

December 10, 2010

Dear clients and colleagues,

While in recent years, most companies seem to have turned to emerging markets for growth, mature markets, such as the U.S. or Europe, continue to offer tremendous opportunities that a certain group of companies should not overlook. That is the case for Homeserve (HSV).

HSV operates in the home assistance market where it provides emergency insurance policies and property repairs business to households. It covers areas such as plumbing and drainage, boiler and heating and electrical. Its products are directly offered to homeowners, landlords and appliance manufacturers. It has also designed products in collaboration with affinity partners such as utility companies to distribute its policy membership products. While the company conducts business mainly in UK, it has entered continental Europe and the US in recent years. Those markets represent a tremendous growth opportunity for HSV.

Target market size

The European and U.S. home emergency service is a vast underpenetrated market. In the US alone, it has the potential to tap into 128 million households. Currently, there are only 9 million households that hold some kind of emergency policy. HSV, with close to 800,000 U.S. customers, is well positioned to benefit from this massive market.

Competitive advantage

HSV offers strong value added to its customers and utilities partners. It is hard to find a reliable and affordable tradesman in an emergency situation and the cost associated with such repairs can be excessively high. Homeserve has also been very successful in launching new products such as the aerial & satellite and locksmith services they introduced recently. HSV offers a broader product offering than that of other big utility companies or smaller competitors. It has a dominant position and a healthy balance sheet to support its expansion.

Growth strategy

The penetration of emergency insurance in the U.S. and Europe is very low and HSV will benefit from its scale and expertise. Keep in mind that close to 86% of homeowners have suffered a domestic emergency at some point, but home emergencies aren't covered by most household insurance policies. Cross selling is another opportunity for growth. For instance, it sells only 1.3 policies per customer in the U.S as compared to 2.3 in the U.K. The company wants to intensify its partnership with utility companies and manufacturers. In the U.S. there are 51,000 water companies and 1,000

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electricity companies and we expect HSV will continue to grow by striking affinity deals with some of these. Finally, the company plans to expand its business to other countries such as Canada, Germany and the Benelux region.

Risk

The industry is somewhat exposed to the real estate and the retail environment. HSV could face difficulties in attracting new affinity partners which would translate into slower future growth. A too-aggressive expansion campaign could impact the pricing of its policies. Potential erosion in its customer retention rate could become an issue in some markets.

Investment theme

The themes we have identified for Homeserve include outsourcing and security.

Valuation

Based on a WACC of 10.5% and a terminal growth of 1.5%, our target price is £5.50.

www.homeserve.com

Market cap: £1470 million; P/E (forward): 16.2x; EV/EBITDA (forward): 9.5x; net debt to EBITDA: 0.5x;
Free cash flow yield: 5.0%.

Regards,

The Global Alpha Team

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