HELIOS UNDERWRITING

Timing its growth with the insurance cycle

Over the last few months, Helios has transformed itself. Having raised £64m, and acquired over £10m of additional capacity, it has greatly increased its ability to add to its exposure to its desired Lloyds syndicates. It can do this through continuing to acquire new vehicles, increasing its retention by reducing its quota share arrangement, or obtaining tenancy agreements with existing syndicates. The timing for doing this looks ideal: after several years of losses, premium rates have been increasing strongly since 2018. Notwithstanding the recent COVID-19-related claims, the prospects for improved underwriting results are very good.

- **Strategy:** Helios has aims to build a portfolio of exposure to high-quality syndicates at Lloyds of London. Its primary method for executing this has been to buy out Names through the limited liability vehicles (LLVs) through which they now conduct their business, generally acquiring these at a discount.

- **2020 interims:** The interim results reflected a mixed pattern. While the 2018 and 2019 underwriting years showed a positive development, reserving for COVID-19 losses in 2020 reduced underwriting income to £154,000. Helios made a small loss of £96,000.

- **Valuation:** Post the November fundraise, the adjusted NAV per share was 151p. Helios currently trades at a 13% premium to this book value. Helios management views NAV per share as a key metric, and aims to grow it over time. It will take a little while to see the financial benefits of the increased balance sheet.

- **Risks:** While increased premium rates bode well for underwriting profitability, and Helios has reinsurance protection, it is still subject to the usual variations in claims. The final effect of COVID-19 remains uncertain in some areas, and there are the usual ongoing risks of large adverse events.

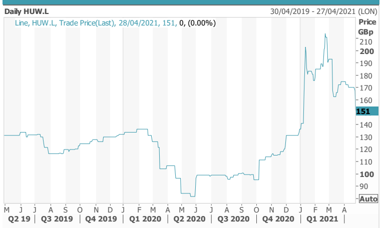
- **Investment summary:** Although it will take a couple of years for the full effect of the larger balance sheet to come through, Helios appears to have increased this at the right time in the insurance cycle. With the benefits of premium rate increases to come and increased share liquidity, we believe it has some attractions for investors.

Financial summary and valuation

Year-end Dec (£000)	2016	2017	2018	2019
Net earned premium	22,908	29,426	30,952	42,688
Claims	-12,805	-18,032	-18,972	-27,624
Expenses	-11,788	-13,107	-12,933	-17,528
Pre-tax profit	779	-1,305	327	4,287
Total assets	109,431	117,920	173,242	179,938
Net assets	22,519	21,010	21,045	28,148
EPS (p)	6.2	-4.8	3.1	25.6
DPS (p)	5.5	1.5	3.0	0.0
NAV/share (p)	154	139	139	153
P/E (x)	24.5	-32.1	48.6	5.9
Dividend yield	3.6%	1.0%	2.0%	0.0%
P/NAV	1.0	1.1	1.1	1.0

Source: Hardman & Co Research

Non-life insurance



Source: Refinitiv

Market data

EPIC/TKR	**HUW**
Price (p)	**170.0**
12m High (p)	214.0
12m Low (p)	81.7
Shares (m)	67.8
Mkt Cap (£m)	115.2
Adj NAV (£m)	102.3
Free Float*	65%
Country of listing	UK
Market	AIM

**As defined by AIM Rule 26*

Description

Helios Underwriting is a corporate Lloyds vehicle that is building a portfolio of exposure to high-quality syndicates.

Company information

CEO	Nigel Hanbury
CFO	Arthur Manners
Chairman	Michael Cunningham

www.huwplc.com

Key shareholders

ILS Capital & associated funds (Tom Libassi)	19.3%
Nigel Hanbury	13.6%
Other directors	2.1%
Hudson Structured Capital	18.6%
Polar Capital	14.2%
Will Roseff	7.7%
Ardnave Capital	4.2%

Diary

May 2021	Annual results

Analyst

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Strategy

Aiming to add exposure to desired Lloyds syndicates

Helios aims to build a portfolio of exposure to high-quality syndicates at Lloyds of London. Its primary method for executing this has been to buy out Names through the LLVs through which they now conduct their business.

As Names age, and with some recent underwriting losses, their desire to exit makes this an attractive option for Helios, which can acquire these vehicles at a discount to their underlying value. From a Name's perspective, there are few buyers in the market, with Helios being the largest, and the main alternative is to close down the LLV, which is not tax-efficient. Any gain on purchase also contributes reverse goodwill to earnings.

The acquisition of each LLV gives Helios rights to the following:

- A share of future underwriting profits/losses in the underlying syndicates, plus the investment returns, pro-rata with its capacity ownership. This includes returns from any open years (Lloyds closes underwriting years after 36 months).
- The net assets in the LLV.
- Pre-emption rights, whereby it automatically gets a pro-rata share of any increase in capacity at no cost. This represents a substantial saving over buying at auction.

Recent fundraising and acquisitions

Raised £64m across two fundraisings plus acquired four LLVs

The latest accounts (Jun'20 interims) list 38 corporate vehicles that Helios owns, with at least half a dozen more having been acquired since then. Over the past couple of years, Helios has grown its balance sheet quickly. In particular, the last six months have seen two significant fundraisings, a summary of which is given in a table on page 4.

The Nov'20 issue was combined with the acquisition of four LLVs; the executive directors held an interest in three of these. As well as £6.96m of shares, the consideration included £2.37m of cash, of which £1.17m was retained by Helios to repay an intercompany loan. This leaves the executive directors with no underwriting exposure outside the company, reducing potential conflicts of interest. Terms were set by the non-executive directors and were subject to shareholder approval. The 120p issue price was dilutive to net assets, but the benefits were judged to offset this.

These were bought at an average discount of 21% to the Humphrey's Valuation (which includes the net assets, the auction value of capacity and adjustments for open underwriting years). We understand that this is a larger discount than may be expected for future acquisitions.

The Mar'21 raise was much larger, at £55m. In aggregate, the amount raised, less consideration (pre-expenses), across the two fundraisings was £64m. Given that the net assets at the Jun'20 interims were £28m, these have been transformative in terms of scale. This also brought in some credible institutional insurance industry investors.

Getting the right syndicates

Helios seeks exposure to high-quality syndicates…

While there are usually a number of LLVs available at any one time, Helios aims to have exposure to high-quality ones. While Lloyds has effectively closed many of the worst-performing syndicates, Helios rightly looks for capacity in the better ones. For the 2021 underwriting year, it started with exposure to 20 different syndicates; the syndicates managed by the top eight agents represented 83% of capacity.

The ideal LLV acquisition will most likely have exposure to these syndicates. However, Helios expects to do some management after purchase, selling unwanted capacity in auctions and focusing on its desired syndicates.

Current activities

Helios's capacity in past four underwriting years				
£m	2018	2019	2020	2021
Retained at 17/11/20	27.6	23.3	21.1	
Reinsured at 17/11/20	38.2	39.0	49.1	
Retained – acquired post 17/11/20	8.5	8.0	9.7	
Retained at 31/3/21	36.1	31.3	30.8	58.6
Reinsured at 31/3/21	38.2	39.0	49.1	51.6
Total capacity 31/3/21	74.3	70.3	80.0	110.3

Source: Hardman & Co Research

Reinsurance policies

…but needs to manage exposure carefully

With its small capital base, Helios needed to be careful to manage its exposure appropriately. A key part of this has been the use of reinsurance, the largest part of which has been a quota share arrangement. Up to the 2020 underwriting year, 70% of capacity was reinsured at the start of the year. The larger balance sheet allowed this to be reduced in 2021 to just under 47%. The expectation is that retentions will increase further in 2022, although the amount will be contingent on the amount of acquisitions this year.

In addition to the quota share, Helios has a stop loss policy, which kicks in when overall losses exceed 5% of capacity. This also covers any potential solvency gap. A bank facility of £4m is in place, if required.

Acquisitions effectively increase retentions. The capacity from open years at the time of purchase is usually not reinsured. However, the purchase price is adjusted for the forecast performance – so net exposure is effectively reduced.

Financial results

Insurance cycle been challenging in last few years, but Helios has outperformed market

The insurance cycle has been challenging for the last few years. 2017 saw a combined ratio for Lloyds as whole of 114%. While 2018 and 2019 were better, losses are still expected for these years. Helios has outperformed the market in each of the last six years. For 2018, the final result was a loss of 0.3%, against a market average loss of 5.9%. For 2019, the latest mid-point estimates are a Helios loss of 2.15%, versus a 5.19% loss for the market – a 3% outperformance.

COVID-19 claims have adversely affected development…

Generally, Helios expects years to improve as they develop. Managing agents are incentivised to show that they are adding value by reducing claims, so tend to be conservative with initial estimates. This was not the case for 2019, as COVID-19 claims adversely affected development. Helios estimates an additional 5% on its combined ratio for 2020 as a consequence of COVID-19 on event cancellation lines. There may be further employment and health claims to come.

…but underwriting losses have had positive effect on premium rates

These underwriting losses have had a positive effect on premium rates. Since the start of 2018, premium rates have increased by 28%, with 10.5% in 2020 alone, and Lloyds seeing "positive rate momentum continuing in the first quarter of 2021". While the pandemic has cost money, these higher rates bode well for profitability in the next few years.

Until 2018, Helios paid a base dividend of 1.5p per share, increased by special dividends, as appropriate. Recently, it announced that the dividend would be reinstated with a base of 3p. Surplus over salaries, reinsurance and the base dividend will be paid as a special dividend, or reinvested if opportunities are available.

Financial summary and valuation

Year-end Dec (£000)	2016	2017	2018	2019
Net earned premium	22,908	29,426	30,952	42,688
Other revenue	3,019	1,242	1,561	4,891
Claims	-12,805	-18,032	-18,972	-27,624
Expenses	-11,788	-13,107	-12,933	-17,528
Pre-tax profit	**779**	**-1,305**	**327**	**4,287**
Reported taxation	-66	611	129	-233
Underlying net income	713	-694	456	4,054
Underlying Basic EPS (p)	**6.22**	**-4.75**	**3.14**	**25.64**
DPS (p)	5.50	1.50	3.00	0.00
P/E (x)	24.5	-32.1	48.6	5.9
Dividend yield	3.6%	1.0%	2.0%	0.0%
Balance sheet				
Intangible assets	10,732	12,175	16,051	21,178
Financial assets	45,580	48,074	58,075	67,151
Reinsurance assets	12,222	17,190	26,755	30,783
Cash	6,212	2,844	12,202	6,037
Total assets	**109,431**	**117,920**	**173,242**	**179,938**
Claim reserves	50,087	59,833	88,032	95,616
Unearned premium	16,821	15,916	24,772	26,522
Borrowings	0	1,094	9,196	2,000
Net assets	**22,519**	**21,010**	**21,045**	**28,148**
Number of shares (m)	14.6	15.1	15.1	18.4
Book NAV/s (p)	154	139	139	153
Helios adjusted NAV/s (p)	196	160	190	206
P/book NAV	1.0	1.1	1.1	1.0
P/adjusted NAV	0.8	1.0	0.8	0.7

Source: Hardman & Co Research

Fundraisings since last interims (Jun'20)

	Gross amount (£m)	No. shares (m)	Price (p)	Comment
Nov'20 – placing, subscription and offer	11.7	9.75	120	
Nov'20 - acquisition of 4 LLVs	9.32	5.79	120	Cost includes £2.37m cash
Mar'21 – placing and offer	54.8	34.24	160	

Source: Hardman & Co Research

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The full detail is on page 26 of the full directive, which can be accessed here: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF

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