

Third Party Administration Market and M&A Trends

We expect the operating environment in the property & casualty (“P&C”) third party administration (“TPA”) sector to remain very challenging for the foreseeable future. We believe, however, the market leaders and certain niche players will continue to outperform the industry and be able to generate attractive returns for their investors. We expect the pace of M&A activity to accelerate as scale becomes increasingly important and capital is more readily available. The companies that can demonstrate certain key attributes, including: (i) strong customer relationships and retention rates, (ii) solid EBITDA margins, (iii) maintaining revenue or modest revenue growth, (iv) diversified product offering including solid medical management capabilities and (v) critical mass will generate the highest valuations.

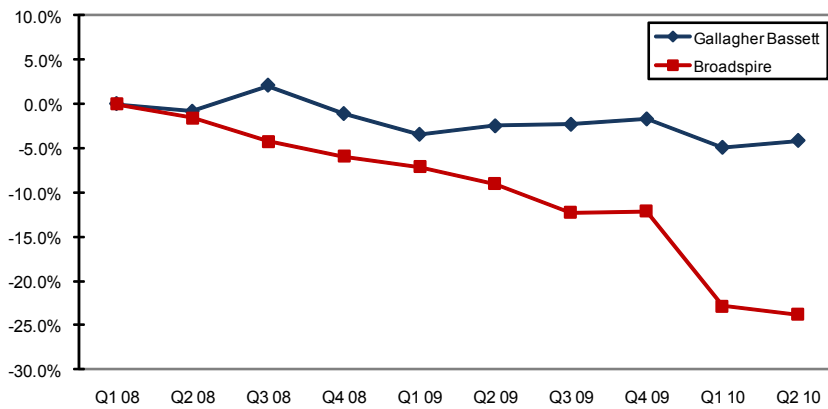
Challenging Claims Trends

The TPA sector has been facing an extremely challenging operating environment over the last several years. The prevailing trend of declining claims volume due to the shift away from manufacturing jobs and increased safety standards has been exacerbated during the recent economic downturn, as the number of unemployed workers has swelled. The challenges in the workers’ compensation marketplace are demonstrated by the drop in total insurance industry workers’ compensation net premium written of 15% in 2009 and 41% since 2004, according to A.M. Best. Because approximately 60% of the revenue generated by the P&C TPA marketplace is related to workers’ compensation insurance, we do not anticipate a change in the overall claims volume trend since we do not foresee a near-term impetus for a significant increase in employment. Based on the lack of organic growth in the claims market, competition over both price and services has continued to increase as companies fight over accounts. Despite this fierce competition, however, retention rates remain strong due to the willingness of incumbent TPAs to retain renewal business at single-digit operating margins and to the relatively high switching costs for customers.

National Market

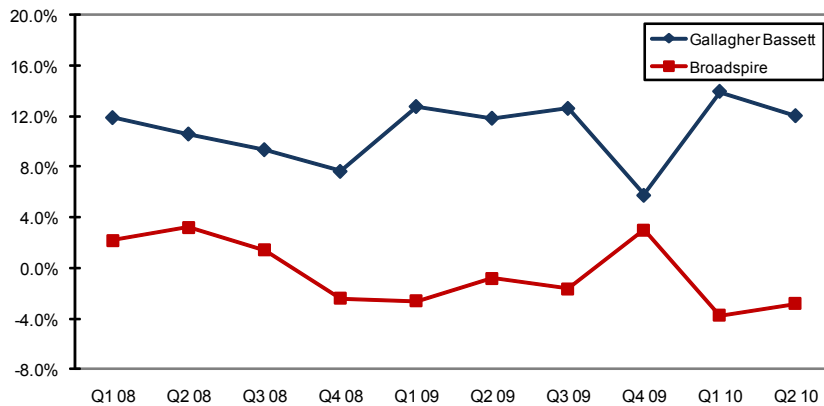
The national account marketplace has been the most competitive both in terms of pricing and services provided. As a result, scale is a very important factor. The larger companies have been able to enjoy an expense advantage and compete more effectively in the marketplace than some of the relatively small or midsize players. Renewal rates in the business continue to remain strong as the frictional cost of moving business remains significant. The increasing importance of scale is reflected in the performance of the largest players in the marketplace. In particular, Sedgwick CMS and Gallagher Bassett have been able to outperform their competitors as measured by both top-line growth and EBITDA margin. Please see the tables below comparing the recent operating trends of Gallagher Bassett to those of Broadspire Services, Crawford & Company’s TPA.

Cumulative Quarterly Revenue Growth



Source: A.J. Gallagher & Co. and Crawford & Co. 10-Qs

Quarterly Operating Margin



Source: A.J. Gallagher & Co. and Crawford & Co. 10-Qs

The cost to compete in the national account segment of the TPA market is greater as increasingly sophisticated risk managers have raised their expectations about both the level of services they expect (account management, detailed reporting, loss control services, etc.) and the technology used to deliver these services. This is a trend that we expect to continue, and as a result, we expect fewer players will be able to continue to effectively compete in this segment of the market.

Regional and Local Markets

The regional and local players have been impacted by the economy in varying degrees based upon their geographic and industry focus. Competition has also increased for business as some of the larger players in the marketplace have expanded their target markets in an effort to grow in a stagnant environment. Certain sectors of the market, such as public entity business, remain attractive as they enjoy strong renewal rates and frequently more attractive margins. As margins continue to compress for pure TPA business, it has become increasingly important to generate medical management revenue and margin by either providing services directly or by receiving referral fees or private labeling other services.

M&A Trends

Private equity remains the primary driver of M&A activity in the TPA sector. Private equity investors have viewed claims services as a more attractive investment opportunity than risk-takers or distribution companies. The TPA sector is a very large addressable market and has additional upside if insurance carriers decide to increase their outsourcing, a trend that has been predicted for years but that is taking longer than expected to emerge. Although M&A has been relatively slow for the last three years, we have seen a recent uptick of late and expect that trend to continue. Stone Point Capital and Hellman & Friedman's \$1.1 billion acquisition of the sector's largest TPA, Sedgwick CMS, has attracted additional interest to the sector. The M&A activity in the sector has primarily been from private equity firms buying platform companies and then completing add-on acquisitions. Examples include:

- Odyssey Investment Partners' acquisition of York Insurance Services Group, Inc. and subsequent acquisitions of Eventide Risk Management LLC and Gregory B. Bragg & Associates, Inc.
- Fidelity National Financial, Inc., Thomas H. Lee Partners, LP and Evercore Capital Partners' acquisition of Sedgwick CMS Holdings, Inc. and subsequent purchases of CompManagement, Inc. and VPA, Inc.
- KRG Capital Partners' merger of Frank Gates Companies and Attenta (d.b.a. Avizent) and subsequent acquisition of Forte/Rockport in the PPO sector.

We expect M&A activity to increase as the well-capitalized companies seek additional growth by acquisition. Trapped in a low-growth, low-margin industry, weaker TPAs may be forced to pursue combinations with other competitors or risk going out of business. Eliminating some of the weaker existing competitors should ultimately help improve the pricing environment for TPAs and lead to better organic growth opportunities in the long run.

Sedgwick CMS has primarily focused on organic growth over the last several years, but with their new private equity partners we expect them to more aggressively pursue acquisitions. Gallagher Bassett, which historically has focused solely on organic growth, made its first acquisition with the recent purchase of GAB's TPA operations and affiliated medical management company, MedInsights. We think the pace of acquisitions could include both some of the larger players in the marketplace as well as some of the smaller/regional players whose owners may be seeking liquidity.

We, however, do not expect the business process outsourcing companies or companies with a model to outsource to India to be a major factor in the marketplace. This was a significant trend expected to emerge a few years ago that for the most part has not materialized. The only significant acquisition of this nature was Scandent's acquisition of Cambridge in October 2004, which was subsequently sold to XChanging in October 2008. It appears that most companies have come to the conclusion that clients typically expect local or at least regional service and significant offshoring of employees can result in poor customer service and lost customers.

Key Valuation Drivers for TPAs

There are two primary drivers in valuing TPAs: (i) the multiple of EBITDA and (ii) potential balance sheet or working capital adjustment. Every transaction and company is different, but based upon our experience, the companies with the following characteristics garner the highest EBITDA multiples:

Strong Customer Relationships and Retention Rates: The ability to demonstrate an attractive customer base with strong historical renewal retention rates is of critical importance.

Solid EBITDA Margin: A combination of attractively priced business, expense efficiencies and the ability to generate medical management revenue is essential to driving an attractive EBITDA margin. It is our experience the majority of the industry generates 5% - 10% margins, which is significantly less than the 15% margin level at which many companies say they set their prices.

Maintaining Revenue or Modest Revenue Growth: The growth rate of the business has a direct impact on the valuation. Every company is facing challenges, and the companies that can either outgrow or shrink less than their competitors without sacrificing their EBITDA margins in a challenging environment will achieve higher valuations.

Diverse Product Offering Including Solid Medical Management Capabilities: Having a diverse product offering which generally consists of being able to offer additional medical management capabilities such as medical bill review and case management can be a competitive advantage in the marketplace in terms of both service (“one-stop shopping”) and margin. To the extent that a company can bring new capabilities to an acquirer, this can lead to multiple expansion.

Critical Mass: Like other industries, there is definitely a valuation premium for size. The smaller size transactions are equally as difficult to complete as larger transactions and sometimes have greater risk of client concentration and technology underinvestment. The larger companies can drive a higher multiple particularly if they can be viewed as a platform for future growth.

Balance Sheet – Valuation

Although EBITDA multiples and occasionally revenue multiples (much less reliable) tend to get the most focus, sometimes the most important factor in valuing a TPA can be the quality of its balance sheet. Since TPAs are service businesses that do not assume balance sheet risk as an insurance company does, there is often a misconception that a TPA’s balance sheet is not significant. To the contrary, a TPA’s deferred revenue liability or cost to complete its life of claims files can be the single largest valuation driver, depending upon the type of claims serviced or the type of pricing employed. The TPA industry has not used consistent accounting for deferred revenue liability. Some companies have been caught in the trap of getting paid in cash up front to service claims to their completion (known as “cradle to grave”) while not correctly accounting for and funding the long-term nature of that exposure.

Financing Availability

The debt financing market appears to have significantly rebounded in recent months compared to the last few years. This has a direct impact on the valuation multiples that private equity firms are willing to pay and as a result overall M&A valuations in the market. We have heard of staple financings being available for large transactions with strong margins in the 5.0x EBITDA level or greater for total leverage. Middle market transactions can get total leverage of 4.0x EBITDA or greater. This is not quite at the leverage levels seen in 2006 and 2007 M&A transactions, but they are very close and can increase EBITDA valuation multiples.

Recent Transaction Description – Gallagher Bassett’s acquisition of GAB Robins North America’s TPA and Managed Care Businesses

Gallagher Bassett announced the acquisition of GAB Robins North America’s TPA division and MedInsights on September 29, 2010. This transaction follows the previous sale of GAB Robins’ international operations and EFI Global in February 2009 to Cunningham Lindsey. GAB Robins will continue to operate its North American loss adjusting services business.

This represents the first acquisition for Gallagher Bassett in the TPA sector and confirms A.J. Gallagher’s long-term commitment to Gallagher Bassett as a key component of their long-term growth strategy. The acquisition provides Gallagher Bassett with immediate revenue growth from GAB’s strong existing customer base and adds additional medical management capabilities. Gallagher Bassett should be able to meaningfully increase the profitability of the business by leveraging their existing infrastructure to eliminate duplicate corporate level expenses while maintaining a high level of customer service to GAB’s existing clients.

StoneRidge Advisors’ Claims Services Expertise

StoneRidge Advisors has been the only investment banking firm with a consistent focus on the claims services sector. While most recently we advised Brera Capital Partners and GAB Robins North America on the sale of GAB Robins North America’s TPA division and MedInsights, StoneRidge Advisors continues to actively work with several leading players and has also completed the following claims services transactions:



has sold
its third party administration and
managed care businesses
to




Gallagher Bassett Services, Inc.


The undersigned acted as financial advisor
to GAB Robins North America, Inc.

SRA SECURITIES, LLC

September 2010



has been acquired by



INSURANCE SERVICES GROUP, INC.

The undersigned acted as financial
advisor to Daynard & Van Thunen

STONERIDGE
ADVISORS, LLC

January 2010




has acquired
the international businesses (excluding its
UK operations) and its U.S. forensic
engineering firm, EFI Global
from




The undersigned acted as financial
advisor to Cunningham Lindsey

STONERIDGE
ADVISORS, LLC

February 2009




has sold



BROADSPIRE

to



The undersigned acted as financial
advisor to Platinum Equity

STONERIDGE
ADVISORS, LLC

October 2006

About StoneRidge Advisors

StoneRidge Advisors is an investment banking firm that specializes in the insurance industry. Our clients include property, casualty, life and health insurance companies, reinsurance companies, as well as insurance brokerage, managing general agency, claims management and other related service companies. Our firm combines extensive experience and best practices to help our clients achieve their strategic goals and financial objectives.

Services

StoneRidge Advisors provides services related to all aspects of an M&A transaction, including identification, valuation, negotiation, structuring and financing. In addition, we assist companies in developing and executing upon capital raising initiatives.

Mergers & Acquisitions

- Buy-Side Advisory
- Sell-Side Advisory

Capital Raising

Financial Advisory

- Business Valuations
- Fairness Opinions
- Consulting Services

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