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Dollar Bills for 70¢

InsWeb and Quotesmith

Venture Capital
Bargain Basement

IN OUR MARCH 1999 ISSUE we published "How to Influence People and Sell Insurance—Awful Disclosure: The Annals of Misleading Disclosure." Based on the lack of feedback from subscribers, we've concluded that the article didn't go over well. This was disappointing, for at 14 pages, it was our longest article yet. Perhaps our "problem" was that we chose to focus on financial disasters, failures, and insolvencies during a time of unbridled optimism.

We still think our 14,000-word romp through centuries of financial catastrophes is a fine piece. Our concerns about Frontier, Amwest, and Condor—to name three of many companies we mentioned—seem prescient now. History offers useful information, and we often look at the past when forming our opinions about the future.

In March 1999 we wrote: "Financial institutions, by their very nature, are prone to all sorts of problems, particularly during the busts that tend to follow booms. Whether one chooses to call the current U.S. economic environment a boom, bubble, bull market, or new era, it will, in all likelihood, be followed by what will be known as a bust, bear market, recession, or depression." As an aside, we wrote that "the Internet-stock mania is a good example of a current speculative bubble." We then digressed into "instances of financial hysteria and speculation that are more pertinent to the insurance business."

The New Economy

It seems so long ago, and in a way it was. It was the middle of a "new era" in which that old mantra—"This time it's different"—had been dusted off and put on display. The shackles of the Old Economy had been shaken off, and many were able to convince themselves that in the New Economy, everything was not only possible, but probable.

On July 23, 1999 InsWeb, an Internet insurance marketplace, went public at $17 per share (almost six times what the insiders had paid for their shares) and immediately soared to $44, giving it a market cap of $1.5 billion, a price that struck us as high for a company that had generated $8 million in revenues and $23 million of expenses during the first six months of the year. We expressed our skepticism in our August issue, and took note of the record-breaking 8,477 words that comprised the "risk factors" section of InsWeb's prospectus.

We took another swipe at InsWeb in December 1999, marveling at its billion-dollar market cap and wondering why it was worth twice as much as insurance broker Brown & Brown, which, unlike InsWeb, was quite profitable. (Since then, Brown & Brown's stock has doubled, while InsWeb's has disintegrated.)

We kicked off 2000 with a piece on "E-Madness"—the ludicrous valuations accorded to companies associated with the Internet—and compared those valuations with the bargain-basement, Graham-and-Dodd valuations accorded to dozens of decent insurance companies. We closed our piece with a rhetorical question: "Why buy InsWeb and Quotesmith (which have negligible revenues and a combined market cap of $900 million), when, for the same combined market cap, one can buy W. R. Berkley, PXRE, and United Fire & Casualty?"

That article—or perhaps its sassy tone—even prompted an angry letter from a subscriber we like. Don't go sticking your nose into the Internet business, about which you know nothing, he wrote.

Much has changed during the past year, which raises a new question: why buy W. R. Berkley, PXRE, and United Fire & Casualty (whose stock prices have now benefited from a cyclical upswing and have a combined market cap of $1.55 billion), when, for three percent of that figure one can buy InsWeb and Quotesmith, which are worth a meager $42 million?

One reason to prefer the insurance companies is that they're unlikely to run out of money anytime soon. Another reason is that they're almost certain to show respectable earnings this year.

InsWeb and Quotesmith, admittedly, are cash-guzzling moneylosers with uncertain futures. There can be no assurance that they can ever make money, that they can raise funds to continue their operations, that their technology won't become obsolete, that anyone will want to use their services three years from now, that their key employees won't go to work for companies that have a greater perceived longevity, or that their computers won't develop irreparable viruses.

Despite these risks, we've made modest investments in both companies. We paid 69¢ per share for InsWeb and 87¢ per share for Quotesmith. (At Tuesday's close, the stocks were at 81¢ and 72¢, respectively.)

Although both companies stand a fair chance of disappearing from the face of the earth, as investments they have certain merits: it's always possible that these online quoting services may catch on, achieve profitability, or get bought by someone who thinks that they will catch on or achieve profitability.

What especially attracted us, however, was the companies' balance sheets. We'll examine InsWeb's briefly. As of September 30 it had $55 million in cash and short-term investments. Subtract total liabilities of $9 million and you're left with $44 million. Assuming that InsWeb lost $9 million in the fourth quarter, cash will be reduced to $35 million, to which we can add $3 million of accounts receivable, bringing net cash and cash equivalents to $38 million, or 90¢ of net cash per share. (When InsWeb completes its merger with Intuit's QuickenInsurance, it will have 42,000,000 shares outstanding.)

Although buying InsWeb at 75% of net cash strikes us as a reasonable proposition, it's hardly a license to print money. InsWeb *expects* to lose money for awhile. If it doesn't reduce its losses or create value, it may end up as a ward of the bankruptcy courts.

Quotesmith's financials are reminiscent of InsWeb's. The company has \$1.39 of net cash and receivables per share, versus a stock price of 72¢.

Investing in either InsWeb or Quotesmith involves a high degree of risk, including the very real chance of losing one's entire investment. On the other hand, these two companies have spent \$160 million to get to where they are today, and they're selling for less than their cash. (One can't *start* a business for less than cash.)

If running an online insurance quoting service or insurance agency proves to be viable, these two companies might be survivors.

At 70¢ on the dollar, we like the odds.

Editor and Writer .... David Schiff
Production Editor .... Bill Lauck

Publisher .... Alan Zimmerman
Subscription Manager....... Pat LaBua

Editorial Office
Schiff's Insurance Observer
300 Central Park West, Suite 4H
New York, NY 10024
Phone: (212) 724-2000
Fax: (212) 712-1999
E-mail: David@InsuranceObserver.com

Publishing Headquarters
Schiff's Insurance Observer
SNL c/o Insurance Communications Co.
321 East Main Street
P.O. Box 2056
Charlottesville, VA 22902
Phone: (804) 977-5877
Fax: (804) 984-8020
E-mail: Subscriptions@InsuranceObserver.com

For questions regarding subscriptions please call (804) 977-5877.

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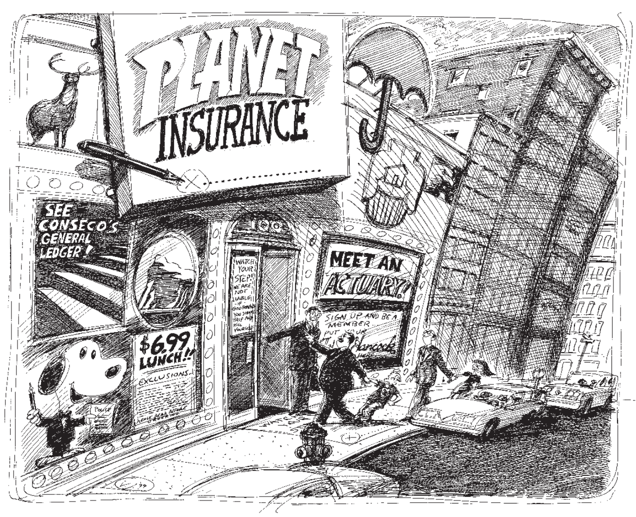

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