Esure

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ESUR

GBP £2.70 Special MED. B

More than just commercial

As covered in our special review last week, many constituents in the general insurance sector have faced earnings pressure in the past few years, with a competitive environment keeping a lid on premium growth. This is as customers have become more selective, facilitated partly by a surge in price comparison websites. Another factor has been that the general incidence of claims across the industry has been trending down which has meant insurance 'supply' has been strong.

We believe however that there are many signs that the earnings headwinds facing the industry are set to abate in the medium term. Competitive pressures and now starting to ease and premiums for many classes of insurance look to have bottomed and are trending back up, with the recent 'weather event' in the UK likely to give things a further boost.

Such an improvement in the environment will provide a significant benefit to insurance companies, and in particular those which are already performing well. In this regard we believe that esure (LSE, ESUR) is a high quality exposure. The company, which listed last March, has a low risk underwriting strategy, well branded products, and is a lean operator which has allowed it to perform solidly in challenging trading conditions. The company therefore has significant earnings leverage in our view to a sustained improvement in premium rates.

From a valuation perspective the shares trade on a forward multiple of 12 times with a prospective yield of 5 percent. We regard this is as attractive and are therefore recommending Esure as a buy to all Members around current levels.

Turning to the charts ESUR has a reasonably short trading history, but the outlook is encouraging nonetheless. After reaching lows of 212p in November prices have swiftly rotated higher, bouncing off the significant 61.8% Fibonacci retracement. More importantly support has been found at previous resistance at 263p. We now expect to see prices move higher towards the 290p region, being the next significant Fibonacci level.

History

Esure Group is a fairly young company having been first established in 2000 by insurance entrepreneur Peter Wood. The company started off selling direct car insurance, and then moved into direct home insurance in 2001. The company also extended its services into insurance brokerage in 2011 offering the products of other selected insurers, but underneath its own brands. The Group also owns 50 per cent of top-four UK insurance price comparison website, Gocompare.com.

The company has two main brands in esure and Sheila’s Wheels. Savvy marketing has seen the customer base of both grow consistently in recent years, with the group having 1.5 million customers all told.

As the company points out these brands have both built up strong identities. Esure has long been associated with the late Michael Winner's catchphrase 'calm down dear, it's only a commercial' which helped it to secure rapid growth in its formative years. Sheila's Wheels was launched in 2005 and has had an equally identifiable marketing campaign behind it.

The company however is not just about marketing, and having been highly successful in attracting customers, has also demonstrated a solid retention rate. A disciplined approach to underwriting meanwhile has also ensure that revenues haven't grown at the expense of quality.

Listing

As far as the stock-market goes esure is a fairly new entrant, having listed less than a year ago. The ride has not exactly been a smooth one for investors, with stock market volatility, industry premium pressures, and a set of maiden results below expectations, combining to ensure that the shares remain below their listing price.

We believe that sentiment is set to improve however, with insurance premiums, including those for motor, esure's key business, back on the rise. The earnings impact of this will be significant for the company which is already writing high quality, and very profitable business on a lean cost base.

Maiden results

Often new listings set themselves up for a fall given the fanfare of the associated capital raising. And it is not unusual to see this play out in a negative fashion when the first set to results are released. Certainly this was the case for Esure.

The company's first set of results in the stock-market were actually reasonably solid with a 16. 9 percent increase in profit after tax up to £44.3 million, on gross written premiums which were up 6.7 percent to £265.4 million, in the six months ended 30 June 2013.

	1H 2013	1H 2012	Movement	FY 2012
Gross written premiums (£m)	265.4	248.8	6.7%	515.0
Trading profit (£m)	65.2	60.8[1]	7.2%	138.1[2]
Profit after tax (£m)	44.3	37.9	16.9%	88.1
Combined operating ratio (%)	89.6	94.4[1]	4.8ppts	92.8[2]
Loss ratio (%)	65.7	70.4[1]	4.7ppts	69.2[2]
Expense ratio (%)	23.9	24.0	0.1ppts	23.6
Investment return (%)	1.1	2.0	(45.0)%	5.2
In-force policies ("IFPs") (000s)	1,855	1,701	5.5%*	1,759
Pro forma earnings per share[3] (pence)	10.6	9.1	16.9%	21.1
Dividend per share (pence)	2.5	nil	-	nil

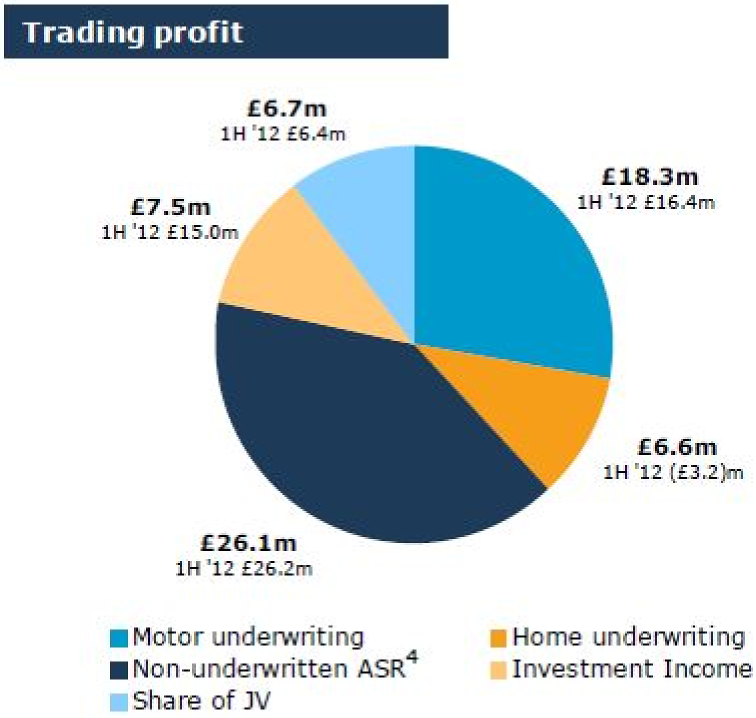
Source: Company 2013 Interim results Presentation

The company also delivered a meaningful improvement in underwriting profitability with the combined ratio (claims+expenses as a percentage of net premiums) falling from 94.4 percent to 89.6 percent at the half year.

So what didn't the market like?

It seems that investors were slightly disappointed by the dividend payout with 2.5p a share been less than expected. **The payout ratio was 70 percent and we believe much more than this would not be particularly prudent.**

The market was also no doubt concerned about the trading environment and the impact on profits (the makeup of which is shown on the graph below), Management also made comments at the interims about the pressures the company was facing, and that premium growth would be lower in the second half (which it has been).



Source: Company 2013 Interim results Presentation

As noted in our sector review last week we believe that there are signs that industry pressures are abating. Motor vehicle premiums for instance were under severe pressure last year falling by 9 percent, but that trend appears to be reversing. The Association of British Insurers reported that reported that average premiums increased 1.4 percent in the December quarter.

A recovery in premiums also gels with the trading statement from esure issued in November. Management stated that they had seen a 4.8 percent increase in gross written premiums year to date to £427 million and the company was on track to meet full year expectations despite a competitive environment. The company has looked to hold the line on pricing and rely on the strength of its two core brands.

Esure reported that premiums in motor (around 80 percent of the total) and home were up 4.8 percent and 4.2 percent respectively year to date, and 1.7 percent and 1.3 percent for the third quarter. The company is now closing on the 2 million mark total policies wise, with 1.906 million in force compared to 1.759 million the year before.

We believe that the evidence from the industry, and the company itself, is suggestive that key premium rates have bottomed. And with the company well placed to continue growing and retaining customers on the back of two strong brands, this bodes well for long term earnings growth in our view. **We expect this to be further confirmed when the group releases full year results next month.**

The outlook for premiums will have also been boosted by the weather in the UK over recent months. We have already seen a number of companies in the sector talk about 'pricing implications' of weather related losses in the UK. This will extend to premium rates in relation to simple insurances such as home contents, and motor.

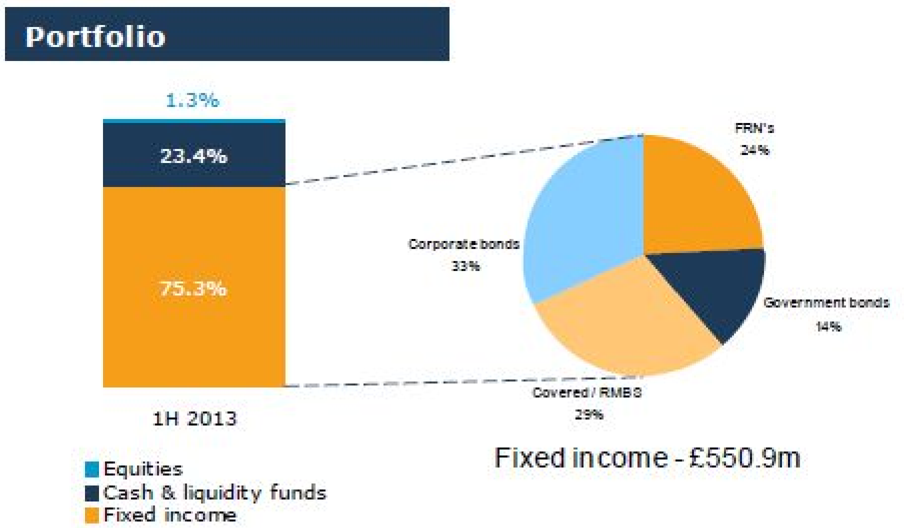
Balance sheet and Capital

Balance Sheet wise esure is robust with no debt. The company also adopts a highly prudent reserving strategy with the total here 15 percent about the 'actuarial best estimate' of claims.

As at the 30 June 2013 (£m)	1H 2013	FY 2012 (Adjusted)	FY 2012
Statutory solvency capital			
Total tier 1 capital	295.4	253.0	287.9
Tier 2 capital	0.0	0.0	50.0
Group regulatory capital resource	**295.4**	**253.0**	**337.9**
Group capital resource requirement	96.4	96.4	96.4
IGD Coverage	306%	262%	351%

Source: Company 2013 Interim results Presentation

It is also worth pointing out the composition of the company's investment portfolio below. The majority of the portfolio is as you would expect in fixed income but the average duration of the portfolio is just 1 year. **This means that esure is well placed to see a gain in investment income over the longer term as interest rates rise.** Although granted our near-term view is that rates are generally going to remain low for the next year.



Source: Company 2013 Interim results Presentation

Summary

Overall we view esure as a high quality play on our expectation of a sustained recovery in premium rates for both motor and home. The company has strong brands, and boasts a disciplined approach to underwriting and a strong track record of profitability here.

From a valuation perspective the shares trade on a forward multiple of 12 times with a prospective yield of 5 percent. We regard this is as attractive and are therefore recommending Esure as a buy to all Members around current levels.

Snapshot ESUR

Esure

Latest Closing Price: £2.70

Market Capitalisation:£1.14b

	FY1	FY2
Price to Earnings	12.0	11.4
Dividend Yield (%)	5.0	6.5
Price to Book	5.6	4.1
Return on Equity (%)	36.4	43.6