STEADFAST: A COMPANY THAT HAS CAUGHT OUR ATTENTION

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In the current slow economic environment and where earnings growth is particularly hard to achieve, we look for companies with the above criteria that can achieve earnings growth through a strategy of either restructuring of the company or through new products to increase their market share or through sensible accretive acquisition strategy.

One company that has caught our attention recently is Steadfast, a stock in which we recently became a substantial shareholder.

Steadfast is an industry leader in insurance broking in Australia. It was established as a buying group for independent insurance brokers, in order to provide scale and bargaining power with major insurers. Unlike insurance companies themselves, Steadfast's broking and underwriting businesses take no insurance risk on the company's balance sheet.

CEO Robert Kelly established the company in 1996, and he has over 45 years experience in the industry as a broker, risk manager and underwriting agent. The Steadfast network began by providing technical advice and claims triage, along with tools for servicing clients, professional development and compliance. The insurance broking network quickly grew from 43 brokers in 1996 to become the largest in Australasia.

Currently, Steadfast is a broker network and provider of services to 306 broker businesses and 22 underwriting agencies located in 750 offices across Australia, New Zealand and Singapore with combined billings of over $5bn in premium.

The IPO in 2013 represented a structural change in the business, with Steadfast agreeing to take equity stakes in over 50 of its own network brokers and list on the ASX.

Steadfast has a strong franchise in SME insurance broking and underwriting. The strength of the business lies in the scale of the franchise and the strength of the relationships with the broking network and with insurers. SME insurance broking is a fragmented industry; independent brokers tend to operate out of suburban locations and align with groups like Steadfast, meaning that direct competition is limited.

Steadfast insurance brokers provide an essential, non-discretionary service under a relationship of trust. They sell a complex product, help clients tailor insurance coverage and assist in lodging claims. For this reason, customers tend not to churn.

Steadfast has strong bargaining power with insurers in that they provide a distribution network which cannot be replicated, help insurers communicate policy terms and handle claims. Underwriting agencies represent a complementary part of the business, sitting between brokers and insurers and underwriting specialised or niche lines of business on behalf of insurers.

Steadfast brokers tend to generate recurring earnings as insurance volumes are reasonably insulated from the economic cycle because insurance coverage is a necessity for most SMEs. SME insurance prices also tend to be stable, meaning that commissions to brokers are reasonably resilient through the cycle. Moreover, insurance brokers earn higher fees when they find cheaper insurance options for their clients, which helps to offset falls in commissions when markets are weak.
Steadfast has opportunities for both organic and inorganic growth. Network premiums have grown at over 10% pa for the last 5 years. The market is now at weak point in the cycle with commercial insurance rates declining in the last year. However, in this market Steadfast has demonstrated the resilience of its SME-focused business, outperforming peers and growing earnings through increased market share, cost savings and acquisitions.

Recent acquisitions include several network brokers, along with the Calliden and QBE underwriting agencies. Following these acquisitions, management revised guidance for FY15 cash earnings growth of 22-25%. The run-rate of growth from these acquisitions is just over 30%, providing further earnings growth in FY16.

Acquired businesses remain independently managed and require minimal integration, so they can be viewed as relatively low risk. Having spoken to management at length about their acquisition criteria, due diligence processes and post-acquisition analysis, we have confidence in their acquisitions and believe that they are acutely aware of the risk of destroying shareholder value by overpaying for businesses.

Given the quality of the business and our confidence in the company's earnings, in our view Steadfast represents good value trading at a PE of less than 14x FY16. The balance sheet remains strong, leaving capacity for further acquisitions of brokers in their network, and the earnings outlook is reasonable, despite the softness in the commercial insurance market.

For more insights from Anton and the team at Investors Mutual, **view their profile on Livewire.**