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Insurance Mergers&Acquisitions

CHRONICLING THE INDUSTRY'S RESTRUCTURING

Q&A

Father, son open new investment bank in Charlotte

Insurance investment banking has a new player in Charlotte. F. Laughton Sherman has joined his father, Walter B. Sherman, to open LMC Capital LLC. Both men have extensive business experience. Walter B. Sherman spent most of his career in the textile business, then went to work for two European companies specializing in capital equipment. F. Laughton Sherman has spent most of his career as a corporate and investment banker. He worked in Citigroup Inc.'s Asia-Pacific financial institutions group in the early 1990s, then joined Arthur Andersen and led a group specializing in insurance consolidation. Most recently, he worked for WFG Capital Advisors LP and, among other deals, helped advise the government of Korea during its negotiations to sell Hyundai Group to Prudential Financial Inc.

"The insurance business is an international business, very much a cross-border business," said F. Laughton Sherman. "In the other sense, it can be a very local, state business."

LMC will focus strictly on insurance, say its founders, and has already worked on several deals since opening for business in March. Among its first transactions: The firm advised the Indiana Department of Insurance on the $280 million acquisition of pre-need insurer Forethought Financial Services Inc. by the Devlin Group.

"We are not an investment bank opening our doors trying to be all things to all people," said the senior Sherman. "For example, I promise you if somebody came in here with an M&A deal involving textiles, which I know like the back of my hand, we wouldn't take the engagement. Our focus is insurance and insurance only. It's a big enough playing field that that will occupy us very well, thank you."

The Shermans say that the size of their firm — themselves, two other specialists and a clerical employee, plus an advisory board of two — will allow them to provide specialized service in any sector of insurance. They are targeting midmarket deals valued between $5 million and $250 million, and their business model is the small, hometown bank that tailors its product to client needs.

"We're not looking at closing 10 deals a month, that's for sure," said the younger Sherman. "It's hard to say because business does come and go. But our target is to close a handful of quality deals over a six- to 12-month period."The two Shermans talked with Insurance Mergers & Acquisitions Editor Dail Willis recently about LMC Capital and what they see in the pipeline for themselves and the market at large. What follows is an edited transcript of that discussion.

SNL: Tell me about your new firm — when it began, what led to its creation.

F. Laughton Sherman: LMC Capital is an investment banking firm dedicated exclusively to the insurance and financial services industries. My father, Walter, and I started together in March 2004. We established our offices and hired three employees in May 2004. We are headquartered in Charlotte, NC, home of the second largest banking center in the U.S. We have always wanted to work together. My return to Charlotte from New York set the stage for us to realize our dream. We've both enjoyed two solid careers in corporate America. Now, we're using those experiences combined with our individual talents to build a firm worthy of our vision and expectations.

You've targeted the insurance industry. What kinds of companies are you advising — size, lines of business, kinds of deals?

Walter B. Sherman: We cover life and health insurers, managed care companies, property & casualty insurers, insurance brokers and related companies. We provide highly qualified industry-specific advice as it relates to mergers and acquisitions, capital formation, valuations, and/or evaluating strategic alternatives.

F. Laughton Sherman: We are currently working on several engagements. Just to name a few: We are advising a foreign life insurer that recently demutualized and went public. They are looking for their first acquisition in the U.S. We expect that transaction to be fairly significant in deal value. Additionally, we are representing a public insurance broker and a private equity backed insurance agency on $20 million-plus bank financings. We are also working with an MGA and a nonstandard auto operation, both to raise equity.

Insurance consolidation has declined in recent years; do you think it will improve in the next 18 months?

F. Laughton Sherman: There will always be activity. I've been working in the insurance industry since December 1993. Insurance cycles come and go, and in the case of this business we are talking about a massive industry with a considerable group of sectors and many players. You've got P&C, life and health, managed care, distributors, technology companies — and then you have lines of business within each sector.

Walter B. Sherman: The largest brokerages continue to report pipelines full of deals to consider. Collectively they announce a steady stream of 10-plus deals per month. We believe the sector will actually become more active in terms of M&A activity covering the full range of deal sizes. We expect improvement in the life sector over the next 18

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One SNL Plaza, P.O. Box 2124, Charlottesville, VA 22902 Phone: 434.977.1600 Fax: 434.977.4466 snl.com

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months. Valuations are still quite low and we believe that spread compression will be alleviated in a rising-rate environment. The managed care companies are looking at five-plus years of double-digit rate increases, and companies are always happy to do deals when confidence is high. Finally, P&C companies will look to acquire next year when they believe that the hard market will officially be over and new growth must come from acquisitions. However, considering this year's hurricane season in the southeastern United States, we are not convinced the hard market will end as soon as many have anticipated.

What kinds of transactions do you expect to see?

Walter B. Sherman: We expect to represent insurance brokers on the sell-side. With the party drawing to a close, rates stabilizing, and capital gains tax rates where they are, we expect more brokers and agencies to put themselves up for sale.

F. Laughton Sherman: We expect to represent departments of insurance on large, complex mergers, restructurings, demutualizations, etc. And, finally, we expect to work on a number of buy-side and sell-side transactions for P&C companies, L&H companies and managed care companies.

What kinds of business and deals have you done so far?

F. Laughton Sherman: We represented the Indiana Department of Insurance from April to July 1 of this year, advising the department on the $280 million acquisition of Forethought Life, a pre-need insurer, by the Devlin Group. It was a complicated transaction involving the securitization of a closed block and inter-company restructurings. Transactions take a long time to close in this business. We only began operations in May, so we do not expect to close any transactions before the fourth quarter of this year.

Do you have a marketing strategy to bring business to you? Are you focusing on regional business?

Walter B. Sherman: Like the industry, we operate nationally and internationally. We currently have clients in New York, Canada, Indiana, Chicago, Georgia and overseas. Our families are still waiting for us to be engaged by a client in the Carolinas.

We do publish one periodical and we are quite pleased to already have an active subscriber base, which is a clear indication of interest in our specific areas of endeavor. We have three basic reasons for publishing: to communicate our expertise, to develop new relationships, and, most importantly, to keep our name out in the market.

We will also do some advertising as soon as we decide which vehicles best fit our targeted client base.

Having said all that, we know the best of all marketing strategies to bring business to us is good old word-of-mouth about our competencies and successes. We intend to provide exceptional service to every client and thus earn those critically important word-of-mouth endorsements from them every day.

What kinds of firms will you compete with for business?

F. Laughton Sherman: We expect to compete only with expertise. Providing competent insurance-industry advisory services requires understanding complicated issues such as reserving, risk-based capital, insurance accounting, etc. If we are up against a potential competitor who lacks the proper expertise, we should win the mandate every time. Some firms are strong with insurance companies, but don't focus on an insurance broker if the transaction size is too small. We want this kind of business. At the end of the day, it all boils down to the delivered price/performance by the investment banker.

What advantages will you have over boutique banks?

Walter B. Sherman: We think our advantages lie in four basic areas: Our expertise, our network of contacts, our ability to maintain strong relationships, and our desire to be the very best that we can be at what we do. Our approach to clients is for the long haul. If the relationship doesn't last past the first engagement, we haven't done our jobs. Our mentality with regard to relationship building and maintenance is the same as the old-fashioned small-town bank: We will succeed because of our commitment to unsurpassed personal service and results. I've been involved in building relationships for sales and marketing for over 25 years. I know that short-term thinking leads to very little, if any, repeat business. Laughton has also known this for years, and our employees understand its importance. In short, our biggest advantage is our size. We are not limited by any bureaucracy and every client receives the full attention of our senior leadership.