

## Guidewire Software, Inc. (GWRE)

Guidewire Software, Inc. (GWRE) is a provider of software and data services to the property and casualty insurance (P&C) industry. The company's products cover the three primary operational functions of an insurance provider: policy, billings and claims. Guidewire also offers data and analytics services that allow its customers to run their businesses more effectively. The company was founded in 2001 by a team that included current Chairman Marcus Ryu. It became a public company in 2012.

P&C insurance companies provide coverage on assets (cars, houses, etc.) as well as liability insurance for accidents and injuries. It is one of the oldest products in the financial services category, and due to the nature of the risks and leverage involved, the industry has an established history of conservative underwriting and investment practices. Of course, consumers of insurers appreciate a conservative approach; if your house has burned down you don't want to find that your insurance company can't pay the claim because it wrote too many policies or invested your premiums irresponsibly.

Unfortunately, this conservatism has often carried over to operations and customer service. P&C insurance companies have become prone to taking an "if-not-broken-don't-fix-it" approach to the adoption of new processes and technologies. As a result, much of the insurance industry runs on very outdated technology which is costly to maintain and very inflexible. These systems are characterized by the famous "green screens" of mainframes (think early computing systems of the 1970s and 1980s). While still robust, these outdated systems offer little flexibility which means new products (such as different policy offerings to meet new risks, like cybersecurity) can take months or even years to come to market due to the need to finely customize ancient systems.

It is imperative that insurers upgrade their technology, and not just because they are running on old, expensive-to-maintain systems. An inability to fully understand risks increases instances of fraud, and not having a complete view of customer needs means being at risk of customer churn.

Insurance is unique among financial services in that, unlike other industries, insurers largely didn't migrate toward outsourced processing where there is a collective advantage as processors compete and face pressure to innovate. While financial services lags other industries in terms of digital transformation, even banking (another area that heavily uses outdated tech) is considered ahead of the insurance category. Each insurer developed its own bespoke systems with complicated rules and customizations. As these systems aged and new customizations and extensions were stacked on top of prior ones, the cost in terms of money and lost time to market became more burdensome. Insurers needed a modernization solution. But until Guidewire arrived, most of these "fixes" consisted of highly customized solutions which took years (as everyone reinvented their own "wheel") and didn't always use the most modern technology.

The Guidewire founders believed they could upgrade the technology of the entire insurance industry by moving off mainframes and into modern programming languages running on industry-standard servers. The company started with its ClaimCenter product in 2003 and then developed PolicyCenter and BillingCenter in 2004 and 2006, respectively. Collectively, the company refers to this as the Guidewire InsuranceSuite which is targeted toward larger insurers. Through an acquisition in 2017, Guidewire offers smaller insurers a complete suite through its InsuranceNow product. Sales cycles were (and remain) long as prospective customers were reluctant to adopt new technology. It took Guidewire until 2011 to reach the 100-customer mark. By the end of the 2021 fiscal year, it had over 350 customers. Today, the company is the clear leader in providing insurance software, and the long sales cycles and conservative nature of the customer base provides an element of competitive advantage.

Although Guidewire software represents a step change in terms of modernity and flexibility, many customers have yet to adopt the company's full suite across all operations. As a result, despite now being in business for over 20 years, there is still a large revenue pool available just in Guidewire's existing client base. The company estimates that just over a quarter of P&C industry premiums written today use at least one of the Guidewire InsuranceSuite products. This somewhat underestimates the opportunity, as a client using ClaimCenter is counted as premium that has been "modernized," but even with such a client, there is still an opportunity to adopt BillingCenter and PolicyCenter.

As software began "eating the world" (in the words of entrepreneur and software engineer Marc Andreessen), disrupting traditional industries around the world, and as consumption moved to cloud-based systems, the insurance industry was slow to demand a cloud solution. As a result, Guidewire focused on giving customers what they needed and were demanding. That is why Guidewire didn't initially emphasize a cloud product, although it developed a version of the software that could be run on cloud computing services such as AWS and Microsoft Azure. While there were several early adopters of these cloud-based services, by 2018 Guidewire's clients signaled a willingness to move to a more robust cloud solution.



### **BARTON HOOPER, CFA**

Director of Equity Research

Barton Hooper, CFA, joined Weitz Investment Management in 2007. Prior to joining the firm, he was a research analyst at Oak Value Capital Management and Trilogy Capital Management. Prior to his investment management experience, Barton worked at George K. Baum & Company and was a certified public accountant at Deloitte & Touche LLC. Barton has a bachelor's in accounting from the University of Missouri and an MBA from Washington University in St. Louis.

One bottleneck to cloud adoption is that Guidewire's customers, even as they adopted InsuranceSuite, insisted on heavy customization. Doing so meant that customers were repeating earlier mistakes, because they would slowly fall behind the latest release. This all stems from a belief within the insurance industry that IT systems represent a proprietary component of their offerings. In other industries this point of view has given way to an argument that software and IT infrastructure should be standardized as much as possible to allow for speed, low cost, and flexibility. Doing so allows for a focus on customer needs and innovation – regardless of the industry. Insurers are slowly coming around to this perspective, which is why there is a greater willingness to adopting cloud solutions as implementing a true cloud product means high levels of standardization and reliance on the software provider to build desired features that serve the entire customer base. This can be done because new features can be pushed to users more quickly because the code base is the same across customers.

In 2019, former Salesforce executive Mike Rosenbaum joined Guidewire as CEO, a move that heralded a significant shift in Guidewire's development and approach to the cloud. Rosenbaum had a deep understanding of technology platforms and customers' need for digital transformations. He set to work applying this knowledge to Guidewire's opportunity. The company introduced the Guidewire Cloud platform with the Aspen release in spring of 2020. Aspen has been followed with a new release approximately every six months. Adoption of Guidewire Cloud has been measured but steady with 13 customers signing on in 2019, 26 in 2020, and 52 in 2021. Some of these customer wins are new to Guidewire, while others are current customers of Guidewire's on-premise software who are moving at least part of their systems to Guidewire Cloud. We believe there is a substantial runway of customers who will move their current Guidewire implementations to the cloud, along with the large untapped base of insurers who have yet to move to any sort of modern software.

Guidewire has a substantial lead in terms of market share over its nearest competitors, Duck Creek Technologies (a public company) and Majesco (private). The success of Guidewire Cloud gives us confidence that the company will at least maintain its market share. While our investment doesn't depend on Guidewire becoming a monopoly provider, we do believe the company's shift to the cloud creates an opportunity to expand share. As more customers move to the cloud, Guidewire should see positive flywheel effects from the benefits of having the most customers on the same version of software with frequent updates. Customers will get more value from the software as features are added more quickly and they are able to better utilize the data Guidewire provides. Happy customers deriving more value should result in longer lifetime value and increased consumption of additional modules.

Guidewire's stock price has yet to reflect the opportunity we believe lies ahead for the company. While there was uncertainty about the quality and acceptance of Guidewire Cloud, we believe those issues are mostly resolved as more customers sign up and systems integrators build practices which extend Guidewire's sales and implementation reach ahead of its competitors. We acknowledge that there are open questions about execution and the pace of adoption, but our due diligence suggests Mr. Rosenbaum is a strong leader who has built a talented team focused on leveraging Guidewire's advantages. While adoption is out of the company's control, P&C insurers are just like companies in just almost every industry – they need to undergo digital transformations sooner rather than later or face serious trouble from competitors who have moved. This backdrop provides a long-term tailwind which we believe will grow Guidewire's business value. As a result, Guidewire is a strong representative of the Weitz Quality at a Discount framework in action – a market leader with strong growth prospects, led by a team that has multiple opportunities for reinvestment. We believe these facts will result in strong forward returns for our clients.

As of 03/31/2022, the following portfolio company constituted a portion of the net assets of Balanced Fund, Hickory Fund, Partners III Opportunity Fund, Partners Value Fund, and Value Fund as follows: Duck Creek Technologies, Inc. (DCT): 0.0%, 0.0%, 0.0%, 0.0%, 0.0%; Guidewire Software, Inc. (GWRE): 0.0%, 3.1%, 0.0%, 2.3%, 0.0%; Salesforce, Inc. (CRM) 0.0%, 0.0%, 0.0%, 0.0%, 2.7%.

Holdings are subject to change and may not be representative of the Fund's current or future investments.

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