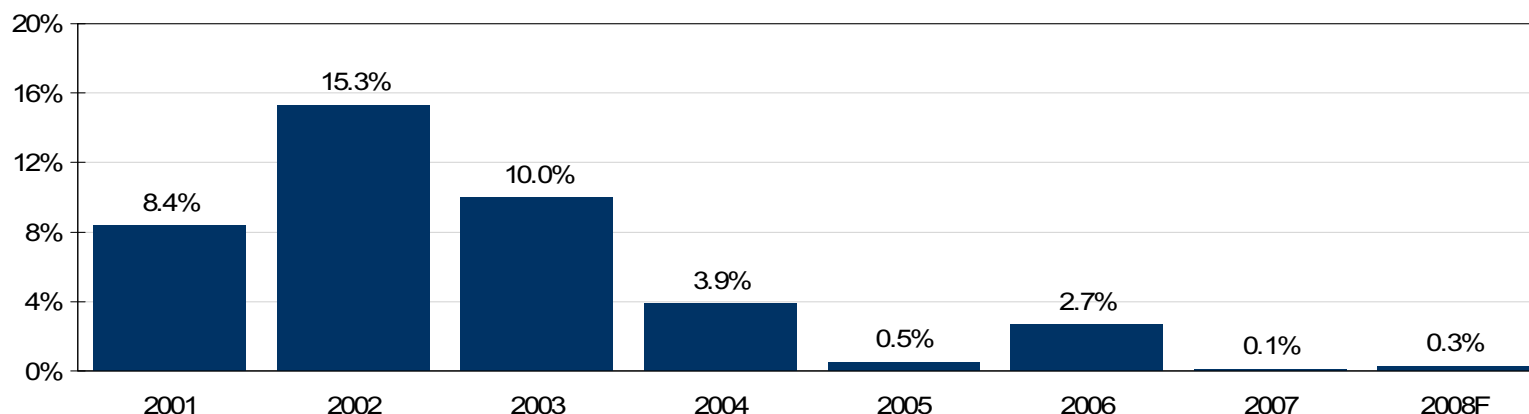
The Value of Innovation

Market Update and Trends

- ◆ We are in a “soft” market
- ◆ Public market valuations are declining, reducing “arbitrage spread” in acquisitions
- ◆ Transaction multiples are holding, but earnout terms are harder to achieve
- ◆ Accessing capital at “right” price with “right” terms is tough
- ◆ Market rewards “innovation” if it can deliver above average growth rates and margins
- ◆ Potential tax reform would reduce seller’s net proceeds

The Value of Innovation

Year-over-year growth of Net Written Premiums in the P&C insurance carrier market has slowed in recent years. This growth rate is expected to continue over the short term (Source: AM Best)



Annual Organic revenue growth was lower across all the brokerage sector in 2007 and Q1'08

- ◆ The growth further lowered down in the first quarter of 2008. Gallagher (Arthur J) & Co and Willis Group Holdings posted an organic growth of 3 % each in the first quarter of 2008, followed by Aon corp. and Marsh at 2% each among the Hales Index constituents. Brown & Brown posted a negative growth rate of 4.1%, the least among its peers.
- ◆ Without organic growth, companies are being forced to rely more heavily on acquisitions in order to fuel top-line growth

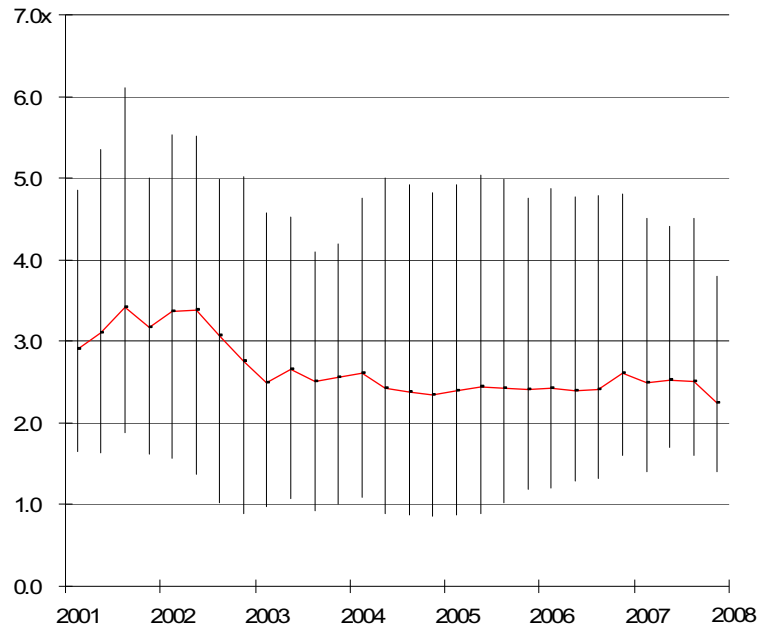
Organic Revenue Growth

Company	Ticker	2001	2002	2003	2004	2005	2006	2007	Q1'08
Aon Corp	AOC	8.0%	13.0%	9.0%	0.4%	1.0%	5.0%	2.0%	2.0%
Brown & Brown Inc	BRO	11.5%	12.1%	6.1%	5.1%	6.8%	5.5%	(3.4)%	(4.1)%
Gallagher (Arthur J.) & Co	AJG	18.6%	17.0%	10.6%	4.7%	(2.0)%	6.0%	5.0%	3.0%
Hilb Rogal & Hobbs Co	HRH	5.6%	8.8%	5.5%	2.1%	0.7%	4.4%	(0.3)%	1.1%
Marsh & McLennan Cos	MMC	10.0%	15.0%	13.0%	1.0%	(6.0)%	2.0%	4.0%	2.0%
Willis Group Holdings Ltd	WSH	12.0%	18.0%	15.0%	4.0%	5.0%	8.0%	3.0%	3.0%
Average		11.0%	14.0%	9.9%	2.9%	0.9%	5.2%	1.7%	1.2%

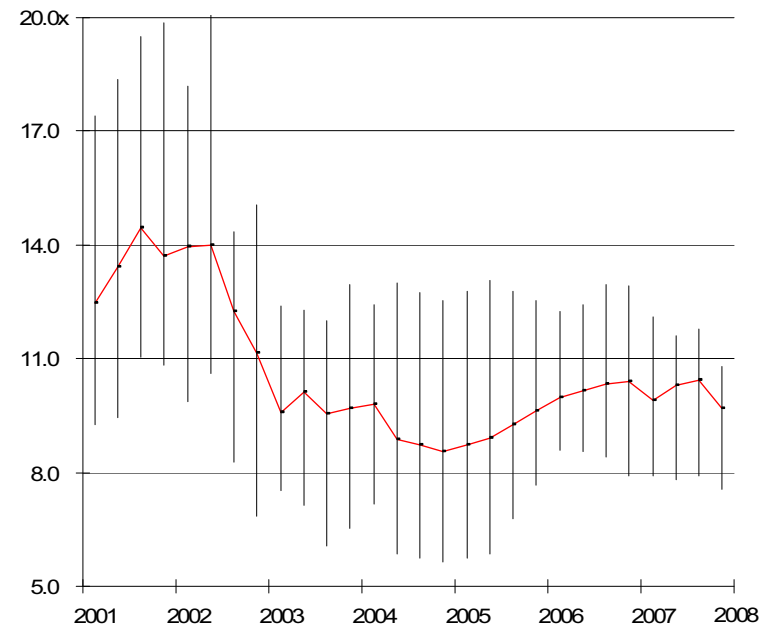
The Value of Innovation

Market multiples for insurance brokers are flat

Enterprise Value / LTM Sales



Enterprise Value / LTM EBITDA



The Value of Innovation

Market multiples for the S&P 500 Insurance Index have declined steadily since 2002.

Since 2002, Price/Book multiples for the S&P 500 Insurance Index have steadily declined from 2.4x down to a current level of approximately 1.1x

Price/Earnings multiples have seen a similar decline as they have fallen from a high of 28.3x in 2002 to a current level of about 12.4x

Price / Book Value



Price / Earnings

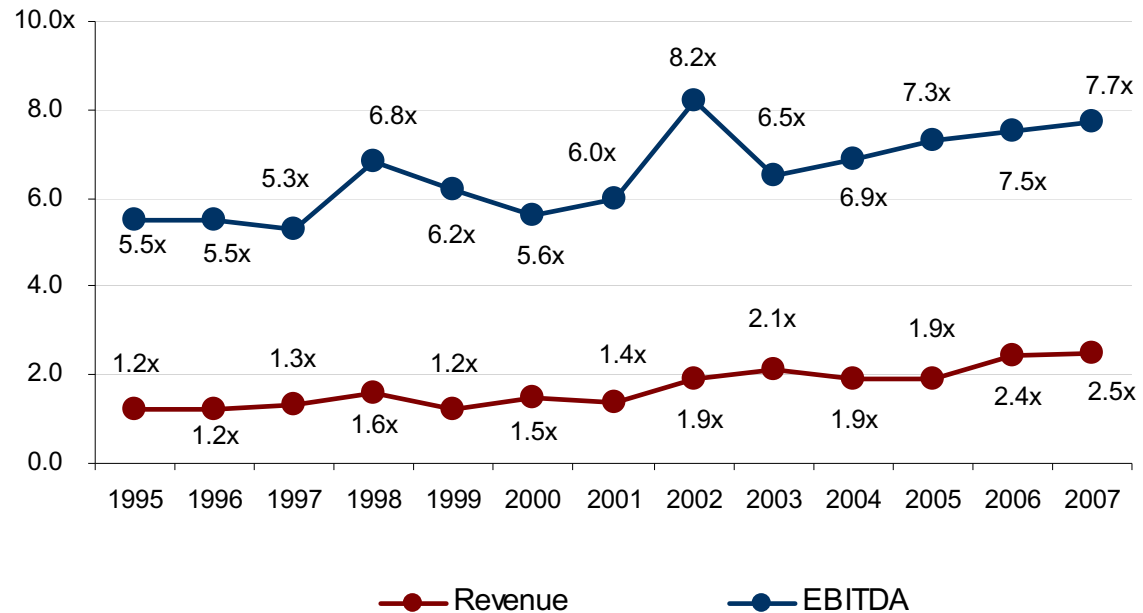


The Value of Innovation

Private Transactions

EBITDA multiples have historically averaged between 5.6x to 8.2x and are largely correlated to EBITDA margin performance

- ◆ Typically, 70-80% of multiples are guaranteed with the remainder in the form of an earnout
- ◆ Earnout targets generally include minimum growth hurdles



Accessing capital at “right” price and “right” terms is tough

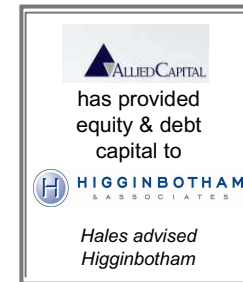
- ◆ The “credit crunch” that began in the summer of 2007 has curtailed what had been a string of private equity – led, levered deals
- ◆ Although private equity is awash with capital to invest, most funds are chasing larger deals (minimum \$25 - \$50 million equity investment)
- ◆ Many buyers are using private stock in acquisitions
- ◆ There are many types of capital sources (traditional banks, mezzanine, traditional private equity, business development companies, hedge funds, etc.)

The Value of Innovation

Market rewards “innovation”

- ◆ **Creative sales techniques that deliver above average growth**

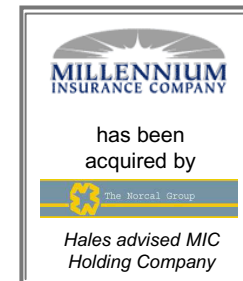
- ▶ Case Study: Higginbotham



2007

- ◆ **Specialty Underwriting**

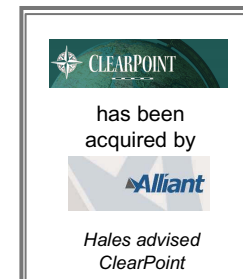
- ▶ Case Study: Millennium Insurance Company



2008

- ◆ **Information Technology**

- ▶ Case Study: ClearPoint



2008

How do you navigate today's market challenges?

- ◆ Explore multiple sources of capital simultaneously
- ◆ Create tension in negotiations to maximize terms
- ◆ Approach markets in well-organized, disciplined manner
- ◆ Address operational or organizational challenges before buyers or investors do