

## The Perspective of a Leading Insurance M&A Advisory Firm

### Recent Noteworthy Transactions

(\$s in millions)

#### PROPERTY / CASUALTY DEALS

Target	Buyer	Value	Price to SAP:	
			Surplus	Op. Inc.
Specialty Underwriters'	Tower Group, Inc.	\$107	1.1x	15.9x
Advocate, MD Fin'l Group	FPIC Insurance Group	\$34*	1.1x	6.2x
Zephyr Insurance Co., Inc.	Investor Group	\$32	1.3x	1.8x
Victore Companies	American Safety Ins.	\$5	1.3x	5.7x

\*\$33.6mm upfront, \$12mm contingent

#### AGENT / BROKER DEALS

Target	Buyer	Value	Price to:	
			Revenue	
Elliot Special Risks LP	Markel Corporation	\$69	5.3x*	

\*PSCO estimate

#### LIFE / HEALTH DEALS

Target	Buyer	Value	Price to SAP:	
			Surplus	Op. Inc.
Continental American	Aflac Incorporated	\$100	3.1x	8.2x
XL Re Life America Inc.	SCOR S.E.	\$45	1.4x	NA

### The Search for Agency Deals

Declining rates and a struggling economy have taken a toll on insurance agency / brokerage profitability. Consequently, valuations have declined even in cases where multiples have remained unchanged. This has led to a steep drop off in merger and acquisition activity, as many would-be sellers have opted to sit on the sidelines and hope that business conditions improve. The decrease in agency transactions can be observed at the publicly traded serial acquirers. For example, Brown & Brown acquired only 7 agencies with \$17.6 million in annualized revenue in the first half of 2009, compared to 24 agencies with \$77.8 million in annualized revenue in the first half of 2008. Some insurance distribution veterans are predicting that 2010 will be a big year for agency / brokerage transactions as owners, interested in maximizing after tax proceeds, rush to beat the expected change in the capital gains tax rate. However, the rate change from 15% to 20% is relatively small, compared to the hit that many agencies / brokerages have seen in their P&Ls over the past few years, where a 10% decrease in revenue may translate into a 30% decrease in pretax earnings and thus a 30% decrease in value. This is not to suggest that now is a bad time to sell. In fact, for agencies / brokerages that have not experienced a marked drop in commission revenue, now is an opportune time to sell as the limited number of sellers ensures that agencies / brokerages being marketed will receive the full attention of potential acquirers that are hungry for growth. There are many potential acquirers that are very eager to do acquisitions as good opportunities have been few and far between. Simply put, there are too many buyers and not enough sellers.

Underwriters continue to acquire premium in various ways as they are in need of growth in the face of declining organic premium production. For example, Markel acquired Elliot Special Risks in order to enhance the company's international specialty offering. Elliot Special Risks is the second largest MGA in Canada, and should serve as a platform for Markel to push other products through, as well as a source of premium and commission revenue. Meanwhile, AmTrust acquired the renewal rights for workers' compensation writer Cyber Comp from Swiss Re. This transaction makes strategic sense for AmTrust, as workers' compensation has traditionally been a strength, accounting for over half of the company's premium. Furthermore, it is in line with AmTrust's method of growing and creating value through renewal rights transactions. AmTrust has purchased renewal rights from Unitrin, Alea, Aon (Muirfield Underwriters), and others. Meanwhile, Specialty Underwriters' Alliance was aggressively pursued by Hallmark which offered \$6.50 per share in July 2008, but ultimately announced a sale to Tower for \$6.72 per share in June 2009. Specialty Underwriters' went public at \$9.50 per share in November of 2004. On the reinsurance front, the IPC battle finally came to a conclusion, as the company, which previously signed a merger agreement with Max Capital, backed

### Insurance Carrier Stocks

#### PROPERTY / CASUALTY CO.'s

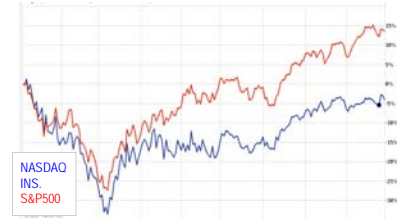
Median Price to Earnings (ttm): 12.7x  
Median Price to Book (mrq): 1.0x

#### LIFE & HEALTH COMPANIES

Median Price to Earnings (ttm): 15.2x  
Median Price to Book (mrq): 0.8x

#### MULTI-LINE COMPANIES

Median Price to Earnings (ttm): NM  
Median Price to Book (mrq): 0.7x



#### INDEX PERFORMANCE

NASDAQ Ins. YTD 9/30/09: -4.4%  
S&P 500 Return YTD 9/30/09: 17.0%

### Insurance Broker Stocks

Price 9/30/09 to TTM 6/30/09

	Revenue	Earnings	EBITDA	EBITDA/Revenue %
Maximum	2.7x	19.7x	16.0x	34.9%
Minimum	1.2x	12.6x	6.1x	7.5%
Median	1.5x	17.0x	8.3x	17.4%

### The Search for Agency Deals cont'd.

out of that deal and instead combined with Validus in a transaction valued at \$1.8B. Under the terms of the merger agreement with Max Capital, IPC was required to pay a \$50 million termination fee. Validus paid \$50 million to IPC in order to cover IPC's payment to Max Capital. As one would expect during these trying economic times, there were several transactions involving sellers facing challenging financial situations. A recent example included Canada-based insurance carrier, Kingsway, which sold Zephyr for \$31.5 million to a Hawaii-based investor group, providing the company with some needed cash. Kingsway bought Zephyr for \$25 million in 2005.

Ratings pressure, soft market conditions, and volatile equity markets have helped boost the number of mutual affiliations in 2009. 2009 affiliations include Phenix Mutual's affiliation with Motorists Insurance Group, Grain Dealers' affiliation with Main Street America Group, and Southern Mutual's affiliation with Donegal Mutual Insurance Company. In each of these cases, the policyholders will benefit, as the affiliations will result in more financially stable, better diversified groups. Mutual carriers have been looking for partners as they have faced ratings pressure from A.M. Best. This pressure is the result of deteriorating operating results due to soft pricing, CAT losses, and investment portfolio losses earlier in the year. The rate of mutual affiliations will likely increase throughout 2009 and 2010, as management teams evaluate their position and consider the merits of partnering with larger, well capitalized companies.

### Deal Notes

PartnerRe reached an agreement to acquire 77% of PARIS RE in a stock deal whereby PARIS RE shareholders will receive 0.3 shares of PartnerRe. Prior to the close of the transaction, PARIS RE will dividend \$310 million or \$3.85 per share to common shareholders. The deal values PARIS RE at \$2.0 billion, and will add \$1.7 billion of equity to PartnerRe. This transaction will bring PartnerRe's stake in PARIS RE to 83%, since they had previously acquired 6% of the company's outstanding stock at the same rate. Following the close of the block purchase, PARIS RE has agreed to call a special meeting in order to vote on the proposal to merge PARIS RE into a wholly-owned subsidiary of PartnerRe. Many industry prognosticators have been calling for consolidation in the reinsurance segment, however, there has been much debate over when this consolidation will take place. This transaction represents another step toward the eventual consolidation.

# SOME OF OUR TRANSACTIONS...



Phenix Mutual Fire Insurance Company

*has agreed to affiliate with*

The Motorists Insurance Group

PhiloSmith acted as exclusive financial advisor to Phenix Mutual Fire Insurance Company



Heath XS, LLC

*has been acquired by*

Hallmark Financial Services, Inc.

PhiloSmith acted as exclusive financial advisor to Heath XS, LLC



The Hanover Insurance Group, Inc.

*has acquired*

AIX Holdings, Inc.

PhiloSmith acted as exclusive financial advisor to The Hanover Insurance Group, Inc.



The assets of Longhorn General Agency, Inc. & Longhorn Insurance Services, Inc.

*have been acquired by*

NALICO General Agency, Inc. a subsidiary of NLASCO

PhiloSmith acted as exclusive financial advisor to Longhorn General Agency



Republic Companies, Inc.

*has acquired*

Southern States General Agency, Inc. a subsidiary of Unitrin, Inc.

PhiloSmith acted as exclusive financial advisor to Republic Companies, Inc.



Four Corners Insurance Services, Inc.

*has been acquired by*

Republic Companies, Inc.

PhiloSmith acted as exclusive financial advisor to Four Corners Insurance Services, Inc.



Professionals Direct, Inc.

*has been acquired by*

The Hanover Insurance Group

PhiloSmith acted as exclusive financial advisor to Professionals Direct, Inc.



Texas General Agency, Inc.

*and their affiliates*

Gulf States Insurance Co., TGA Special Risk, Inc., & Pan American Acceptance Corporation

*have agreed to be acquired by*

Hallmark Financial Services, Inc.

PhiloSmith acted as exclusive financial advisor to Texas General Agency, Inc.



D.E. Love Associates

*a subsidiary of*

Direct Response Corporation

*has been acquired by*

National Penn Bank

Philo Smith & Co. acted as exclusive financial advisor to Direct Response Corporation



GMAC Insurance Holdings, Inc.

*and its subsidiary*

Motors Insurance Corporation

*have agreed to acquire*

MEEMIC Insurance Company

*a subsidiary of*

ProAssurance Corporation

PhiloSmith acted as exclusive financial advisor to GMAC Insurance Holdings, Inc.



Beecher & Carlson Risk Management, Inc.

*a subsidiary of*

American Re Corporation

*has been acquired by*

Risk Strategy Partners, Inc.

Philo Smith & Co. acted as exclusive financial advisor to Munch-American Global Services, Inc.



Capital City Holdings Company, Inc., Davis-Garvin Holdings, Inc. & affiliates

*have agreed to be acquired by*

North Pointe Holdings Corporation

PhiloSmith acted as exclusive financial advisor to Capital City Holdings Company, Inc.



Andrews & Murray Associates, Inc.

*has been acquired by*

Neighborhood Insurance Connecticut, LLC

Philo Smith & Co. acted as exclusive financial advisor to Andrews & Murray Associates, Inc.



Allianz of America, Inc. and Fireman's Fund Insurance Co.

*have agreed to sell*

Fireman's Fund Direct to Response Insurance Group

Philo Smith & Co. acted as financial advisor to Allianz of America and Fireman's Fund Insurance Co.



Unitrin, Inc.

*has agreed to acquire*

Merastar Insurance Company

PhiloSmith acted as exclusive financial advisor to Unitrin, Inc.



Future Planning Associates, Inc.

*has been acquired by*

U.S.I. Holdings Corporation

Philo Smith & Co. acted as exclusive financial advisor to Future Planning Associates, Inc.



Legion Insurance Company (in Liquidation)

*has sold its subsidiary*

Professional Risk Management Services, Inc.

*to*

Transatlantic Holdings, Inc.

PhiloSmith acted as exclusive financial advisor to Legion Insurance Company (in Liquidation)



Response Insurance Group

*has acquired*

Worldwide Insurance Company and Worldwide Direct Auto Insurance Company subsidiaries of Great American Insurance Company

Philo Smith & Co. acted as exclusive financial advisor to Response Insurance Group



Patrons Mutual Group of Connecticut

*has affiliated with*

State Auto Mutual Insurance Company

PhiloSmith acted as exclusive financial advisor to State Auto Mutual Insurance Company



Harleysville Mutual Insurance Company

*has agreed to merge with*

Penn Mutual Insurance Company

Philo Smith & Co. acted as exclusive financial advisor to Harleysville Mutual Insurance Company

# PHILOSMITH

Advising Insurance Companies Since 1962