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A New IPO Play Developing In Mutual Insurance Companies

◆ By JENNIFER GOLDBLATT

Mutual insurance companies may be set to follow the stock conversion trail blazed a decade ago by thrift institutions.

In the first initial public offering of its kind, Old Guard Group Inc., a property and casualty insurance company based in Lancaster, Pa., recently sold 3.6 million shares to its policyholders.

The move drew heavy interest from investors, hungry for a piece of the action as change and consolidation begin to transform the once-quiet insurance industry.

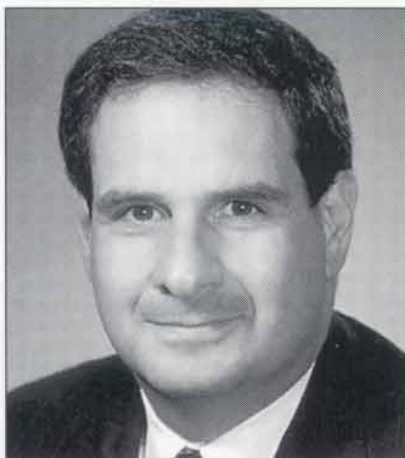
"Given the rapid rise in the bank and thrift stocks, with valuations we haven't seen in a long time, investors are looking for the next attractive investment alternative," said analyst Mark Fitzgibbon of Sandler O'Neill & Partners, New York.

Indeed, shares of Old Guard, which Berwind Financial Group initially appraised at \$10 a piece, have enjoyed a big run. The stock jumped almost 50% in its first days of trading on the Nasdaq National Market — and has maintained those gains in the month since its debut.

Underscoring the changed landscape of financial services, Old Guard was brought public by Hopper Soliday & Co., the section 20 investment banking unit of Dauphin Deposit Corp., Harrisburg, Pa.

But Nicholas Pirsos of Ryan, Beck & Co., West Orange, N.J. advised that a wave of stock conversions by mutual insurers is unlikely. "There won't be a major thrust at any one point," he said. "We'll see a steady flow of companies over the course of the next few years."

Old Guard is the first company to act on a revision of regulations by the



Robert E. Kafafian
Executive vice president,
Hopper Soliday & Co.

Insurance Department of Pennsylvania. Those changes, sanctioned last Dec. 27, allow mutual insurance companies to convert to stock form in a way that mimics thrift conversions.

Similar legal changes have occurred in Illinois and Michigan.

The nascent movement toward the public markets by property and casualty insurers is the outgrowth of these companies' increasing struggle to grow their business lines.

"This is a difficult environment in which to compete, and a lot of other companies are looking to grow by finding the right acquisitions," said Mr. Pirsos.

Some insurers have opted to form mutual holding companies, similar to those in the thrift industry. These companies sell a limited stake in a public offering, with the rest remaining in private hands.

But policyholders were clearly overwhelmed last month when Amerus Life Holdings Inc., Des Moines, converted to a mutual holding company. Only 20% of Amerus' policyholders bought shares in the \$4.6 million offering led by Goldman Sachs & Co.

"The opportunity to convert, following the thrift model, quite clearly represented the ability to raise the greatest amount of capital," said David E. Hosler, Old Guard's chief executive. "A mutual holding company structure would have limited that. More than 1,000 thrifts have followed that model successfully, so we decided on it too."

Meanwhile, Old Guard is acquiring First Delaware Insurance Co. and New Castle Mutual Insurance Co. in a parallel effort to bolster its strength. But last May the company wrote off a soured \$250,000 investment in a Missouri insurer.

Old Guard plans to use the capital raised in the initial public offering to expand its business lines. "We'll push forward with our three-point plan to assist in diversifying territorially, across business lines, and to upgrade our systems," Mr. Hosler said.

The company's fundamentals got a thumbs-up from Mr. Pirsos of Ryan Beck. "This is a sound company, especially when you add in funds from the IPO," he said.

Analysts anticipate that as insurance industry regulations are revised in more states, other insurance companies will follow Old Guard's example.

Observers say that this is one of the main items on every state's plate right now, though some may hesitate to move on it, anticipating a move on the federal level.

And investors have already put out the welcome mats

Sources close to the Old Guard transaction cite a flurry of calls from curious professional investors, many of them the same "players" who previously realized big gains from thrift conversions.

But in sharp contrast to thrifts, insurance company conversions won't be as convenient for investors to handle.

An investor who seeded a deposit in a thrift could patiently watch the funds draw interest while awaiting the chance to capitalize as an insider when the public offering came along. An investor who buys an insurance policy as a stakeout vehicle must pay the policy premium until the company goes to market.

The Old Guard offering also demonstrates that conversions are not an entirely smooth route. Two groups of policyholders

have launched lawsuits against the company, asserting claims that echoed some issues that arose in thrift conversions.

On Jan. 7, Donald H. Nikolaus, an Old Guard policyholder, initiated a lawsuit challenging the validity of the company's conversion because "the plan [to convert] does not provide for compensation to policyholders."

Mr. Nikolaus is also president and chief executive officer of Donegal Mutual Insurance Co., Marietta, Pa., Old Guard's main competitor. Three months earlier, Donegal had launched a hostile bid for Old Guard — which Old Guard promptly rejected.

Mr. Nikolaus' also attempted to obtain an injunction against the Old Guard policyholders' meeting related to the conversion. The move was unsuccessful, but the lawsuit is still pending.

In an interesting twist, Mr. Nikolaus was formerly also a director of Central Savings

and Loan Association, of Columbia, Pa., which converted from mutual to stock form in 1988 at \$10 per share.

In 1992, Central was sold to a rival commercial bank at \$40 per share. Mr. Nikolaus then owned 9.9% of Central's stock.

Industry observers doubt that Mr. Nikolaus' claims will pose a significant roadblock to future conversions of mutual insurers.

"This conversion has opened the eyes of insurance companies around the country," asserted Robert E. Kafafian, executive vice president of Hopper Soliday.

Though there are not as many mutual insurance companies as mutual thrifts, Mr. Kafafian maintained that "there are enough that policyholders could have the opportunity to participate in a good investment — and the insurance industry can also strengthen its capital position." ◇