

Interview with Tim Klusas, President of The Marketing Alliance, Inc.

By Matthew Miller

The following is a phone interview that took place on October 26, 2009. The interview has been transcribed here. Please see the end of the interview for important disclosures.

MM: Tim, please give us a brief description of what The Marketing Alliance, Inc. (TMA) does.

TK: We look at our business as a distribution company and the product that we distribute is life insurance. And so what we try to do is make that distribution faster by making it more efficient and less costly. We try to distribute as much product as possible and have as robust an offering as possible. We look for more productive points of distribution, because if we do all three of those things we'll have a very efficient distribution [system], distributing more products to more people across the country.

MM: When did you join TMA and what did you do prior to arriving in St. Louis? What types of things have you done to improve the business since then?

TK: I would say I had a couple of what I would call experiences or assignments before I came in that were very helpful. The first was that I was a commercial banker making loans to small businesses. That experience gave me a good appreciation for what a small business owner goes through, how tough it is and how lonely it is to run a business, and the things that you can do that have a profound effect on how the companies perform. Secondly, and more recently, before I came to The Marketing Alliance I was working in the corporate development and planning department at Eaton Corporation. Eaton is a Fortune, I believe, 300 company. Eaton is a diversified manufacturer of goods in the trucking, automotive, hydraulic and electrical industries. What I was doing there was working with others on the corporate strategy, trying to articulate where we wanted to go and formulate a plan, and then also working with some of the acquisitions and divestitures that Eaton did as parts of those businesses.

Note: Mr. Klusas joined The Marketing Alliance in April of 2005.

A lot of the things that we've done have been more along the lines of really getting the company to run more like a business. Here are some of those things. Things like establishing a planning culture, where we're looking at the next year and beyond. We have a business plan. We measure how we do against our goals. We evaluate our performance and we're pretty ruthless about the fact that the bar just has to keep going higher and higher and higher. We've tried to establish a minimum standard of performance throughout the company. I think some of the things that the customers have seen are things like the benefits of establishing infrastructure. And we've put all of our sales and marketing activities under one roof. We have all of our business processing activities centralized in another facility, but what we've done is brought those things into one place. And I think we have become a lot more deliberate and a lot more strategic about the things we bring out to our customers - strategic in the sense that we can maximize what we have to offer with what we have to work with.

The best part about it is it doesn't end. We just keep measuring how we've done and raising the bar. Fortunately, we have established a culture of people here who feel the same way.

MM: Please share with us who you compete against and on what terms you compete.

TK: Sure. Obviously, like any business, we compete with many different companies in many different shapes or forms. We have some companies that we compete with that market directly to the selling agent, which is something we've chosen not to do. And the reason we've chosen not to do that is that we look at our customer as what I refer to as the General Agent, someone who has selling agents working with them. Some companies are competing with us on this wholly integrated model, which again we've chosen not to do. We think it positions us more successfully with our key customer, the General Agent. We have other competitors who are groups of other General Agents, like our customers, that band together. We feel like we can compete on better terms because of our commitment to run more like a business. We don't have competing side businesses that we also run that may have dual agendas. This is our full-time job. When everybody's responsible, nobody's responsible. And we've got infrastructure where we can compete with them because they don't have the luxuries of having that leverage that comes with it. Some of the other people we compete with are groups similar to us who organize in different shapes or forms but it seems they really don't have that business focus. It makes it a key differentiator for us.

I'm trying to think of what other terms we compete on. Terms like service, potential areas for growth, or the compensation we pay out and lots of mixtures in between. But it seems the way people see us is really around our key value proposition, which is independence and growth opportunities. And the independence is because with that General Agent that we are doing business with, we don't have a retail side with selling agents so we won't compete with them for selling agents, unlike other companies. And independence because we don't ask that General Agent out there to put business with his competitors or potential competitors. In other words, he or she can do business with us and feel like it's done in a secure, safe way. And it's done with that General Agent out in front of the selling agents, working with them to grow their business. And regarding the growth opportunities, we feel with our infrastructure and the numerous things we have to offer - what we can do is offer more products, more growth opportunities and more sales ideas to our distribution.

MM: How would you describe the company's ability to cope with the current economic environment? Your business has been fairly resistant to date; do you expect that to continue?

TK: We try to match what we do to the current economic environment. You know we actually try to match it more closely to what the consumer is doing. We look at things like unemployment. We look at general consumer sentiment and then look at what is going on out there as far as tax policy and things like that. So we've tried to build this company as flexible as possible for our customers, and that has allowed us to adjust as some of the economic needs have changed. When we look at what is going on with the consumer and particularly when it comes to insurance, we receive study after study that shows us how the public is grossly uninsured [as it pertains to life insurance]. There is a large unfulfilled market out there that needs [life] insurance but hasn't yet bought it. That makes us optimistic about the future.

MM: Does the current financial health of the life insurers you represent give you worry?

TK: I wouldn't say worry. It is always something we look at because I think every business looks at the quality of their suppliers. Here's what we look at when we look at their financial health. We rely on the state regulators, the insurance regulators, and the rating agencies to do their job to tell us about the financial health of each of the life insurers. The thing we're more interested in going forward is whether life insurers will have capital - and obviously a related issue is the cost of that capital - to issue new business. We look at that and some of the changes in the capital markets. That's probably a better indication of their capacity to write new insurance.

MM: Can you speak to the long-term health of your agent base. Does the aging population of agents worry you? How many agents are part of your network and is your agent base something that can grow over time?

TK: The long-term outlook or health of the agent base is something that has been written about extensively in our industry. And it really has to do with that traditional insurance agent - the persons whose job it is to sell insurance 100% of the time. And we think they're right on. It is clearly a concern of ours, for that traditional agent is getting older. And it's a function of the fact that many fewer traditional agents are coming into the distribution. So as a result, the agents that are left are getting older every year. Now there are a couple of counters to that that I think need to be examined. One, you've got insurance being sold from non traditional sources. For instance, banks, credit unions, some CPA's, some attorneys, broker-dealers, stock brokers, and other people who sell insurance part-time that are coming into the distribution. So we don't think you can look at that in a nutshell and say that the whole distribution is not investing in it because we think they are, it's just coming from what we call non-traditional places.

I'm confident we have thousands of agents in our distribution working with General Agents. It would be quite an exercise to actually count because some of the agents are appointed with many companies so you could have some repeat appointments in there. It's not something that we really measure because we look at that as what the General Agent does in their value proposition. They get to decide who they want to appoint and not appoint. I would estimate it into the thousands though. And as far as the ability to grow that agent base over time, it relates to whether the General Agents' businesses are growing. From what we're seeing, many are growing.

It's not something we manage to [number of General Agents]. We're more concerned with the quality of the General Agents we're bringing in. In any given year we're adding and subtracting. Obviously adding ones we think can be productive and subtracting the ones that aren't as productive. We really don't look at that as a significant number because, for instance, if we have 500 and they're not producing we're much worse off than if we have 50 that are.

MM: What is the secret that allows the company to earn the strong returns on capital that it generates?

TK: I'd like to say there's a secret or a secret sauce, but there's really not. It's just profit over capital and trying to be very careful about the capital that we employ in the business. One of the things we look at is to make sure that when we enter new businesses, make sure we can get a decent return on capital, so we're not throwing good money after bad. We think that is just being very disciplined about the kind of things you invest in and making sure the time is right and your capabilities are right when you enter that business. So I can't tell you it's really a secret. We don't think there is anything magical to it.

MM: How would you describe the company's long-term business prospects? Does the company in its current state have the ability to grow at a rate higher than GDP?

TK: We look at the long-term business prospects in two ways: the macro economy and demand for insurance; and then also our ability to answer the challenge to provide the capabilities to meet that demand. As the long term outlook for insurance, I go back to something I mentioned a little bit before about how we see study after study by bodies of research like LIMRA and the Life Insurance Foundation that show us how America is grossly underinsured. There are many people out there who would benefit from buying a simple insurance product to protect their future and their family. Not the least of which now are maybe even less capable of meeting those obligations with what has happened in the economy with job losses or stock market losses or a combination of both. We are also seeing more retirement pensions being reduced. Those things lead us to believe if we, as a

country, were grossly underinsured before, we're even more grossly underinsured now, which leads us to think there is a good long-term prospect out there to provide more insurance to America at large. Now we think the biggest thing for us to do as a company is to make sure we have the tools and processes to meet that demand. And this is where we think we're better positioned by having an infrastructure, by having the means to accomplish very efficient distribution and very fast distribution of insurance products. It's going to be up to us to execute to meet that demand.

MM: Can you share the company's dividend strategy with us?

TK: I could talk about it but I just want to clarify I'm talking about is as a member of the Board of Directors because that's really the Board of Directors' decision, not the operating company's decision nor the CEO's. The Board represents the shareholders; the shareholders communicate to the Board what they want as far as dividend policy and what they're looking for in exchange for the privilege and use of their capital. The Board, when they get that feedback from the shareholder base, votes on a dividend policy or a dividend for that particular year. Our track record is that we want to grow the dividend. We want to grow the dividend every year. We can go back and fact check this, but I believe it's been 20% compounded over the last four years. We aspire to grow that dividend every year and handsomely give back to the shareholders. That aspiration is balanced by other shareholder needs and wants such as things like personal tax deferral or wanting us to go ahead and deploy more of their precious capital in the business to get that high return on even more capital. And all the while making sure we have the capital to run the business.

In the past - and I emphasize in the past, because this is no statement on what's going to happen in the future - the Board has made that decision at the end of the year, and typically its been paid at the end of the year or in January. That has been our past track record.

MM: What are the company's thoughts with regards to its excess capital? How would you quantify that excess capital?

TK: Very good question. We've been fortunate enough to accumulate capital over the last few years. The operations now seem to be operating profitably and have been able to throw off more capital as well. When I look back at the last year, especially the last 18 months, really what changed is that capital became scarce all of a sudden and so it feels good to be capitalized as we are at this particular point in time. So as far as having excess capital, we think it helps us do things in the business. For instance, in implementing our business processing capabilities, that takes capital to get up and running. You accumulate losses before you make it profitable. One of the new offerings that we launched back in 2006 was our annuity offering which is now contributing to the business. So that takes capital to do as well. So vis-à-vis our competitors, we believe having capital allows us to do those projects that you couldn't do without capital or you'd be forced to do it on a shoestring that delays your plan any maybe doesn't make it as viable. So having that capital helps with the business. As far as quantifying the excess capital, I don't know. I've seen many definitions of working capital. I'm not sure which one would be the best, but I'm sure the truth lies somewhere in there if you look at all those different ways to measure.

The voice of our shareholders, which is what we talk about of course when the Board of Directors meets, is part of the conversation when we talk about the future path of the business. They've been very patient with us and they've seen what we've done in the past with their capital and the kind of returns they've gotten on their capital and on their investment. They've been very patient and broad with us as far as what we could do to deploy that capital next. We feel like their expectations are that they want us to invest that capital based on the dividend policy concerns and everything else mentioned before. So we'll continue to look for projects. We don't see any limits on it. We'll look where we can get a very good return on capital, whether that's in the business or outside the business. We haven't received a mandate to say it's either one or the other. We think their biggest

concern is just to make sure we're acting in a good shareholder faith and we're getting a good return for them. We think they've looked at our track record and we feel that we have established some credibility with them.

MM: What are some of the pluses and minuses that come with the fact that The Marketing Alliance is a Pink Sheet company?

TK: Well that's a good question. I think the good points are, clearly, for a company with a market cap of approximately \$12 million, we can have a mechanism for owners to trade shares of the business. I think that's capitalism at its best. I think that's entrepreneurship at its best. And the fact that we can do that with a \$12 million market cap in a business that was started by a dozen or so principals I think is extremely positive. And it is something we really value the opportunity to do.

I think some of the downside of it could be things like sometimes as a Pink Sheet company, I think potential investors make an assumption about the level of your reporting. We've always strived to have the highest level of reporting that we could and that we thought was economically feasible. That's a potential downside. I think another potential downside could be that I think any time you have a company that is traded publicly you've got costs obviously involved that your competitors may not have, so that is a potential downside. It is not onerous by any means and in fact helps us be more transparent.

MM: What do you hope to accomplish with TMA over the next five years? I'm assuming you'll be there for five years.

TK: I'm assuming I'll be here five years too! All kidding aside, the Board and shareholders have always expressed their preference for long-term results over short-term results. You know, it is funny, when I first came here our goal was to improve the operations and we wanted to become the most sought after distribution vehicle for the life insurance industry. It's still that way today and I feel like it's still going to be that way five years from now. Now the day-to-day challenges - the tactical plans, the execution and the strategies - may change, but that's the goal. Let me just articulate what that means for a second. I think that means for our carriers, who are our suppliers, being the distribution source that they'll go to when they plan to launch a new product, when they plan to enter a new market or when they plan to try out a new idea. They'll come to us first because they know we can provide a turnkey solution for distribution; everything from processing the business, to marketing the business and spreading the ideas, to helping them access new markets.

For our customers, the General Agents, I think they recognize with us they can have a broader product portfolio. They can offload some of the administrative costs that maybe prevent them from entering new markets or carrying additional products. Really I think there are lots of benefits for the end consumer: there is more choice; it's efficient distribution; we help them find the right product for what they may be seeking through the General Agents and their agents. I think all are positive, and I think if we can continue to be true to our vision to be that most sought after distribution source and continue to advance our strategy along those lines and continue to pursue that vision, I think that's a good course for us.

MM: Thank you Tim very much for your time.

TK: You're welcome.

Disclosure: Matthew Miller is a portfolio manager at Chanticleer Advisors and the fund Chanticleer manages owns shares in The Marketing Alliance, Inc. It may in the future buy or sell shares and it is under no obligation to update its activities.