PHILOSMITH *M&A SNAPSHOT*

The Perspective of a Leading Insurance M&A Advisory Firm

Recent Noteworthy Transactions

($s in millions)

PROPERTY / CASUALTY DEALS

			Price to GAAP:	
Target	Buyer	Value	Equity	Op. Inc.
Mercer Insurance Group	United Fire & Cas. Co.	$191	1.1x	14.2x
First Mercury Financial	Fairfax Financial	$299	1.0x	NM
Michigan Insurance Co.	Donegal Group, Inc.	$42	1.2x	18.6x*

**PSCO calculation based on YE'09*

AGENT / BROKER DEALS

			Price to:
Target	Buyer	Value	Revenue
DiMartino Associates, Inc.	Brown & Brown, Inc.	$10.5	2.4x
Thomas R. Jones, Inc.	Brown & Brown, Inc.	$14.6	2.2x

Source: 10Ks, 10Qs, Press Releases

LIFE / HEALTH DEALS

			Price to SAP:	
Target	Buyer	Value	Surplus	Op. Inc.
Liberty Life Insurance	Athene Holding	$628	2.3x	NM

Plenty of Buyers...Old and New

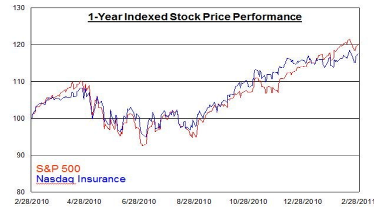
The historically low P&C company valuations barely changed during 2010, yet M&A activity, in terms of number of deals, was up nearly 30% from 2009. The last half of 2010 was particularly interesting. Specialty insurer, First Mercury paid $55 million (roughly book value) for Valiant Insurance in July. But by October First Mercury was announcing it was selling to Fairfax Financial at about book value (1.0x book / 1.2x *tangible* book) or $299 million / $16.50 per fully diluted share. First Mercury IPO'd in October of 2006 at $17.00/share and the stock closed at $19.50 on its first day of trading. Although the stock faltered with the market in late 2008 and failed to recover, the company paid $2.15/share in dividends during 2009/2010. The deal with First Mercury capped a busy year for Fairfax which struck a deal back in February to buy CA based workers' comp insurer, Zenith National, for $1.3 billion (1.4x book value). And, just recently, Fairfax announced its $65 million deal with Pacific Insurance Berhad, a Kuala Lumpur based general insurance provider also known for pioneering medical insurance in Malaysia.

Recent activity in the non-standard auto space included a number of mutual companies buyers seeking both product and geographical expansion. WA-based Enumclaw Mutual purchased the Las Vegas-based, direct storefront writer, Nevada General Insurance while MN-based Western National Mutual acquired Arizona Auto and its sister company, Legacy Insurance Services. These deals followed on the heels of another mutual, Utica National, which bought Founders Insurance, a sizable, Chicago-based non-standard auto & small commercial writer, for $108 million earlier in 2010. PhiloSmith was an adviser in all three of these deals. Meanwhile, Hallmark Financial struck a deal with State Auto Financial to buy its non-standard subsidiary, State Auto National (SAN) for $14 million in cash plus $2 million in potential earn-out based on a % of premiums over three years. SAN writes about $37 million via independent agents in 21 states. Lastly, while we wait for news on Mendota Insurance, which Kingsway said last summer it intended to sell, other non-standard auto deals are rumored to be brewing.

Two other deals of note in the standard, regional market include West Bend Mutual's sale of Michigan Insurance Company to Donegal for $42.0 million (1.2x GAAP book value) and United Fire & Casualty's recent announcement to buy PA-based, publicly-traded, Mercer Insurance Group for $191 million / $28.25 per fully diluted share (approx. 1.1x GAAP book value and 14.2x operating earnings). Interestingly, United Fire's last deal dates back to 1999 when it purchased Texas-based American Indemnity. Another dealmaker in 2010 that had also been out of deal-making for over a decade was specialty insurer RLI, which inked a $137 million deal for Contractors Bonding and Insurance Company in December. Interestingly, three weeks prior to announcing the deal, RLI declared a $7.00 a share extraordinary

Insurance Carrier Stocks (2/28/11)

PROPERTY / CASUALTY CO.'s	
Median Price to Earnings (ttm):	12.1x
Median Price to Book (mrq):	0.9x
LIFE & HEALTH COMPANIES	
Median Price to Earnings (ttm):	11.6x
Median Price to Book (mrq):	0.7x
MULTI-LINE COMPANIES	
Median Price to Earnings (ttm):	11.8x
Median Price to Book (mrq):	0.7x



1 YEAR INDEX PERFORMANCE
NASDAQ Ins. (2/28/11): 17.6%
S&P 500 Return (2/28/11): 20.2%

Major Insurance Broker Stocks

	Price to TTM Revenue	Enterprise Value to TTM EBITDA	EBITDA / Revenue %
Maximum	3.7x	14.4x	35.4%
Minimum	1.5x	9.5x	11.9%
Median	**2.0x**	**10.8x**	**18.4%**

Price 3/2/11, TTM through 12/31/10

Plenty of Buyers...Old and New, *cont'd.*

dividend to shareholders, which amounted to about $147 million or roughly 16% of the Company's 9/30/10 equity.

The last months of 2010 and the beginning of 2011 have been active for agents and brokers. The last minute reprieve on the capital gains tax hike didn't seem to hold-up sellers. Brown & Brown, which did 22 deals (est. $71 million in annual revenue) in 2010, completed 13 acquisitions (est. $37 million in annual revenue) from last October through mid-February 2011. Hub International also announced 13 deals during the same period. AJ Gallagher was notably active in 2010 having completed 19 transactions, topping the 15 deals done in 2009. Meanwhile, Marsh McLennan Agency continues to acquire some comparatively larger firms. In 2010 it announced four deals with aggregate revenue of $180 million. And, Ryan Specialty Group, which was started by Pat Ryan in the beginning of 2010, has already acquired six firms including American E&S Insurance Brokers from Wells Fargo Insurance.

Slow organic growth has certainly driven agent/broker acquisitions, however, it appears the improvement in public market valuation should help push deal activity higher. The major public brokers (MMC, AON, BRO, AJG, WSH), which were trading at a median Total Enterprise Value to EBITDA of about 8.5x in early 2010, are now trading at 10.8x TEV/EBITDA. Additionally, it appears that some private equity players are re-entering the fray. In fact, the large PE firm, GTCR is putting $250 million of equity (with leverage, "buying power" of probably $750+ million) behind two former Brown & Brown executives for a roll-up. GTCR has a solid track-record in insurance and so do these execs. So, maybe some lift in deal pricing coupled with, and aided by, some additional buyers, will pull more would-be sellers off the side-lines in 2011.

Deal Notes

VA Farm Bureau plans to buy Countryway Ins. Co. from United Farm Family Mutual, which purchased the company in 2002 to expand beyond Indiana. Countryway wrote $38.7 million on $20.8 million of PHS primarily in NY, KY, PA, ME and VA. United Farm Family was downgraded to A- by A.M. Best in 2009 after its surplus dropped 22% in 2008 due to storms / investment losses and a $34 million pension liability increase. Countryway's 5 yr. average combined ratio is about 113.

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