

STOCK DATA	
Ticker	BXXX
Shares Outstanding	14210
Market Cap.	\$155,033.90
TEV	\$241,055.90
2008E EBITDA	\$55,578.30
Target Price	\$16
Current Price	\$10.89

This evaluation recommends Brooke Corporation (BXXX) as a **BUY** for the following reasons:

- ❖ New franchise growth is expected to continue its strong growth.
- ❖ BXXX's business segments create synergies that provide a competitive edge by reducing the need for outsourcing.
- ❖ BXXX is undervalued. A discounted cash flow analysis indicates BXXX is undervalued by 42%; a relative valuation indicates BXXX is undervalued by as much as 153%.

Overview

Brooke Franchise Corporation

Brooke Franchise Corporation ("Brooke Franchise") is one of the largest franchisors of property and casualty insurance agencies based upon number of locations in the United States. Brooke Franchise is able to capitalize on smaller market insurance needs due to their ability to attract local entrepreneurs who typically have experience and contacts within their community. Franchises are able to compete more effectively in their markets with the assistance from the resources and opportunities afforded to them through the BXXX network. Volume is a critical issue to the insurance agents' ability to offer a variety of products. BXXX is able to consolidate the entire franchise product needs in order to obtain the top products available in the market. Additionally, BXXX provides the franchises with the top notch marketing, facility and financial assistance, typical of a large company. Brooke Franchise is the key revenue driver for BXXX (79.2% of 2006 revenue)² in that all other operating units depend upon the agents and franchises to do business. In return, the franchises need the capital, niche insurance deals, and banking products and services offered by the other lines of business within BXXX. The number of franchises increased 34% from 2005 to 2006 however the revenue per franchise decreased approximately \$23 thousand (Appendix 1). This decrease can be partly attributed to startup fluctuations of revenue but as the number of franchises grow it will be vital for the current startups to increase their revenue stream to offset startup lulls of future franchisees. It will be critical for BXXX to continually increase the number of franchises to grow this division as the company as a whole depends upon its growth.

The franchise segment aligns the goals of the management and the shareholders. Their central focus is the initiation, sustainability, and profitability of their franchises. Management's primary

method for generating location growth is through individual startups. However, their conversions team has become a very important source of this growth. Management is looking for large conversions similar to the first quarter 36 location acquisition. While it is hard to speculate on future acquisitions of this magnitude, management has stated there is currently nothing on the horizon. They go on to say their conversions team is speaking with six or seven acquisition targets with a magnitude of approximately 15 to 30 locations each. Management is also concerned with meeting their 1,000 location goal for the end of 2007. While this remains their goal, it will be unattainable without one or two more major acquisitions. Another consideration of management is market saturation. This could dramatically impact the growth of new franchises. The sustainability of franchises relies heavily upon BXXX's listening tour as well as their ability to maintain a competitive edge against the competition. The listening tour was designed to reconnect with franchisees, identify deficiencies and derive an agenda for the remainder of 2007. Management and stockholders are also concerned with the profitability of the franchises. The increase in interest rates has increased expenses, which has resulted in a decrease in their operating margin. These metrics are the driving force behind BXXX's cash flow, revenue, and earnings growth.³

Brooke Credit Corporation

Brooke Credit Corporation ("Brooke Credit") is a specialty finance company that lends to retail insurance agencies, managing agencies, and funeral homes. Brooke Credit began operations in 1996 with the primary purpose of extending credit to Brooke Franchise but over the years developed an expertise in the small market insurance segment due to the absence of a traditional lender footprint. Brooke Credit works with four types of borrowers: agents and agencies that are franchisees of Brooke Franchise, agents and agencies that are not franchisees, managing general agencies (MGAs), and funeral home owners. Loans extended to retail insurance agents and agencies that are franchisees of Brooke Franchise represent 58% of Brooke Credit's loan portfolio. These loans are secured by the individual franchise business and owner(s) and range in loan type depending on the stage of business. Brooke Credit extends loans to agents and agencies that are not a part of Brooke's franchise business primarily for the acquisition of the agency. These loans represent 11% of the loan portfolio and are secured by working capital and personal guarantees of the agency owner(s). In addition to acquiring individual agencies, Brooke Credit acquires MGAs through extension of credit. These loans represent 18% of loan balances. Brooke Credit makes loans with funeral homes with three or more years of operating experience for acquisition purposes as the need for insurance plays an important role in the business. These loans constitute 12% of the portfolio. Brooke Credit plays a critical role to the franchise business in that it can take over the operations of franchises that default without compromising the value of the franchise due to their ability to access client records through Brooke Corporation. Also, BXXX has established a collateral system which decreases the effect of default by collecting payments and fees from commissions earned

by franchises before distribution of the balances. Brooke Credit increased loans outstanding 74% from 2005 to 2006; this number should increase as a result of the merger with Oakmont.⁴

Shareholders have raised concerns about the impact of the sub-prime lending catastrophe on demand for loans in BXXX's secondary market. Management has indicated there is no change in the funding platform. This is due to the fact that BXXX offers a different type of product than that of the specialty lenders that are currently suffering. However, management does address this issue as a concern.³ In addition, management should focus on their lending practices as well as the default risk of their clients.

Brooke Brokerage Corporation

Brooke Brokerage Corporation ("Brooke Brokerage") is a wholesale insurance broker which assists Brooke Franchise agents and other unaffiliated agents in finding insurance coverage for hard to place and niche risks. This operating unit supports the franchise business with services which generate revenue without placing additional costs on the individual franchises. Additionally, Brooke Brokerage supports Brooke Credit through consulting with management of insurance agencies and funeral homes, referring these businesses to Brooke Credit for their financing needs, and then providing collateral preservation services to Brooke Credit for the loans. In January 2007, Brooke Brokerage acquired Generations Bank, now Brooke Savings Bank as an inexpensive distribution channel for bank products and services for the franchise line of business. The referrals, products and services offered through this line of business create synergy by addressing the needs of the individual business segments so that it is not necessary to find outside services.⁵

Management of the brokerage segment should focus on the credit risk associated with its clients as well as the interest rate risk associated with the federal interest rate. The following factors are also a concern: the number of delinquent loans, loan quality, and credit loss. Management has taken a proactive approach to reduce the amount of delinquent loans by monitoring its borrowers' revenue on a quarterly basis rather than monitoring the delinquencies. When dealing with warehouse loan providers and loan pool investors Brooke is indirectly exposed to credit loss. If these lenders reach a level of unacceptable loss Brooke would no longer be able to originate new loans.⁶

Merger

On July 18, 2007, Oakmont Acquisition Corp. ("Oakmont") a public, blank check company was merged with and into Brooke Credit. The surviving corporation, Brook Credit Corporation is now a public company with BXXX as its largest shareholder. Brooke Credit's operations remain as a specialty finance company that lends capital primarily to insurance companies. Each share of Oakmont's outstanding common stock was converted into one share of Brooke Credit stock. BXXX and seven former BXXX equity holders received 16,303,981 shares of Brooke Credit common stock as a result of the merger. The company now owns 62% of Brooke Credit's issued and outstanding shares of common stock (total outstanding 25,722,898 shares) as a result of the shares received through the merger and shares purchased by the Company in the open market. BXXX's ownership could increase if Brooke Credit achieves earnings goals set for 2007 and 2008. An additional 1.2 million shares of Brooke Credit are reserved for issuance based upon warrants issued by the former Brooke Credit. Also, 500,000 shares of Brooke Credit are reserved for issuance of

stock or options that could be granted based upon Brooke Credit's 2007 Equity Incentive Plan. This plan was approved by the Oakmont stockholders within the Merger Agreement. An additional 4 million shares of Brooke Credit common stock could be issued to former Brooke Credit stockholders in the event Brooke Credit reaches the adjusted earnings goal of \$15 million in 2007. In conjunction, an additional 1 million shares of Brooke Credit's common stock could be issued to former Brooke Credit stockholders if the combined company reaches the goal of \$19 million adjusted earnings in 2008.³ If the earnings goals are met in the coming year end 2007 and 2008, the company will benefit from the merger.⁷

Risk Analysis

BXXX faces risks at each level of their corporate chain similar to the independent companies who offer the same products and services within the market. High interest rates may affect borrower's ability to repay loans issued from Brooke Credit. Inability to add more franchise locations could halt company growth due to the dependence on the franchise segment for business opportunities in the other segments. BXXX funds their loans through the sale of secured loans to third parties which are then issued as asset-backed securities therefore poor market conditions could have an impact on the company's financial performance.⁶ BXXX's ability to access capital through available lines of credit or through the sale of additional loan participations is an important contingency plan if market conditions for asset-backed securities are unfavorable. In addition to these risks, BXXX extends credit to franchisees, agencies and funeral homes, which are often partially secured by the personal guarantee of the individual franchise, agency or funeral home owner. Using personal guarantees as collateral should force BXXX to have a selective screening process when evaluating potential franchisees and borrowers.

BXXX is able to leverage these risks in each segment to effectively create a competitive advantage for each of their lines of business. Through the synergies between segments, BXXX has created a business plan that allows them to avoid many of the risks that others in the industry might face. The creation of Brooke Credit allows BXXX to deal with rising interest rates internally. Franchisees can offer a range of products regardless of their volumes due to Brooke Brokerage's ability to purchase products that have the highest demand. In the event that a franchise cannot make payments on their loans, BXXX deals with the issue internally so that business is not interrupted and customers receive the same level of service.

Assumptions of Growth

The driving factor of the franchise portion of the BXXX projections is the estimate for franchise growth going forward and the margins earned per franchise. Growth, as measured by percentage of new stores to total stores, is expected to continue declining as seen in Figure 1, as the geographic market for BXXX becomes saturated. Margins, however, are expected to level off as the primary revenue generator shifts from startup costs to commissions (Figure 2).

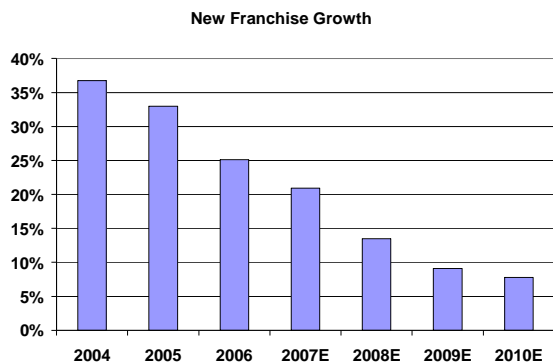


Figure 1 – New stores as a percentage of total stores continues to decline but not as fast as in previous years.

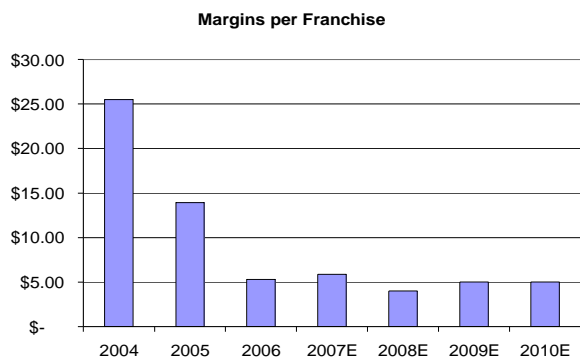


Figure 2-Margins per Franchise level off as revenue shifts to commissions

Valuation

DCF Valuation

The intrinsic value of the company was calculated to be \$15.60 per share using a three year growth model with a terminal growth rate of 2% (near the historical GDP growth rate) and discounting all future cash flows to present value at a required rate of return of 15%. The high required rate of return was used to adjust for the risks inherent in this sort of growth company but was moderated by our belief that the substantial dividend, currently 6.7%, can grow with the company. This DCF analysis indicates that BXXX is undervalued by approximately 40% at the current price of \$10.89.

A sensitivity analysis found that should the key growth factors be off by 25% the intrinsic value would range from \$15.09 to \$16.23. This adds a level of confidence that even if estimates are high, the stock is still trading well below its value.

Intrinsic Value	
Required Return	15%
NPV of Future FCF	\$94,327.09
Terminal Value	\$213,352.17
Debt	\$86,022.00
Total Equity NPV	\$221,657.26
Units Outstanding	14210
Price	\$15.60

Figure 3 – Intrinsic Value of BXXX is calculated to be \$15.60 per share.

Relative Valuation

Relative valuations using forward P/E and P/S multiples were used to strengthen the hypothesis that BXXX is undervalued. Three comparable companies were used to determine average multiples, 21st Century Holding Co, Allstate Corporation and Manulife Financial Corporation. Using the average P/E and P/S multiples

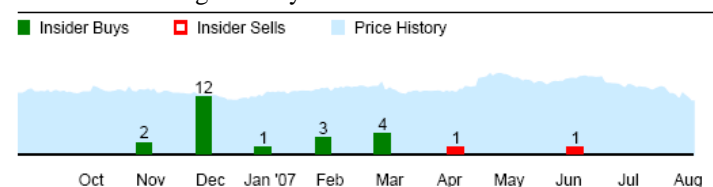
implies a target price \$14.79 and \$27.66, leaving the current share price undervalued by 35% and 150% respectively. Figure 4 explains the outcomes of these relative valuations; the forward BXXX price to earnings is based upon the 2008 estimates and percent undervalued is calculated from the latest trade of \$10.89

Relative Valuation Results		
	F P/E	P/S
BXXX	6.72	0.63
TCHC	5.99	1.11
MFC	13.14	1.9
ALL	8.21	0.89
AVG	9.1	1.3
Implied Target Price	14.79	27.66
Undervalued by	35%	153%

Figure 4 – Relative valuation metrics show significant discount in current price when evaluated by industry comparables.

Observation of Management's Valuation

Executive Trading Activity



*Table provided by Standard&Poors⁹

It is management's practice to buy back company stock when they believe it is undervalued. December was flooded with buy orders; BXXX used 12 purchase orders to buy 30,000 shares at \$10.30-\$10.65 per share. March was also a busy month; BXXX used 4 purchase orders to buy 4,988 shares at \$10.10 - \$10.41 per share. Director Derrol Hubbard sold 10,000 shares at \$11.82-\$12 in April, and another 3,000 at \$14.76 in June. This trading activity indicates that management believes their stock is undervalued at \$10.65 and overvalued at \$11.82.¹⁰

Recommendation

A discount cash flow analysis as well as a relative valuation indicates that BXXX is undervalued by at least 42%. Although market saturation and increased competition is eminent, management is taking the proactive steps necessary to ensure BXXX continues to grow. Our estimates indicate management will not meet their 1,000 franchise goal for the end of 2007. However, our analysis indicates new franchise growth will decrease at a lesser rate. Overall we maintain an optimistic outlook for BXXX and recommend a weak buy due to the uncertainty and volatility of new franchise growth in the Franchise segment.

¹Brooke Corporation Form 10-K 2006 p. 2-5

²Brooke Corporation Form 10-K 2006 p. 113

³Brooke Corporation Q2 2007 Earnings Conference Call August 8, 2007

⁴Brooke Corporation Form 10-K 2006 p. 5-9

⁵Brooke Corporation Form 10-K 2006 p. 9, 10

⁶Brooke Corporation Form 10-K 2006 p. 16-18

⁷Brooke Corporation Form 10-Q June 30, 2007 p. 37

⁸Brooke Corporation Form 10-K 2006 p. 77;

Brooke Corporation Form 10-Q June 30, 2007, March 31, 2007 Sept. 30, 2006, June 20, 2006

⁹Standard&Poor's. "Quantitative Stock Report: Brooke Corp." August 18, 2007

¹⁰Yahoo! Finance. "Insider Transactions: BXXX." August 25, 2007

Appendix 1⁸
Brooke Corporation (BXXX)
(in 000's except for franchise and share amounts)

	2004	2005	2006	2007	2008	2009	2010
Franchises							
Total	370	552	737	932	1077	1185	1285
Revenue/Franchise	\$ 230.07	\$ 215.61	\$ 193.15	\$ 190.45	\$ 190.00	\$ 188.00	\$ 190.00
Franchise Revenue	\$ 85,126.00	\$ 119,018.00	\$ 142,348.00	\$ 177,501.46	\$ 204,630.00	\$ 222,780.00	\$ 244,150.00
Other Revenue	\$ 16,797	\$ 26,400	\$ 37,347	\$ 69,799	\$ 97,719	\$ 131,920	\$ 171,496
Total Revenue	\$ 101,923	\$ 145,418	\$ 179,695	\$ 247,300.46	\$ 302,348.60	\$ 354,700.11	\$ 415,646.14
Expense/Franchise	\$ 204.6	\$ 201.7	\$ 187.8	\$ 184.6	\$ 186.0	\$ 183.0	\$ 185.0
Franchise Expenses	\$ 75,689.00	\$ 111,332.00	\$ 138,441.00	\$ 172,030.85	\$ 200,322.00	\$ 216,855.00	\$ 237,725.00
Other Expenses	\$ 13,920.00	\$ 15,399.00	\$ 17,236.00	\$ 34,899.50	\$ 48,859.30	\$ 65,960.06	\$ 85,748.07
Total	\$ 89,609.00	\$ 126,731.00	\$ 155,677.00	\$ 206,930.35	\$ 249,181.30	\$ 282,815.06	\$ 323,473.07
Operating Income	\$ 12,314.00	\$ 18,687.00	\$ 24,018.00	\$ 40,370.12	\$ 53,167.30	\$ 71,885.06	\$ 92,173.07
Interest expense	\$ 2,340.00	\$ 3,721.00	\$ 6,709.00	\$ 11,040.00	\$ 16,560.00	\$ 23,184.00	\$ 30,139.20
Minority interest in subsidiary	\$ -	\$ -	\$ 575.00				
Income Before Taxes	\$ 9,974.00	\$ 14,966.00	\$ 16,734.00	\$ 29,330.12	\$ 36,607.30	\$ 48,701.06	\$ 62,033.87
Tax Rate	32.9%	35.2%	35.8%	37.5%	37.0%	37.0%	37.0%
Taxes	\$ 3,280.00	\$ 5,261.00	\$ 5,992.00	\$ 11,000.98	\$ 13,544.70	\$ 18,019.39	\$ 22,952.53
Other							
Net Income	\$ 6,694.0	\$ 9,705.0	\$ 10,742.0	\$ 18,329.1	\$ 23,062.6	\$ 30,681.7	\$ 39,081.3
Units Outstanding				\$ 14,210.3	\$ 14,210.3	\$ 14,210.3	\$ 14,210.3
Net Income/Share				\$ 1.29	\$ 1.62	\$ 2.16	\$ 2.75
EBITDA	\$ 14,818.00	\$ 21,119.00	\$ 26,429.00	\$ 42,781.12	\$ 55,578.30	\$ 74,296.06	\$ 94,584.07
Cash Taxes Paid	\$ 2,988.00	\$ 3,955.00	\$ 6,626.00	\$ 8,556.22	\$ 11,115.66	\$ 14,859.21	\$ 18,916.81
Change in NWC	3378	37963	19229	\$ 38,503.00	\$ 47,241.56	\$ 59,436.84	\$ 70,938.05
Capital Expenditures	1634	541	9138	\$ 4,278.11	\$ 5,557.83	\$ 7,429.61	\$ 9,458.41
FCF	\$ 16,062.00	\$ (12,348.00)	\$ 22,964.00	\$ 17,112.45	\$ 25,010.24	\$ 37,148.03	\$ 52,021.24

Total Enterprise Value	
Price	\$10.91
# shares	14210
Market Cap	\$155,033.9
Debt	\$86,022.0
TEV	\$241,055.9

CAGR	
Franchise Rev	29.3%
Other Rev	49.1%
Franchise Op Inc	-35.7%
Other Op Inc	164.4%

Intrinsic Value	
Required Return	15%
NPV of Future FCF	\$ 94,327.09
Terminal Value	\$ 213,352.17
Debt	\$ 86,022.00
Total Equity NPV	\$ 221,657.26
Units Outstanding	14210
Price	\$ 15.60

	2004	2005	2006
New Franchises	136.0	182.0	185.0
Total Franchises	370.0	552.0	737.0
Commission	\$57,619.00	\$80,490.00	\$99,190.00
Initial Fees	\$5,236.0	\$4,916.0	\$2,731.0
Commission Exp	\$49,600.0	\$66,957.0	\$79,462.0
Commission/Franchise	\$155.7	\$145.8	\$134.6
Initial Fee/New Franchise	\$38.5	\$27.0	\$14.8
Net Commission/Franchise	\$21.7	\$24.5	\$26.8

Comparables*	ALL	TCHC	MFC	AVG
F P/E	8.21	5.99	13.14	9.1
P/S	0.89	1.11	1.9	1.30
*Data from finance.yahoo.com				

Relative Metrics	
F P/E (2008)	6.72
P/S (2007)	0.63
TEV/EBITDA	5.63

% of Total Revenue	2004	2005	2006
Franchises	83.5%	81.8%	79.2%
Other	16.5%	18.2%	20.8%

	2004	2005	2006
ROE	91.2%	23.4%	19.0%
ROA-			
Franchises	20.0%	13.2%	6.2%
ROA-	4.7%	14.3%	7.7%

Valuations	
Intrinsic	\$ 15.60
P/E	\$ 14.79
P/S	\$ 27.66