

## Unico (A Hidden Gem)

I spent last Thanksgiving in Vegas. Not very traditional, but my grandmother lives nearby (we weren't gambling with your life savings ☺) and was hosting over 30 for Thanksgiving dinner. It was wonderful to have so many family and friends together in the same place. We all had plenty to be thankful for! Despite being on vacation, my thoughts never stray far from investing. Perhaps like a professional poker player, it's just in my blood. But there is a difference between gambling and investing. With a little hard work, an investor can actually turn the odds in his/her favor. That's why this past fall I was very thankful to have the opportunity to do a little grass-roots research on one of our holdings. A close family friend, who I have known all my life and who has been in the insurance market in California for nearly 50 years, was able to validate one of our recent purchases. I know we've found a real opportunity when I can pair a sound investment case with a great testimonial from someone I trust who has first-hand knowledge of the company. That is exactly what we have in Unico American Corporation (stock symbol: UNAM).

You might recall that in our [February newsletter](#), we shared some thoughts on the volatility in the current markets and how CUSH builds its portfolio to address this. We also gave a brief preview of this March newsletter when we said we would share some in-depth analysis on one of our holdings.

### Unico American Corp (UNAM)

**Unico American Corporation (UNAM)** is a small, relatively unknown California-based property and casualty insurer that does business under the brand name **Crusader**. We see Unico as a good example of a company with a sound business plan, a strong

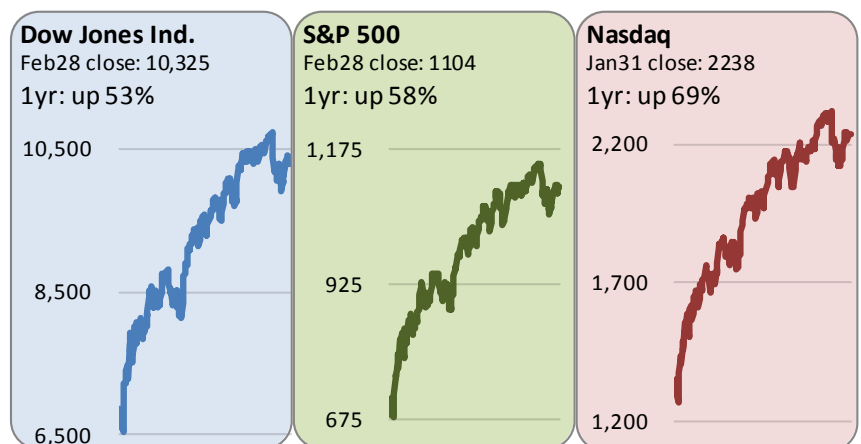
management team, and a stock price that is trading well below its true value. Basically, in Unico, we can purchase an investment-grade portfolio (consisting primarily of U.S. treasuries) for roughly 70 cents on the dollar. Add to that a high-quality insurance operation (run by a capable, highly incentivized, and shareholder-friendly management team) thrown in for free, and you can see why we can't pass this up! This is an example of the "Faberge eggs" we scour the market for to put in our basket. It's also the payoff for the kind of diligence and patience that distinguishes CUSH.

Unico is an example of what we call an obscure microcap, which receives very little notice on Wall Street. Few analysts recommend a company as closely held and as infrequently traded as Unico. The indiscriminate selling of all things small/financial during the market meltdown, in combination with Wall Street's newfound aversion to all things illiquid, has resulted in a wide variety of microcaps still selling at markedly depressed prices. But like most things, not all microcaps are created equal. So, just as with any good due diligence effort, there are a few things to consider:

**1) Management's history of pricing its policies** - Unico's management has an impressive paper trail of quality underwriting.

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Source: Cush Capital Management, LLC / Yahoo Finance

Consider that during the “soft” market of the last three years - a cuthroat period where many competitors were writing unprofitable policies to achieve top-line growth targets - Unico remained focused on profitability. This willingness to sacrifice market share allowed the company to remain consistently profitable and grow its book value in one of the most difficult environments on record. Note: Unico’s combined ratio (a measure of profitability where lower is better) over the last three years has varied between the mid sixties to the mid eighties. For our readers unfamiliar with the industry, this is very, very good! By comparison Allstate had a combined ratio of 96 in '09 and 99 in '08.

**2) Loss Estimates** – As insurance companies collect premiums they simultaneously estimate “loss reserves,” or monies they expect to pay out in future claims. Unico has a history of being very conservative in estimating these numbers. This bolsters our conviction in management and reduces the risk that the company will experience the type of nasty surprise that are so common with undisciplined insurers. Since 2001, Unico has consistently reported lower losses than original estimates. This adds to earnings.

**3) Intelligent Investing?** Our analysis of Unico’s ability to effectively invest its float (premium portfolio) showed some surprisingly positive results. For example, their float is currently comprised almost entirely of short-duration, low-yielding U.S. treasuries. We feel that their present positioning is prudent; after all, why stretch for yield or extend duration in today’s uncertain, low-interest-rate environment? Owning a high-quality, short-dated portfolio of treasuries goes a long way toward ensuring that their balance sheet will remain fortress-like and intact under any scenario short of Armageddon. At the same time, by simultaneously insisting on short-duration assets, Unico management ensures they will remain flexible enough to capitalize on a rising rate environment. We believe rising

interest rates are a certainty -- it’s not a question of if they will rise, but when, how fast and how far? The bottom line here is that, looking out a few years, Unico’s investment portfolio is not only conservative, but perfectly positioned to do well in most any environment.

**4) Valuation** – With a tangible book value (TBV) of \$13.86 per share and a current price of ~\$9.50, UNAM is priced at a roughly 30% discount to its TBV (91% of which is comprised of U.S. treasuries). Investors in UNAM are effectively purchasing t-bills at a 30% discount! But it gets even better! Not only are investors essentially buying completely risk-free assets at a deep discount, they are getting a high-quality, consistently profitable insurance business for less than free. This is a good business, run by top-notch owner/operators with a proven ability to generate profits and a long history of shareholder-friendly stewardship. Moreover, margins are depressed industry wide. This should reverse sharply over the next few years. Perhaps this is why management (who already own roughly 60% of the company) recently reactivated its buyback program and has been aggressively buying back stock.



Valuation	
Stock Price	9.50
Price target	17.00
% discount to target	-44.12%
Price-to-Book	68%
Shares outstanding	5.4 mm
Market Cap	52 mm
Debt	0
Enterprise value	26.3 mm

**5) Risk Factors** – Despite what otherwise might seem like a wonderful investment opportunity, nothing is without risk and these need to be unearthed as well. While most of

the traditional risks involved with Unico (i.e., underwriting risk) have been addressed above, other risks merit consideration:

**Liquidity Risk** – Unico is an illiquid microcap, so clearly a position needs to be sized accordingly.

**Catastrophe Risk** – Along with management’s history of intelligent underwriting, we note that they do not write earthquake policies and their wildfire policies are written nowhere near areas where wildfires are a real risk. Moreover management has entered into re-insurance contracts to protect the firm from unforeseen events.

**Ratings Downgrade** – Not a material concern with Unico, considering the conservative underwriting posture of this firm and their outstanding track record. In fact, A.M. Best, a leading insurance industry rating agency, recently **upgraded** Unico, which will allow it to write more policies and on better terms.

**Asset Quality** – Typically this is a risk for insurance companies, but given the composition of Unico’s investment portfolio and conservative loss reserves this is not of great concern.

#### **A Hidden Gem?**

A business with the qualitative and quantitative characteristics of Unico should never trade at a throw-away price. Again, this is a good business with a proven, capable management team that has been able to consistently underwrite profitable business. UNAM’s management team has an impressive paper trail of intelligently underwriting risk, being conservative with its capital, and avoiding large investment losses. Equally important, they have cultivated a culture that focuses on disciplined underwriting and improving long-term shareholder value, rather than focusing on growth at all costs. They don’t worry about quarterly results or growth targets, just profitable underwriting and the risk-averse investment of capital for the benefit of shareholders. We find that to be

a rather attractive (and rare) combination! It doesn’t seem like much of a stretch to conclude that this team has the right combination of discipline, independence, and expertise necessary to build a sustainable franchise in an industry as highly competitive as insurance.

With historically low interest rates, and a portfolio that consists primarily of short-duration treasuries, the present amount of interest income that the investment portfolio throws off is incredibly depressed. Yet, when interest rates begin to rise, these short-dated assets (as they mature) will be quickly available for reinvestment at higher, more attractive yields. This will substantially boost interest income.

Although we can’t predict when the market will harden, we can predict that at some point it absolutely will! Because management refuses to write unprofitable insurance, the top line is destined to contract during periods like the present. Luckily, soft markets cannot last forever, and when the insurance market begins to firm, we expect both pricing and volumes to ramp considerably – substantially boosting profits.

As today’s headwinds become tomorrow’s tailwinds, it won’t be long before the combination of rapidly accelerating earnings and the recognition of Unico’s AAA asset base leads to a higher stock price. The bottom line here is that Unico should trade at a premium to book value. A multiple of 1.3x seems reasonable to us. This implies a fair value of approximately \$17.00 for a company that currently trades at about \$9.50. Not too bad.

We hope that this analysis serves as a good example of the kind of research and dedication we put into building portfolios to best serve our clients. While Unico may be a rare gem, this type of due diligence is typical for all of our investment decisions. We think it distinguishes us from the pack. If you agree, please forward this to a friend. Your partnership is always appreciated. •

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## Our Mission

CUSH Capital seeks to educate our clients about the market and serve as trusted advisor. By customizing and tailoring financial plans to each client, we strive to create a shared vision of your future. CUSH Capital provides our clients the tools and resources to implement this future. This is only made possible by our independence, which eliminates conflicts of interest and allows us to act as a fiduciary in all matters. We recognize the great depth of our responsibility with regard to our clients' financial future, and we don't take that lightly. Ultimately, our goal is to assist our clients in creating the most secure, comfortable and meaningful lives for themselves and for their families. In every way, in all that we do, we are committed to serving our clients with discretion, honesty, and integrity.

## The Strategy

At our core we are value investors, but in truth our philosophy so clearly differs from that of the herd. We have little difficulty distinguishing ourselves from the frenetic hyperactive trading strategies profiled on the financial news channels and common to so many other advisors. We offer a better alternative by selecting high quality stocks and bonds for the long-run. This low turnover, tax efficient approach is considered one of the most successful techniques for compounding wealth ever created. The key points are:

**1) Targeting businesses with long-term sustainable competitive advantages.** This allows investors to compound gains and avoid excessive transaction costs. (Short-term selling and reinvesting can substantially eat up profits due to trading costs and tax consequences compounded over time).

**2) Recognizing that stocks are businesses with an intrinsic value that correlates to success in the longer-term.** This intrinsic value CAN be measured, but it takes serious work to do that well.

**3) Knowing that it is rare to find a great company with a sustainable competitive advantage trading at a discount to its intrinsic value.** When these opportunities present themselves you have to be prepared to invest with conviction.

## Vern Cushenbery, CFA, CPA Chief Executive Officer

I founded CUSH Capital to deliver my clients the kind of trusted financial advice and portfolio management that is so rare in the financial community.

My years of experience in consulting allowed me to audit the portfolio strategies used by the very best. There is no substitute for hard work in this business -- no secret sauce. The only way to succeed in the long-run is to do your own research and think for yourself because if you follow the crowd or get caught up in the confusion of the financial press, then you are certain to fail.

CUSH Capital pioneered the concept of **wholesale investing**. We do our own research; we don't outsource, we **in-source**. Not only does this keep us independent, but it also lowers your fees. I publish this newsletter to keep clients involved and informed. I invite you to become a part of our team. Visit our website to subscribe to this newsletter today, or call me. I will be happy to answer any questions about your financial future.



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Sincerely,

A handwritten signature in blue ink that reads "Vern". The signature is written in a cursive, slightly slanted style.

Vern Cushenbery, CFA, CPA

Mr. Cushenbery has more than a decade of experience in portfolio management and research. He was formerly Chief Investment Officer with Legacy Investment Management, and prior to that he was with the Buffalo Funds. He holds an MBA and a Masters of Accountancy degree from the University of Missouri at Kansas City, and a BS in Finance from Kansas State University. As a CFA Charterholder and Certified Public Accountant, Vern is uniquely qualified as an investment advisor.

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