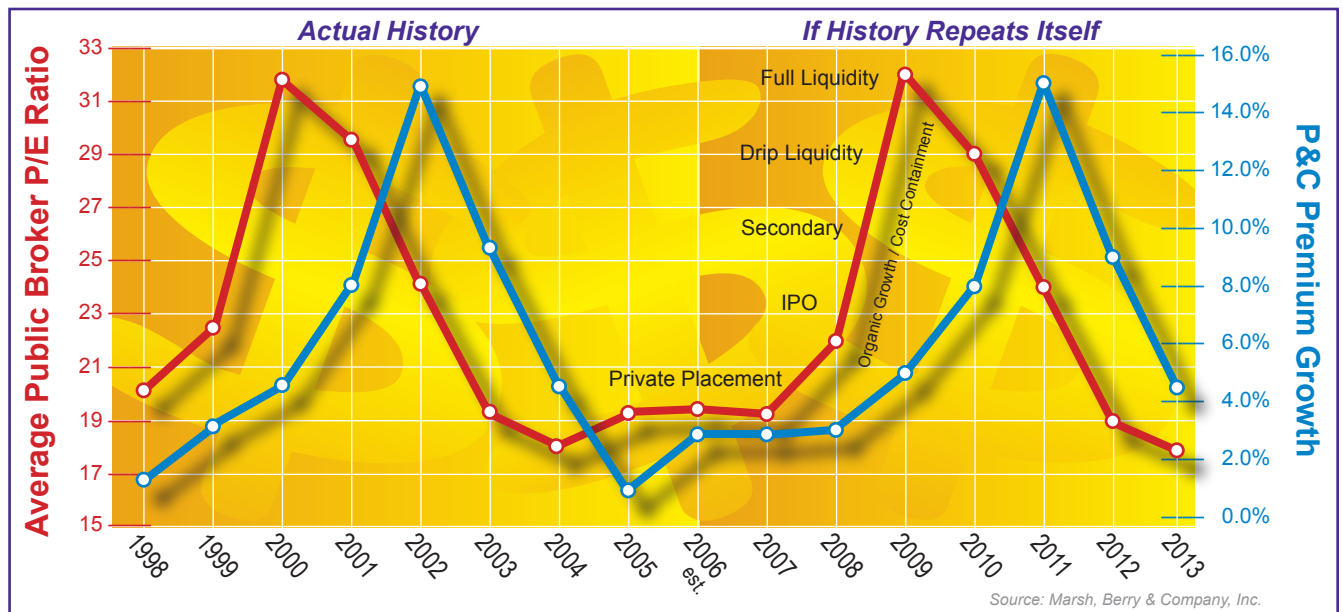


The Tidal Wave of Private Equity

The competitive landscape is changing. Private equity capital has silently permeated the insurance distribution space over the last ten years (Beecher-Carlson, Integro, Alliant, Genatt, Crump, Swett & Crawford, Stewart Smith, etc.) facilitating the creation of public brokers and backing several of the nation's largest private brokers. Recently, the silence has turned into a roar with over \$3.2 billion in announced transaction value invested in the first three months of 2007. First, Goldman Sachs Group, Inc. announced the purchase of USI Holdings Corporation for about \$1.4 billion. Morgan Stanley and Apax recently announced the planned acquisition of HUB International for about \$1.8 billion. Both deals are rich, seeing forward looking EBITDA multiples in the 10.0X range. And this is only the beginning of a new round of capital aggressively seeking deployment.

Most of the private equity players feel that the market is in need of a broker that can achieve a high margin and strong organic growth. Most public brokers and some privately held firms hesitate to take the initial hit to profitability to build a comprehensive producer reinvestment program. By contrast, core to the strategy of many private equity investments is to trade short-term earnings for reinvestment in producer recruiting, producer training, value-added services, and other organic growth initiatives. For smaller insurance brokers, this will translate to a premium in a subsequent sale. An even greater return awaits those that can become of sufficient size and scale to eventually go public. The illustration below shows that the rise in the public broker P/E multiples was an early indicator of the last hard market. If history repeats itself, the multiple arbitrage that awaits investors will be significant and icing on the cake, over and above the value appreciation contributed by leveraging debt capital. (continued on back)

Market Reaction to Premium Growth Rates



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The volume of private equity capital exceeded \$132 billion during 2006 and there is over \$15 billion aggressively seeking additional investment in the insurance distribution segment. While it is doubtful the entire \$15 billion will be deployed, we predict that at least 10 of the top 75 brokers will go private or sell to a private equity firm within the next 18 months. Equity firms have an interest in insurance agencies and brokers for a number of reasons, including:

1. A retention-based business with predictable and strong cash flow
2. Relatively low forward looking capital requirements
3. Fragmented industry with a large number of private firms
4. Opportunity to create a broker that can achieve sustainable organic growth
5. A ready market of buyers ensuring that private equity firms have an exit strategy
6. The potential to participate in multiple arbitrage in an IPO in advance of the next hard market

The initial equity investment is generally leveraged with debt capital to produce a substantial return on invested capital for the private equity investor and the principals who retain ownership post-closing. Once the optimal capital structure is established, the mid-term strategy is to build a broker capable of sustaining organic growth in an industry where few are able to do so. The long-term strategy is to further leverage shareholder value in a subsequent event, either through IPO or divestiture.

The real question for the owner of the average agency or broker is whether the significant upside in value and the very real potential for a double dip offsets the discomfort and uncertainty that often accompanies a deal with a partner with a temporary investment time horizon.

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