HollAnd Advisors

Holland Views: Hiscox– Price: £8.33; MCap: £2.8bn

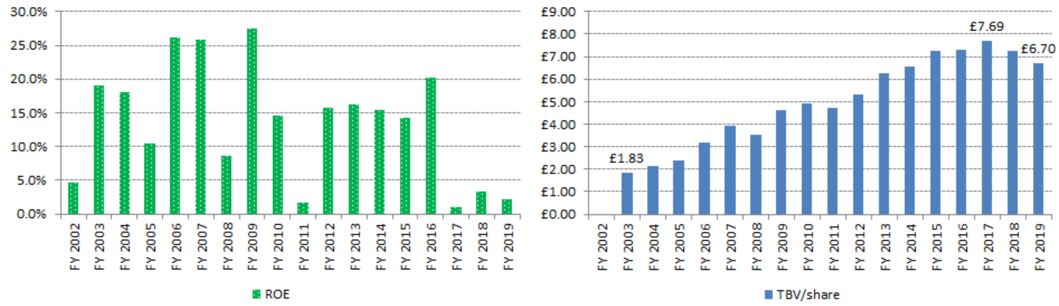
Building a snowball and keeping your word

We present the ingredients of what looks to us a lot like a mispriced franchise business.

This is a UK business that enjoys:

- A long track record of compounding capital: +15% median ROE since 2002 (BVPS compounded at +11% plus + 34% of net income paid out as dividend).

Fig.1: A compounder by any measure



Source: Bloomberg, Holland Advisors

- A track record of prudence and innovation in an industry well known for neither. It enjoys genuine niche/specialist business positioning that is hard to replicate. The industry, dominated by dinosaurs, is ripe for disruption.
- Longstanding management (its CEO in place since 1998) and an envied culture instilled over decades. The business is growing and evolving fast.
- Management that have deftly allocated excess capital into new market developments. Notably, those 15% ROEs above are after a cumulative c.$500m (now c.$90m pa) spent on branding. This brand investment is central to our interest in this share.
- Meaningful *global* growth runway in potential 'snowball' division thanks to "a sector that *is ripe for disruption*" according to its Head of UK. We agree. The new market opportunity has strong analogies with direct-to-consumer pivots that we have studied in other industries. With strong product, brand and distribution, the prospect for this business to gain share (and bypass gouging middlemen) is significant.
- At the same time the core insurance market is finally undergoing a long awaited pricing recovery. After years of over-capacity finally the hardening of rates looks both widespread and lasting. Mr Market however seems less believing.
- All this opportunity is currently over-shadowed by the Covid-19 pandemic and a share price that is back to 2015 levels. Recent fears over business interruption claims and an FCA court cases provide uncertainty yes, but also today's opportunity.
- We think the business is structurally well positioned to continue with it past level of returns and compounded growth. A return to 15% ROE's we think is both reasonable and likely looking at the insurance sector and its retail business prospects. This would justify a share price of £16 three years from now with further compounding to follow.

"It all sounds great – what's the catch?"

The catch, perhaps, is that this franchise is a UK insurance company: **Hiscox Ltd**. As we have said in the past – please don't let a bit of unconventional thinking prompt you to switch off.

> Most of our previous work on insurance businesses built on our study of Berkshire's pioneering use of insurance float to compound capital. That specific work does not apply here.
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> Hiscox's earnings power is primarily centred on its underwriting abilities and the building of a brand. This is a former old school insurer that has evolved and is cementing its new growth prospects.
>
> That said, one area of relevance from our Berkshire work is Geico. Geico is the 800lb gorilla of direct insurance selling and we suggest a template investors should use to think about Hiscox's prospects as a direct seller of insurance to commercial businesses.

We've looked at plenty of great insurance businesses over the years but perhaps it is our work on direct-to-consumer and brand building that was most helpful in identifying Hiscox as a good business.

Bears point to long list of headwinds facing Hiscox shareholders. These including prolonged underwriting losses since 2017, low interest rates that hamper investment returns, 'social inflation' and not least, the ongoing FCA court case. We are cognisant of these risks but we suggest they ought to be seen in context. Particularly in the light of management's long track record of compounding shareholder capital. Also, against the growth prospects of the Hiscox brand, the favourable insurance pricing cycle and that lower starting equity valuation. As ever, you can have good news or cheap stocks, you can't have both. We suggest the news here is not as bad as most think.

In this note, we focus on:

1. Reflections on Hiscox, a business that looks to us a lot like a pedigree franchise
2. What *really* interests us: the brand investment and DTC strategy. Is Hiscox building a snowball?
3. The insurance cycle and FCA court case

Hiscox: a pedigree franchise

If it walks like a franchise and quacks like a franchise….

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

Andrew & Mark **firstname@hollandadvisors.co.uk**

Contact:
Holland Advisors London Limited
The Granary, 1 Waverley Lane
Farnham, Surrey
GU9 8BB

Tel: (0)871 222 5521
Mob: (0)7775 826863
www.hollandadvisors.co.uk

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