

# National Financial Partners Corp.

## Third-Quarter Results in Line With Revised Expectations, Company Moving to Aggressively Deleverage

### Highlights

- Cash EPS declined 23%, to \$0.58, compared with our \$0.50 estimate and consensus of \$0.57 per share, given lower revenue and margin compression. The company had preannounced weak operating metrics for the first two months of the quarter in late September, but no EPS guidance. The upside relative to our estimate was due to lower expenses in all major expense categories.
- Organic revenue growth (e.g., same-store sales) was negative 14.4% versus our negative 12.0% estimate and preannounced negative 10% growth in July and August (total revenue declined 10.9%). The challenging market conditions adversely affected certain businesses in particular, including retail life, executive benefits, and life settlements insurance (about 40% of the total). The group benefits business and financial advisory businesses were relatively stable and life brokerage held up better than retail life. Visibility remains limited over the next few quarters, although organic revenue growth of negative 15% in arguably one of the most stressed quarters in the history of financial markets looks good relative to most financial services companies. Importantly, a Democratic president and a stronger Democratic congressional majority are both positive for the sale of life insurance products or any other tax-advantaged investment product generally—particularly for NFP's high-net-worth customers. President-elect Obama is supportive of the continuation of a healthy estate tax, which is also a positive for the sale of high-end life insurance, NFP's target market.
- Given the difficult environment and the need to reduce leverage and expenses, management announced that the company will suspend its dividend, stop acquisitions with the exception of certain small sub-acquisitions, and cut corporate headcount by approximately 20% (about \$6.0 million of annual expense savings). The near-term elimination of nearly all acquisitions was a foregone conclusion with the drop in the stock price. We are somewhat disappointed with the complete elimination of the dividend, but the move is understandable given the lack of visibility and reducing leverage and expenses more aggressively will create more financial flexibility when business conditions improve. Management is also working more aggressively with its firms to reduce operating expenses, which increased 10.3% during the quarter given that individual firms planned and invested for higher production in 2008. The firm principals are very motivated to cut expenses because they share in the profits of their firms and they also own stock (management and firm principals own 16% of NFP's stock). The principals also own 50% of the operating cash flow of their firms and therefore there is a huge disincentive to walk away from their businesses.

### Financial | Insurance

November 06, 2008

Stock Rating: **Outperform**  
Company Profile: **Core Growth**

Symbol: NFP (NYSE)  
Price: \$4.76 (52-Wk.: \$4-\$52)  
Market Value (mil.): \$255  
Fiscal Year End: December  
Long-Term EPS Growth Rate: 13%  
Dividend/Yield: \$0.83/17.4%

	2007A	2008E	2009E
<b>Estimates</b>			
EPS Q1	\$0.53	A\$0.61	NA
Q2	\$0.76	A\$0.64	NA
Q3	\$0.75	A\$0.58	NA
Q4	\$0.83	\$0.61	NA
FY	\$2.86	\$2.43	\$1.95
CY		\$2.43	\$1.95
<b>Valuation</b>			
FY P/E	1.7x	2.0x	2.4x
CY P/E		2.0x	2.4x

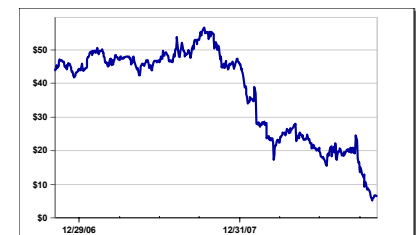
### Trading Data (Thomson Financial)

Shares Outstanding (mil.)	40
Float (mil.)	24
Average Daily Volume	603,614

### Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	39.8
Book Value Per Share (MRQ)	19.8
Enterprise Value (mil.)	510.3
EBITDA (TTM)	165.7
Enterprise Value/EBITDA (TTM)	3.1x
Return on Equity (TTM)	7.1

### Two-Year Price Performance Chart



Source: Thomson Financial, William Blair & Company estimates

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- We believe NFP will renegotiate the covenants within its credit facility prior to violating certain limits—principally a quarter-end ratio of 2.5 for total debt to last-12-months' adjusted EBITDA. We estimate NFP will violate this limit in first quarter 2009 (see attached analysis) or potentially in fourth quarter 2008, but securing an adjustment to its covenants with its banks is not a major obstacle, in our view. NFP could reasonably "pay off" its current credit facility before the end of 2010, highlighting its still-strong cash flow generating ability. NFP is not a rated company and not influenced by the fickle rating agencies, and it is in the banks' best interest to work with NFP to make appropriate adjustments, in our opinion.
- We have lowered our fourth-quarter cash EPS estimate to \$0.61 and our 2009 cash EPS estimate to \$1.95 from \$2.60 assuming a marked slowdown in organic revenue growth. We have also initiated a 2010 cash EPS estimate of \$2.00. Our cash EPS estimates exclude an expected accounting change in 2009 that will increase noncash interest expense for convertible securities.
- NFP faces some near-term challenges, not unlike the majority of financial services companies within our research coverage universe. At this level NFP should be viewed as the largest independent distributor of life insurance in the United States in combination with a specialty employee benefits business and financial advisory operation. We believe the stock is discounting a worst-case scenario (a complete unraveling of the business and/or a highly dilutive capital injection), but it is likely to continue to remain under pressure until the company's capital position or organic revenue growth prospects improve or at least stabilize. The shares trade at 4.7 times EV to a depressed 2009 estimated EBITDA.

National Financial Partners  
Liquidity Analysis

	2004	2005	2006	Q107	Q207	Q307	Q407	2007	Q108 <sup>1</sup>	Q208	Q308	Q408E	2008E	Q109E	Q209E	Q309E	Q409E	2009E	2010E
Cash earnings <sup>2</sup>	71,141	95,763	105,443	20,853	30,317	30,109	33,881	115,160	24,990	26,068	23,743	25,217	100,018	15,783	19,358	18,825	27,487	81,452	85,933
% change									19.8%	-14.0%	-2.1%	-25.6%	-13.1%	-36.8%	-25.7%	-20.7%	9.0%	-18.6%	5.5%
Cash EPS <sup>2</sup>							2.86		0.61	0.64	0.58	0.61	2.43	0.38	0.46	0.45	0.65	1.95	2.00
Operating cash flow	86,111	87,223	81,923	(35,840)	39,142	41,271	63,833	108,406	(44,411)	32,723	49,500	52,500	90,312	(45,000)	30,000	40,000	40,000	65,000	62,500
% change									23.9%	-16.4%	19.9%	-17.8%	-16.7%	1.3%	-8.3%	-19.2%	-23.8%	-28.0%	-3.8%
CAPEX	10,463	15,547	10,622	1,940	3,193	3,182	4,993	13,308	13,007	11,826	7,500	2,500	34,833	3,125	3,125	3,125	3,125	12,500	15,000
Amount available to pay down debt	75,648	71,676	71,301	(37,780)	35,949	38,089	58,840	95,098	(57,418)	20,897	42,000	50,000	55,479	(48,125)	26,875	36,875	36,875	52,500	47,500
% change									52.0%	-41.9%	10.3%	-15.0%	-41.7%	-16.2%	28.6%	-12.2%	-26.3%	-5.4%	-9.5%
Cash and cash equivalents				80,833	86,329	88,674	114,182	114,182	65,663	65,259	67,444	54,444	54,444	53,819	53,194	55,069	56,944	56,944	59,444
Credit facility - matures 2011				70,000	90,000	80,000	126,000	126,000	174,000	169,000	173,000	130,000	130,000	177,500	150,000	115,000	80,000	80,000	35,000
Convertible note - matures 2012				230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000
Total debt				300,000	320,000	310,000	356,000	356,000	404,000	399,000	403,000	360,000	360,000	407,500	380,000	345,000	310,000	310,000	265,000
EBITDA - LTM, "unadjusted" <sup>3</sup>	148,009	156,902	160,576	148,009	156,902	160,576	167,825	167,825	180,355	172,676	162,367	145,416	145,416	124,349	112,974	104,470	107,544	107,544	113,829
% change									21.9%	10.1%	1.1%	-13.4%	-13.4%	-31.1%	-34.6%	-35.7%	-26.0%	-26.0%	5.6%
Total debt to EBITDA - LTM, "unadjusted"				2.03	2.04	1.93	2.12	2.12	2.24	2.31	2.48	2.48	2.48	3.28	3.36	3.30	2.88	2.88	2.33

<sup>1</sup>Adjusted by \$14.4 million for proceeds used to purchase an additional economic interest in an existing firm.

<sup>2</sup>Excludes expected accounting change in 2009 that will increase noncash interest expense.

<sup>3</sup>"Unadjusted" EBITDA excludes any pro forma adjustments for acquisitions or other noncash expenses that are adjusted within the company's credit facility covenant calculations (e.g. - more conservative estimate).

Sources: Company filings and William Blair & Company research

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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	58	Outperform (Buy)	4
Market Perform (Hold)	41	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	1

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