H&G High Conviction Fund
The Markets in Three Charts
October 2021

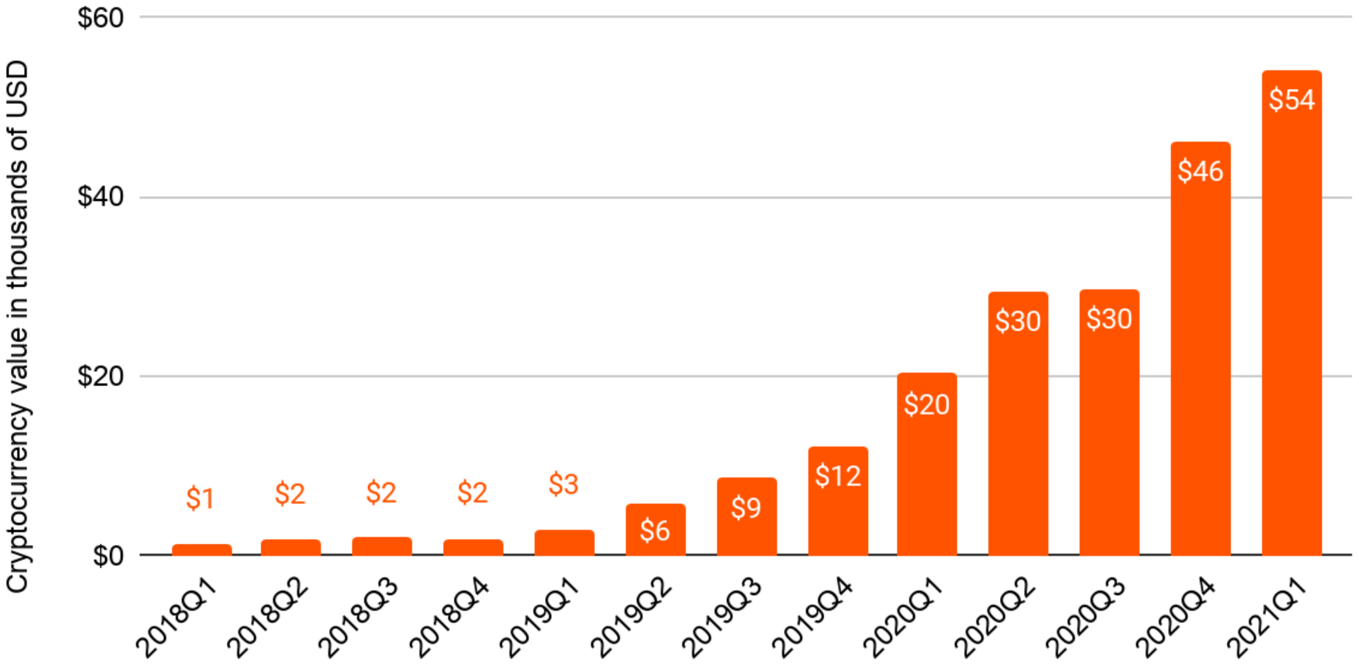
HANCOCK & GORE

Welcome to the October 2021 instalment of The Markets in Three Charts, where each month we present some of our current investment thinking in a social, economic and share price chart.

In this edition, we are focusing on cyber security & insurance premiums, since the Fund has a strategic holding in specialist underwriter Ensurance (ASX:ENA). While the attention on cyber attacks has grown in the media and through education, the flow-through effects have been largely overlooked.

Please note we are presenting general insights into our decision making, not investment advice.

CHART 1 – Average known ransomware payment[1]



Ransomware attacks exploded in 2020 during global lockdowns and show no signs of abating. In a world that rapidly had to shift to working online, businesses and individuals also faced the increasing threat of cyber attacks on the critical infrastructure that allowed them to conduct trade and day-to-day operations in a new, digital environment.

Obviously, cyber attacks are not a new phenomenon, however the number of known payments from victims to attackers has increased dramatically over the last few years. Blockchain analytics firm, Chainalysis, identified over $406 million worth of cryptocurrency paid to attackers in 2020 alone[2].

The economic costs extend well beyond paying these ransoms, to reputational damage, data privacy fines from regulators, and security audits following an attack. It's therefore becoming an imperative to hedge these risks operationally and monetarily.

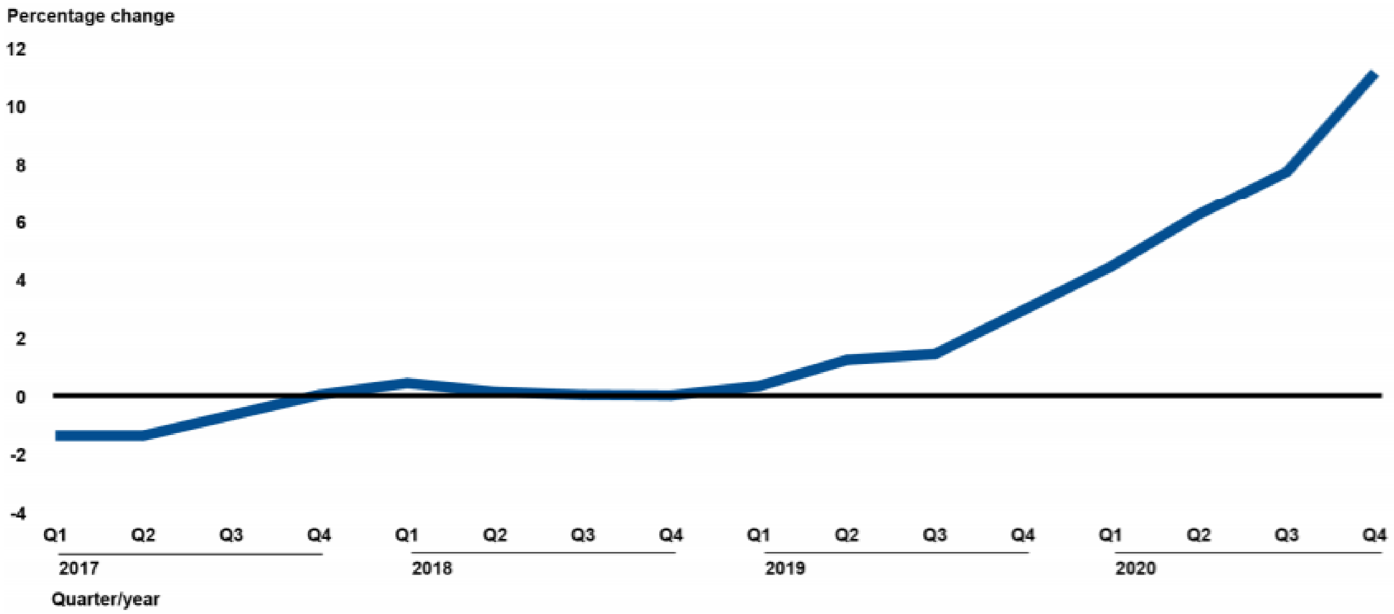
[1] Sourced from: https://blog.chainalysis.com/reports/ransomware-update-may-2021
[2] Ibid.

H&G Investment Management Limited
ABN 45 125 580 305
AFSL 317155

Suite 803
25 Bligh Street
Sydney
NSW 2000

josephconstable@hgl.com.au
www.hancockandgoreim.com.au
+61 431 886 186

CHART 2 – Change in cyber insurance premiums[3]



Source: GAO presentation of data from Council of Insurance Agents & Brokers. | GAO-21-477

As evident, cyber insurance premiums have dramatically increased in 2020, consistent with the surge in average known ransomware payments evident in Chart 1.

The U.S. Government Accountability Office (GAO) is a government agency that provides investigative services for US Congress. In 2021 they undertook an official evaluation of the US cyber insurance market[4].

The GAO found the main drivers of this price trend were:

Increasing take-up – Data from a global insurance broker indicate its clients' take-up rate (proportion of existing clients electing coverage) for cyber insurance rose from 26 percent in 2016 to 47 percent in 2020.

Limited historical data on losses – Without comprehensive, high-quality data on cyber losses, it can be difficult to estimate potential losses from cyber attacks and price policies accordingly. Some industry participants said federal and state governments and industry could collaborate to collect and share incident data to assess risk and develop cyber insurance products.

Cyber policies lack common definitions – Industry stakeholders noted that differing definitions for policy terms, such as "cyberterrorism," led to a lack of clarity insurance coverage. They suggested federal and state governments and the insurance industry work collaboratively to advance common definitions.

For now, this opacity means insurers require greater premiums for taking on relevant risk.

It is our view that these price trends are not transient and that demand for this sort of specialised insurance will only increase in future.

[3] Sourced from: https://www.zdnet.com/article/cyber-insurance-premiums-take-up-rates-surge-says-gao/
[4] Sourced from: https://www.gao.gov/products/gao-21-477

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CHART 3 – Ensurance (ENA) share price over the last 10 years[5]

H&G High Conviction Fund has 3% of its capital allocated in shares of Ensurance (ASX: ENA). The Fund first acquired shares in July 2021 and recently contributed to a placement. In addition, the Portfolio Manager's immediate family holds shares in the company.

What does the company do? Ensurance is an insurance underwriting agency. For the uninitiated, underwriting agencies are specialist insurance businesses that have been given delegated authority to write policies in specialised lines of insurance on behalf of large, general insurers (e.g. AXA), who lack the in-house expertise or require distribution into unrepresented locations. Such lines, which Ensurance underwrites, include professional indemnity, construction, and cyber security. The underwriting model is capital light: it is the larger insurer, rather than the underwriter, whose balance sheet is used. Ensurance takes a clip of the policies they write, known as gross written premium (GWP), and charges an underwriting fee for time spent reviewing the risks associated with setting up the insurance policy.

What has driven share price performance over the last 10 years? As evident, Ensurance's share price has fallen dramatically over the last 10 years. This is largely believed to be due to perceived mismanagement, overpromising, and underdelivering when rolling out a fintech insurance platform. In 2018, Tony Leibowitz (businessman and founder of Pilbara Minerals) became executive chair and initiated a turnaround, selling off the extraneous fintech business and focusing on building the UK underwriting division. Since, GWP has organically grown by 83% p.a. (albeit off a low base) and last year Ensurance UK recorded its first profit, a crucial inflection point. In addition, the Group recently acquired a profitable Australian underwriting agency, which shares key relationships with the core insurer partners of the UK business. The vendor, Tom Kent, is now a substantial shareholder of Ensurance and managing director of Australian operations.

What does the future hold? Tom Kent's key priorities are: (i) distributing Ensurance UK's products into the Australian insurance broker base; (ii) organically growing the existing portfolio by opening new branches on the East Coast, with an office in Sydney opening in January 2022; and (iii) seeking accretive acquisitions in the Asia Pacific region. Accordingly, Ensurance is in a favourable position to capitalise on the likely continued increase in premiums for specialised lines of insurance like cyber security. In a growing market that is currently worth over $10bn across the UK and Australia, its current valuation of $26m appears cheap. Ensurance is the only pureplay underwriting agency listed on the ASX and we believe it has been overlooked by the market because of its chequered past.

[5] Sourced from Thomson Reuters.

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FUND INFORMATION

Fund name	H&G High Conviction Fund
Investment Manager	H&G Investment Management Limited
APIR code	SIA0002AU
Fund inception	November 2007 (relaunched April 2021)
Fund size	A$13m
Fund pricing	Monthly
Fund type	Open-end unit trust
Base currency	Australian dollars
Investor eligibility	Wholesale and sophisticated investors
Trustee	Equity Trustees
Custodian	JP Morgan
Auditor	Ernst & Young
Management fee	1% plus GST p.a. + fund costs capped at 1.05%
Performance fee	20% of benchmark outperformance, with a high watermark, paid annually
Benchmark	5% p.a.
Buy/sell spread	0.4%

Sandy Beard

Chair
H&G Investment Management

Joseph Constable

Portfolio Manager & Director
H&G Investment Management

Iain Thompson

Compliance Manager
H&G Investment Management

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ABN 45 125 580 305
AFSL 317155

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