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Value Investor INSIGHT

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Ahead of the Curve

The property and casualty insurance industry hasn't been an exciting place for investors in many years. If that's about to change, Springview Capital's Guy Baron offers a considered recommendation for how best to take advantage.

Good investment ideas come in all shapes and sizes, but one not uncommon rendition is when an investor believes he or she has a differentiated view on a particular industry and then identifies the best stock to take advantage of that view. It could be the market leader, the highest-quality company, the cheapest – or some combination of each.

Guy Baron of Springview Capital Management believes the prospects for U.S. property and casualty insurers are looking up. Years of large catastrophe losses, large Covid-related losses and increasing fears over things like climate change and cybersecurity have caused insurers to be more conservative and has tightened capital availability. At the same time, buyers of insurance are looking for increased levels of insurance due to many of the same broad worries. The result, he argues, should be a reversal of the multi-year "soft" market in P&C insurance to a multi-year "hard" market characterized by higher pricing and increased profitability. Rising interest rates would be a cherry on top, increasing insurers' yields on their vast, often short-duration, fixed-income portfolios. "I believe we're already in a really strong recovery, which isn't getting a lot of attention from investors," he says.

His top candidate to capitalize on all this is W.R. Berkley. Founded in 1967 out of the Harvard dorm room of still-Executive Chairman Bill Berkley, the company operates through more than 50 autonomous business units focused to a greater degree than most competitors on writing non-standard policies that require more specialized underwriting expertise and that command higher premiums. Its underwriting track record is first-rate, consistently beating – often by a wide margin – industry-average combined ratios, which compare incurred policy losses and expenses to earned premiums. It also reserves conservatively against policy losses, not incurring an adverse reserve development in 15 years. All that, Baron says, is fully consistent with the long-term shareholder orientation of Bill Berkley and his son Rob, the firm's CEO since 2015. "Bill Berkley still owns more than 20% of the outstanding shares, and as far as we can tell has not sold a share in at least 20 years," he says.

INVESTMENT SNAPSHOT

W.R. Berkley
(NYSE: WRB)

Business: Insurer focused on underwriting mostly commercial casualty risks that are more specialized, complex and infrequent.

Share Information (@1/28/22):

Price	**84.66**
52-Week Range	61.72– 87.07
Dividend Yield	0.6%
Market Cap	$14.95 billion

Financials (TTM):

Revenue	$9.46 billion
Operating Profit Margin	15.1%
Net Profit Margin	10.8%

Valuation Metrics
(@1/28/22):

	WRB	S&P 500
P/E (TTM)	15.4	26.0
Forward P/E (Est.)	15.7	19.7

Largest Institutional Owners
(@9/30/21 or latest filing):

Company	% Owned
Vanguard Group	8.5%
Atlanta Capital Mgmt	5.4%
State Street	4.0%

Short Interest (as of 1/15/22):

Shares Short/Float	0.9%

WRB PRICE HISTORY

THE BOTTOM LINE

The company's track record as an underwriter and its clear shareholder orientation makes it an ideal choice to benefit from a turn in the property/casualty insurance market, says Guy Baron. He estimates the stock by 2025, with dividends, will be worth at least $134.

Sources: Company reports, other publicly available information

Baron's $8 base-case EPS estimate for 2025 assumes net premiums earned grow at a 10% annual rate, the average yield on the investment portfolio increases from just under 3% to just over 4%, and that combined ratios come in around 92%, conservative versus the previous hard market. At a 16x P/E – just under the stock's 10-year average – the shares would then be worth $134, inclusive of dividends, against the recent price of $84.70.

His upside case – which assumes somewhat higher increases in earned premiums and in the investment-portfolio yield, but only a 14x P/E – yields a share price of just over $165. "The stock now trades at a relative P/E to the S&P 500 that is more than one standard deviation below the historical mean," he says. "That to us reflects the past far more than it does the future." VII