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Stock Info:

Ticker:	BXXX (NASDAQ)
Market Cap:	\$154.77M
Enterprise Value:	\$143.44M
Current Price:	\$10.89
3 Year Target Price:	\$12.32
Dividend Yield:	6.61%

We place a **HOLD** recommendation on Brooke Corporation for the following reasons:

- Decreasing margins throughout growth stage
- Strong growth strategy
- As long as management stays the course of continuous market penetration

Overview

Brooke Corporation

Brooke Corporation is a holding company with two primary operating segments, franchising and financial services. Brooke Corporation's wholly owned subsidiary, Brooke Franchise Corporation, is a franchisor of independently-owned property and casualty insurance agencies. Brooke Franchise Corp. works in conjunction with the financial services segment in order to streamline the franchising process. The synergy of the two operating segments provides current and prospective franchisees the optimal level of administrative support, lending services, marketing and availability of financial products. Brooke Corp's strategy has made them the most successful franchisor of insurance agencies and was named the country's No. 37 Top Franchise Opportunity by Entrepreneur Magazine (2007).

Brooke Corporation also owns a controlling interest in Brooke Credit Corporation, listed on the OTC Bulletin Board under the symbol "BRCR." Brooke Credit originates loans to Brooke insurance franchisees, local insurance agencies, funeral service companies and other related businesses.

Brooke Franchise

Brooke Franchise Corp. is the largest segment of Brooke Holding Company, accounting for over 79% of total revenues. Through Brooke Corp's innovative franchising strategy, the Company has been able to grow its network to over 828 locations as of 2Q 2007, with plans to reach 1000 by year's end 2007. The franchises offer a variety of insurance products from a wide-range of well-known industry leading companies, such as AIG, Chubb and Hartford. This is an important

differential advantage for Brooke versus smaller franchising insurance companies, who are unable to secure contracts with the larger firms due to a lack of scale.

Within their franchises Brooke has several sources of revenues, the first being initial franchise fees. These franchise fees can be split into two categories. These include basic services fees and Buyer's Assistance Plans (BAP). The basic services fee is the larger revenue generator of the two, and, as the name would suggest, includes all basic services and supplies necessary to start a franchise. This includes access to the use of the "Brooke" brand name, access to insurance products offered by other companies through Brooke Corp. and other administrative tools. It is a fixed fee of \$165,000 that must be paid by all franchisees. A BAP, on the other hand, is a variable fee that is based off of a business's revenues. This is because of the variable amount of effort required by Brooke Corp. depending on the size of the agency.

The most significant portion of revenues earned by Brooke Corp. is insurance commissions. Insurance commissions are a percentage of the premium paid on each policy. Currently, the insurance premium market is under extreme pressure from competition, creating a soft market and thus reducing commissions. Other revenues stem from consulting fees and gains on sale of businesses, both of which represent a small portion of revenues and are extremely variable.

Brooke Financial Services

The financial services segment was added during the first quarter of 2007 as a result of the recent acquisitions of Brooke Savings Bank and a controlling interest in First American Capital Corporation. The financial services segment includes activities associated with the sale of banking services, life insurance policies and the brokering of loans to insurance related businesses.

Brokerage Segment

The brokerage segment previously had two main functions, the brokerage of loans and the brokerage of insurance policies. During the second quarter of 2007 the loan brokerage responsibilities were transferred to the financial services segment. The brokerage segment's primary focus is the sale of hard-to-place and niche-market property and casualty insurance policies. The segment posted a pre tax loss of \$310,000 due to the adverse affect of the elimination of loan brokerage fees. Additionally, the insurance premium market continues to soften and commissions are at multi-year lows across the nation, with the exception of coastal and high risk areas.

Brooke Credit Corporation

In February, 2007 Brooke Credit merged with Oakmont Acquisition Corporation. On July 18, 2007 Brooke Credit went public in order to increase equity, and Brooke Corporation retained 62% ownership of Brooke Credit.

Brooke Credit Corporation was founded in 1988. In 2003 Brooke Credit worked with Standard and Poor's Rating Services to create new securitization asset class for insurance agency loans. They sold five securitizations resulting in an issuance of \$135,350,000 asset-backed securities. One of the main benefits of securitizations is that they improve returns on capital by bringing in off-balance-sheet income. Most of Brooke Credit's loans are to Brooke franchisees. As of June 30, 2007, its loan portfolio balance totaled \$593,400,000. This was a 19% increase for the second quarter, compared to the same period in 2006.

The operating revenue for the end of 2006 was \$26,780,000, which increased 58% from the prior year. Their lending business is important for the overall success of Brooke Corporation because it generates 67% of their total income before taxes.

Oakmont Merger

The highly anticipated merger between Brooke Credit Corporation and Oakmont Acquisition Corporation finally had its long awaited closure. Brook Corporation is the principal shareholder and owns 62% of Brook Credit Corporation. On July 18th, 2007, Robert Orr, CEO of Brooke Corporation, announced that the deal was finalized, and that trading will start on July 19th on the OTC market using the tickers "BRCR," "BRCRW," and "BRCRU," respectively. Oakmont is a special purpose acquisition company (SPAC); SPAC's act as a blank-check company that raise capital through the proceeds of an IPO with the purpose of acquiring an existing company. Upon the completion of the merger, Oakmont changed its name to Brooke Credit Corporation and converted all existing shares into shares of the parent company – the conversion ratio was one-to-one.

The terms of the merger called for investors in Brooke Credit to receive approximately 17.5 million newly issued Oakmont shares. Furthermore, as an additional equity incentive, warrant holders of Brooke Credit will receive an additional four million shares and one million shares of Oakmont stock if adjusted earnings goals of 15 million and 19 million are earned in 2007 and 2008, respectively.

In a phone interview with Anita Larson, we were able to get a better grasp of the reasoning behind the merger. Of Brooke's subsidiaries, Brooke Credit was growing exponentially faster than its accompanying subsidiaries. To offset the massive growth in Brooke's lending arena, Brooke Corp. had to make one of two decisions to increase the size of its equity position. First, Brooke could raise equity capital within; however, this

would ultimately lead to a dilution in shareholder's equity. Or, Brooke could spin off Brooke Credit through a reverse merger, allowing Brooke Credit to raise its own equity.

Moving forward, the merger has the potential to be favorable for both parties. A main focus of management is to increase the size of Brooke Credit's loan portfolio. It's judicious to suppose that flanked by the equity incentive, and Oakmont's ability to raise equity capital that Brooke Credit's loan portfolio can – and will – increase.

Risk Analysis

Brooke, like any franchisor, has a strong incentive to expand in order to fuel revenue growth. This growth is exposed to certain market risks. Brooke recognizes this risk and goes as far to state that they cannot assure stockholders they will continue to grow successfully through adding new franchises. Brooke realizes that failure to grow would have a significant effect on all facets of the business*.

Another significant risk Brooke faces is its reliance on the initial franchise fees. Because these fees represent a significant part of net income, there is a tendency for Brooke to rush the lending process to accelerate franchising. Brooke Corp. acknowledges that it sometimes approves loans to new franchises without applying the stringent guidelines Brooke believes in. With less than perfect franchises being added, simply for the franchising fees, franchise cancellations involving sub-par franchises are expected in the future².

One more risk that should weigh on investors' minds is the relatively low trading volume of BXXX. Brooke's volume in the last three months has averaged 18,840/day. In the event that a shareholder wishes to sell a position of Brooke stock, it may be difficult because of the low volume of shares that Brooke sells.

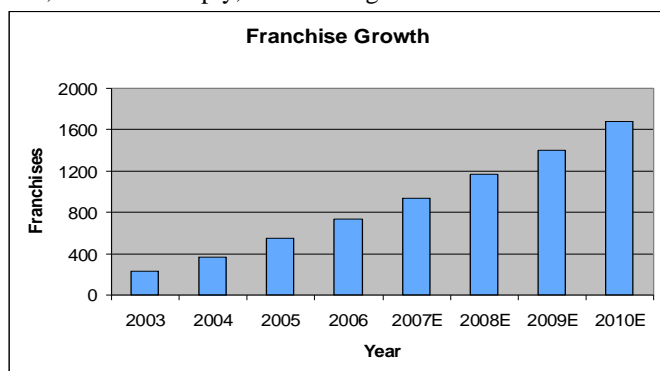
Basic Growth Strategy

Currently, Brooke Franchise Corp. is in the "growth" stage. The Compound Annual Growth Rate (CAGR) of franchises has been 46.6% since 2003. This growth has allowed them to combine the benefits of smaller franchised insurance companies with the products and services only available through companies of Brooke's scale. According to Anita Larson, beginning in 2004, Brooke began a strategy for expansion centered around start-up franchises. This entails a franchisee purchasing a location and beginning the business from scratch. However, they recently have begun to shift their focus to "conversions." Brooke Franchise Corp will buy an already existing agency with a small network of retailing locations, and then flip them as soon as possible to new franchisees. The growth by conversions has proven to be a more effective strategy, as already existing businesses have a higher success rate than start up businesses. Because of the lumpiness of conversions, it can be difficult to forecast franchise growth. Another new strategy that Brooke Franchise

has implemented is a “seminar” style approach to recruiting franchisees. This has likely contributed to the slowdown of franchise growth in the second quarter, however management is optimistic that it will likely lead to a higher-quality, more profitable franchisee. Lastly, they have recently implemented new software in order to identify possible franchise locations in “high growth” areas that lack the presence of a large agency. Management hopes that this will allow them to beat the competition into emerging markets, allowing them to be well-positioned as the area’s population booms.

Performance Metrics

In looking at the Franchise Corp.’s financials, there are several statistics that can be used to gauge the health of the company. First, and most simply, is location growth.



As long as Brooke continues to grow at its current rate, and thus collect the initial fees, they should stay relatively profitable in the short-term. Another metric that management likes to look at is recurring revenues versus recurring expenses. They would eventually like to have recurring revenues be greater than recurring expenses because the variable income, i.e. initial fees, consulting fees, etc., will drop straight to the bottom line. Though they are not quite there yet, they have been working diligently to close the gap. Finally, it will also be important to track the growth of operating revenues against the growth of operating expenses. The last two years, expenses have outgrown revenues, leading to a much smaller bottom line. Management says this margin contraction is a consequence of their growth strategy because as they continue to try to grow, they are forced to spend more and more on marketing and advertising. Additionally, softer market conditions have led to increased strain at many franchises, resulting in lower commission revenues and higher operating expenses. Looking into the future, management expects expenses to continue to outgrow revenues until they transition their focus from growth to profitability. That being said, it will be important for them to eventually reverse this trend and focus on per store profitability, rather than sheer reliance on initial fees to stay afloat.

Valuation

When looking at a growth company’s financials, one often has to take a deeper look at a company’s long-term plan in order to

get the big picture. Thus is the case with Brooke Corporation. In recent years the profitability of Brooke’s core business, its franchising segment, has begun to dwindle, even despite explosive growth. This is due to two primary factors; a softening credit market, which results in lower premiums, and an increase in marketing and advertising expenses. Though it hurts their bottom line for the short term, these expenses are key to Brooke’s future success. In speaking with Anita Larsen about Brooke’s current plan, it is clear that they are seeking maximum market penetration, something that they are not close to doing given they only have roughly 2% of the current market. This strategy has proven very costly in the short-term, as it means they are sacrificing short-term profitability in an effort to maximize long-term gains. Based off of our stock price valuation of \$10.37, this has led to them having a much lower TEV/EBITDA and P/S ratios when compared to their peers, who are currently focusing more on profitability than growth. That being said, within several years they should be well-established in many key growth markets, a current management objective, and can then turn their focus to maximizing profit from established companies. This will pay immediate dividends as they will likely be able to cut costs on many of their services due to their large scale and impressive synergies. Furthermore, they will be able to cut back advertising costs, as they will be solidified in their markets at that time, which will have a huge positive impact on their bottom line. That being said, there is some worry on our side about the brokerage segment, as it has recently posted a loss and is very subject to current market conditions. It is our view that the market will need to harden before it again posts gains.

Therefore, based off of our analysis, we’re recommending a **HOLD**. Though the future is very bright for Brooke, it is all contingent on management’s current forward thinking. If they fail to implement the plan they have laid out, it is likely that their costs will eventually overwhelm their debt as the franchise fees they’ve been relying on to stay profitable begin to dwindle.