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Helios Underwriting

Increased Lloyd's participation at the right time

Initiation of coverage

Insurance

24 February 2022

Price **160p**

Market cap **£110m**

Net cash (£m) at 30 June 2021	62.1
Shares in issue	68.9m
Free float	47.6%
Code	HUW
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(8.6)	(3.0)	(24.2)
Rel (local)	(7.5)	(3.6)	(31.4)
52-week high/low		211p	143p

Business description

Helios Underwriting was established in 2007 (as Hampden Underwriting) primarily to provide investors with a limited liability direct investment into the Lloyd's insurance market. It is an AIM-quoted holding company, providing underwriting exposure across a diversified portfolio of selected Lloyd's syndicates.

Next events

FY21 results	5 May 2022

Analyst

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Edison profile page

Helios Underwriting is a research client of Edison Investment Research Limited

Helios Underwriting is a successful aggregator of Lloyd's of London (Lloyd's) syndicate capacity, delivering a sixfold increase since FY16. This larger portfolio, alongside a hardening underwriting cycle, should fuel strong earnings growth. Helios's ability to acquire further limited liability vehicles (LLVs), offering ageing Lloyd's Members (Names) an elegant, tax-efficient exit plan, is limited by capital constraints. This will slow capacity growth until FY24 when the hard premium cycle should deliver strong earnings, unless Helios can raise additional capital sooner. Increased funding could fuel strong acquisitive growth for Helios in the remaining £3bn pool of LLV capacity. Helios's underwriting investment track record, diversified, outperforming underwriting investment portfolio, ability to enhance capital efficiencies (through diversification and reinsurance) and its long-term growth potential makes it an attractive investor entry point into Lloyd's and a unique exit solution for individual Names from Lloyd's.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/20	52.6	(0.9)	1.6	3.0	100	1.9
12/21e	76.1	(1.3)	(0.4)	3.0	N/A	1.9
12/22e	128.5	6.0	6.9	3.0	23.2	1.9
12/23e	168.7	15.3	17.0	6.0	9.4	3.8

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Large capacity uplift into a turning market

Helios's appeal as a way for Names to exit Lloyd's, led to increased deal activity from FY18, with £34m of underwriting capacity added to FY20, followed by a record £35m of LLV capacity in FY21, all at fair value discounts. Helios also added £88m of capacity in 2021 via pre-emptions, Lloyd's auctions and so on, increasing exposure to the underwriting upturn. The 111% higher £233m start-2022 capacity will only impact results from FY23 as Lloyd's accounting convention back-ends profit releases. We forecast FY23 EPS of 17.0p and NAV of 182.4p/share, with return on NAV (RONAV) rising from 10% in FY23 to c 14% in FY24 and FY25.

Working capital is key for capacity growth

Capacity growth is very capital intensive as acquisition costs and Lloyd's capital requirements need funding. To sustain its strategy of material LLV consolidation annually, Helios needs more working capital than it can generate internally. The improving pricing cycle could release regulatory capital and other options can be pursued, but accessing capital markets should provide a funding bridge until the portfolio matures and Helios becomes self-funding from FY24.

Valuation: 212p/share with capital deployment upside

Strong earnings growth and returns support our valuation of 212p/share at a 33% premium to FY21e NAV/share (a 33% premium to current price). There is valuation upside if more working capital can be generated and deployed in underwriting capacity growth, boosting value drivers. Issuing debt is most valuation accretive, followed by raising capital, while higher quota share reinsurance is largely neutral.

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Investment summary

A growing portfolio of Lloyd's superior underwriting

Helios Underwriting is an AIM-quoted holding company established in 2007 (as Hampden Underwriting) to provide investors with a limited liability direct investment into the Lloyd's insurance market. Helios's attraction to investors is twofold. First, it offers a unique opportunity to invest directly in a diversified portfolio focused on higher-quality Lloyd's syndicates, benefiting from underwriting results and investment return on underlying capital. Second, it has a proven track record of growing its portfolio through actively acquiring interests in syndicates, provided it has sufficient capital resources. Its attraction to current **Lloyd's** Names, which own exposure through individual LLVs, is that it provides an elegant and tax-efficient exit option, or allows them to convert their Lloyd's exposure from an illiquid LLV to a much more liquid and diversified investment in Helios itself. **Lloyd's managing agents** find Helios attractive as they can diversify their capital via a single, large capacity provider which is not a competitor.

Helios's lifeblood is **'**underwriting capacity**'** (capacity), which gives it the right to participate in the premiums that syndicates write and the underwriting profits they generate. The gross written premiums (GWP) of a syndicate may not exceed capacity, so top-line growth requires capacity growth. Helios can grow its own underwriting capacity, and has been doing so, by participating in **Lloyd's** auctions**,** buying directly from other holders of such capacity or supporting new syndicates. A key measure of performance is return on capacity (RoC), which is calculated as the cumulative underwriting profits earned on the level of deployed capacity during a particular underwriting year (January to December). It takes 36 months from capacity deployment in a particular underwriting year of account (YOA) until the final RoC can be measured, but the yearly RoC build-up can be monitored through quarterly syndicate updates.

An important store of value for Helios is the value of the capacity fund or weighted-average value (WAV), which is carried as an intangible asset on the balance sheet. It is industry practice to place a value on the capacity owned, which is held and marked-to-market annually based on the publicly traded (in the **Lloyd's** auctions) prices for each syndicate and applied on a weighted-average basis. The FY21 value was disclosed at £60.1m, which is a 4.6x increase over the past four years, driven by LLV acquisitions, organic capacity growth in Helios's existing LLVs (pre-emption capacity) and a large revaluation in FY21, reflecting the higher prices paid in the 2021 auctions.

The operational upside of Helios is well supported by Lloyd's market dynamics and the outlook for improved RoC. After declining rates since 2014, Lloyd's has seen cumulative rate rises (premium increases) since 2018, in excess of 30%. Helios has consistently outperformed Lloyd's for all closed YOAs since 2013. This outperformance is forecast to continue (by Helios and us) and we expect a meaningful recovery from the negative RoC in the 2017 and 2018 YOAs, and a small profit for 2019. We expect healthy increases in the RoC from the 2020 YOA, consistently rising to c 12% for the 2022 and 2023 YOAs, which will emerge in FY24 and FY25.

The operational upside that we forecast for Helios will have a much larger impact on its value as a result of its significant capacity grab in FY20 and FY21, with the timing well aligned to the high RoC YOAs that we expect for 2021 and 2022. However, because Helios has a strategy to use all surplus free working capital at the end of each year to fund capacity growth, and did so in FY21 (as noted above), this depleted the large cash resources it acquired in its March 2021 capital raise of £54m (after costs). Operational performance should add £14.5m to working capital over the next two years (FY22 and FY23), allowing for an ordinary dividend of 3p/share. After funding additional capital requirements by Lloyd's, including following its pre-emption rights to participate in syndicate capacity growth, we estimate there is only room to grow capacity by c £5m per year through acquisitions over the next two years (3% to 4% including organic syndicate growth).

Lloyd's solvency capital requirements must be physically deposited in the Funds at Lloyd's (FAL) and are determined by Lloyd's after assessing the underwriting outlook for individual syndicates and the level of syndicate members' balances (broadly the net assets on syndicate balance sheets). This is more cautious than the rest of the insurance industry where insurers have the freedom to determine their own appropriate solvency cover range with reference to a regulated minimum. The combined FAL and members' balances at Lloyd's have steadily crept up from 69.5% of total GWP in 2012 to 81% in H121 (77% from FAL and 4% from members' balances). There is an argument to be made that current FAL requirements (plus members' balances), which are 4% higher relative to GWP than the 10-year average and 10% higher than the 20-year average, could moderate if underwriting improvements are sustained and supported by lower solvency cover ranges for the wider insurance industry. If Lloyd's moderates its solvency requirements, significant working capital releases could be possible.

The large capacity acquisitions in FY21 increased the diversification in the Helios portfolio, resulting in the company receiving a larger diversification credit from Lloyd's. This drives a lower level of required capital relative to capacity than in the past, reducing the FAL increase required post acquisitions. This explains why the Helios FAL will look low relative to the total Lloyd's position. Helios also has some options of its own to boost working capital, including the use of reinsurance, enhanced gearing and raising further capital. Although we take a conservative stance in our base case, we consider the risk to be on the upside and test the impact of stronger working capital generation on our forecasts and valuation in the sections below.

Valuation: Over the cycle valuation of 212p per share

Managing the underwriting cycle is key to Lloyd's underwriters and property and casualty (P&C) insurers in general. Helios has successfully negotiated the latest downcycle, which is forecast to turn to healthy profitability in coming years, while also significantly increasing its capacity and therefore its exposure to this upturn (starting with a large GWP increase for the hard-market 2022 YOA). Our valuation, based on an over-the-cycle RONAV versus the price/NAV approach is 212p/share. This represents a 33% premium to our forecast FY21 NAV/share of 160p and is 33% ahead of the current share price. We have also calculated a valuation based on a dividend discount model with explicit forecasts to FY25, producing a similar result. Our valuation is well supported by an earnings recovery to 16.8p/share by FY23 and a RONAV of 10%, rising even further in FY24 and FY25 if the strong anticipated 2022 and 2023 YOA RoCs are delivered.

Financials: Upcycle forecast to boost RoC

Helios had a bumper profit in FY19 with a welcome combined ratio improvement to 96% for its underwriting portfolio, largely due to lower losses on the 2019 YOA (large losses were a feature of both FY17 and FY18) and supported by negative goodwill on LLV acquisitions as well as a reversal of syndicate impairment charges. The COVID-19 pandemic reversed Helios's fortunes in FY20, affecting both open years (2019 YOA and 2020 YOA) and increasing the underwriting portfolio combined from 96% in FY19 to 103% (versus Lloyd's at 110.3%). The parent company contribution was less supportive than in FY19, with additional stop-loss protection costs, continuing quota share reinsurance insurance losses (see explanation under Exhibit 1) and low interest rates offsetting the gains from the profitable sale of capacity in the Lloyd's auction.

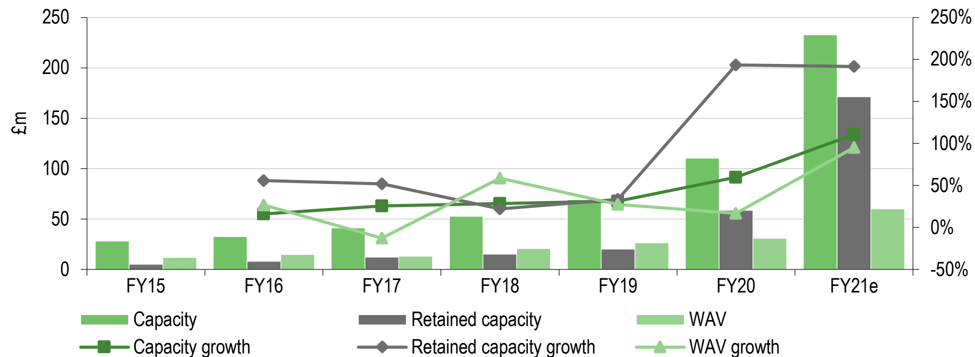
We forecast a combined ratio improvement to 95% in FY21, from a weak base in FY20, but still reflecting a bottom-of-the-cycle hangover, with the claims ratio for YOA 2020 elevated and profit for closed YOA 2019 depressed. The record large LLV acquisitions in the year are expected to produce healthy goodwill on bargain purchases to offset the large increase in stop loss reinsurance costs (put in place to protect against adverse claims experience and to manage solvency capital) and very weak investment returns. We expect a small loss of 0.4p/share in FY21, affected by a one-off deferred tax charge relating to the increased UK corporate tax rate from April 2023, which affects all

companies. However, after a NAV/share decline in FY20, the company is forecast to deliver an increase to 160p/share for FY21.

There are reasons for optimism, which drive our forecast earnings improvement to 17p/share and NAV/share to 182.4p/share by FY23, with ROC delivery of 1.8% in FY22 (from the closed 2020 YOA) rising to 12.4% in FY24 and 12% in FY25 (2022 and 2023 YOAs). These are:

- On 22 December 2021, Helios disclosed its 2022 YOA capacity is £232.8m, an 111% year-on-year rise, accompanied by a 95% increase in the WAV fund (57% from LLV acquisitions, 22% from revaluation on higher auction prices, 7% from pre-emption capacity and 9% from capacity purchased in the auction). This meaningfully increases its participation in the improved results expected for the 2022 and 2023 YOAs.
- Quota share reinsurance has been cut to 26% of FY22 business and will trend down for other open years as additional acquired capacity is wholly retained. While the quota share change reduces the reinsurer share of FAL provided to Lloyd's (and hence increases Helios's net FAL), it gives Helios a larger share of expected positive underwriting profits while quota share profit commission should resume as YOAs become profitable.
- Lloyd's results have turned sharply from combined ratios above 100% from FY17 to FY19 to 97% (ex-COVID-19) in FY20 and 92% in H121. Syndicate forecasts for 2019 and 2020 YOAs have improved returns for eight of the top 10 syndicates in which Helios has positions.

Exhibit 1: Capacity growth

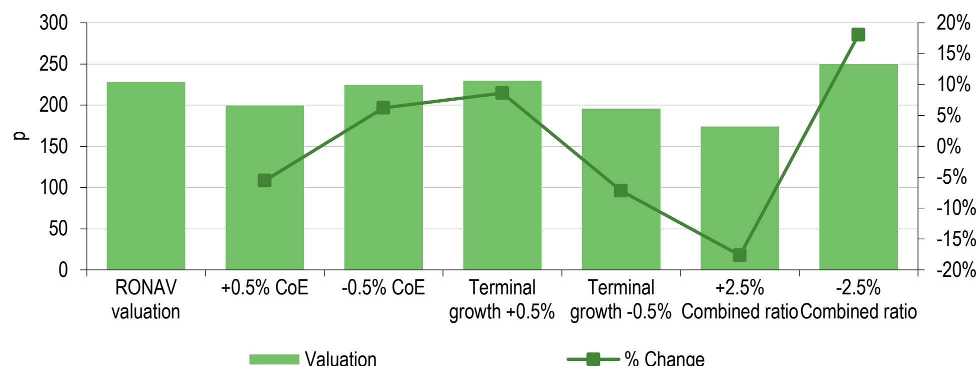


Source: Helios, Edison Investment Research

Sensitivities: Debt and/or equity funding enhances valuation

In addition to the standard sensitivities typically tested, we include additional scenarios relating to working capital generation, LLV acquisition and solvency.

Exhibit 2: Standard valuation sensitivities



Source: Helios, Edison Investment Research

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Our valuation rises/falls by 6% for every 50bp change in our cost of equity assumption, while changing our terminal growth rate by 50bp gives a 9% increase and 7% decrease. The valuation is very sensitive to the combined ratio: a 2.5% change would affect the valuation by 18%.

Our calculations show that an increase in LLV capacity acquisition of 1% of opening capacity in each year from FY22 to FY25 would require an additional £13.0m of working capital over and above our base case. This working capital effect is proportional and increasing capacity growth from 6% to 10% pa requires additional funding of £54m over four years, from solvency efficiencies or capital and debt markets. Full- or part-payment by share issuance reduces the working capital impact. Adding LLV capacity is also value additive and under this scenario (without changing other assumptions to fund the additional working capital) it adds 4% to our valuation. We test the combined effects below.

We demonstrate that for every 2% relaxation of Lloyd's capital requirements, a cumulative £14m in working capital would be released (over four years), while increasing quota share from c 27% to 32% would release a similar amount. Deploying this additional working capital to fund LLV acquisitions leads to a 4% valuation enhancement if relaxed Lloyd's capital requirements are the source, with the quota share reinsurance route less accretive. Lower quota share reinsurance is value accretive, but needs working capital to fund.

Issuing debt is more value accretive than raising equity capital, but there is a limit to the debt facilities available to Helios with its current equity base. Using the current £10m undrawn debt facility to add a one-off 10% of LLV capacity increases our valuation by 9%, with more uplift requiring NAV growth and higher borrowing facilities. A capital raising of £50m or c 40% of the current market capitalisation at FY21 NAV/share allows a one-off 38% increase in capacity and adds c 4% to the valuation with every 10% premium to NAV/share adding a similar amount.

Company description: Unique Lloyd's exposure

Helios is a holding company that owns capacity on 20 Lloyd's syndicates/managing agents, which allows it to participate in the underwriting results of these syndicates. Its exposure is on a limited-liability basis and is backed by underwriting capital that it must deposit in the FAL akin to the solvency margins that all insurance operations hold. It participates in syndicate underwriting results based on the share of capacity (which is the upper limit of GWPs that may be written in an underwriting year) that it owns in the syndicate and must contribute capital in the same proportion, varying between syndicates based on underlying risk.

Helios has actively increased its participation in Lloyd's over recent years by acquiring LLVs and the associated syndicate capacity they participate in, by buying capacity in the Lloyd's auctions and by subscribing to **tenancy capacity**. The latter only provides access to a particular YOA, does not provide guaranteed renewal for subsequent YOAs and does not attract a value, but does require Helios to provide the capital required to write business. However, it can provide the opportunity to dip in/out of underwriting certain risks when the return is forecast to be particularly attractive.

Helios has been particularly successful in aggregating LLVs at attractive prices, which have been below the NAV raised (LLV NAV acquired plus the WAV created for the acquisition) and Humphrey & Co valuations over the past four years (Humphreys is well recognised for providing independent valuations of LLVs' underwriting portfolios). This has allowed it to achieve healthy capacity growth, which will drive strong growth in GWP and increased access to underwriting results.

Management and strategy

Helios has a very light corporate structure, relying on external service providers for most of its operations. Nigel Hanbury, chief executive and chairman of Hampden Agencies (HAL) until 2009, became Helios CEO in October 2012, after the acquisition by Helios of HAL-advised NameCo 917

from his wholly owned Upperton Holdings. Nigel has responsibility for Helios's underwriting and investments. The finance and operations functions are overseen by Arthur Manners, who is CFO. Both Hanbury and Manners have considerable Lloyd's experience ranging from broking, underwriting and member agencies to having their own LLVs with Lloyd's exposure.

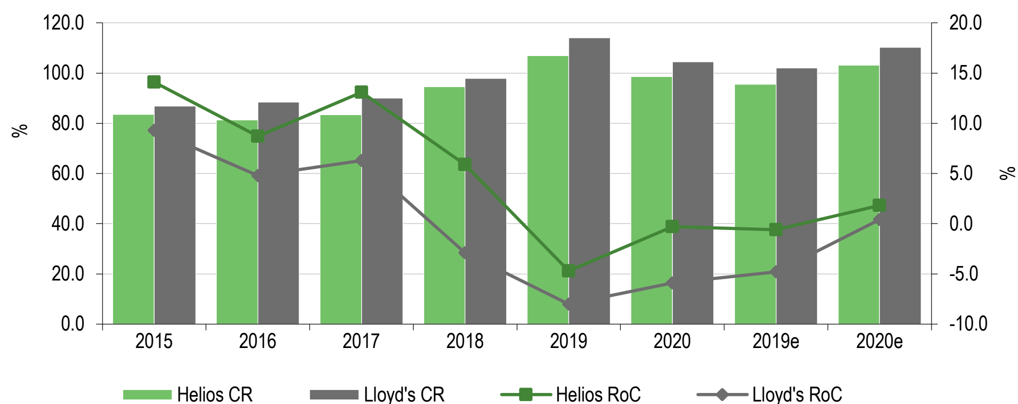
Hanbury has redefined the Helios strategy to 'underwrite at Lloyd's with improved capital efficiency, lower risk and higher return'. To this end, the existing portfolio of syndicates has been refined; active selection of better performing syndicates is an important way for Helios to seek to add value compared with the overall Lloyd's market return, there is a wide spread of performance across syndicates and Helios has been particularly successful at creating and developing a portfolio that has consistently outperformed the Lloyd's market as a whole since the 2013 YOA.

This focus has recently shifted from moderate growth and portfolio selection to aggressively growing capacity, primarily through the acquisition of LLVs. The experience, network and dealmaking skills of the management team have been borne out in numerous acquisitions at discounts to fair value. Additional value has been added to these acquisitions through capital efficiency with the use of quota share and FAL-funding excess of loss reinsurance allowing for the release of FAL in the case of most acquired LLVs.

Diversified syndicate exposure outperforming the market

Helios has outperformed Lloyd's from a combined ratio and RoC point of view since 2013 thanks to careful portfolio selection. Recent increases in solvency efficiency through diversification could add to this trend of outperformance.

Exhibit 3: Comparison of Lloyd's and Helios's combined ratios (CR) and RoC by YOA



Source: Helios, Edison Investment Research. Note: Combined ratios on left axis and RoC on right axis.

In association with its Lloyd's adviser, Hampden Agencies, Helios curates this portfolio on a year-to-year basis. Its tactical management of its portfolio considers likely market conditions for the coming year and the re-balancing needed as newly acquired LLVs are added. In the same way as a trading member of Lloyd's, Helios was offered pre-emptions that amounted to £10.7m for 2021 and £6.1m for 2022. Helios buys and sells capacity in the Lloyd's auctions to optimise its portfolio each year.

In 2021, Helios diversified its portfolio even further with the addition of Blenheim Underwriting, reducing its proportionate exposure to all the other syndicates.

Exhibit 4: Helios portfolio – start of 2022 (£m)

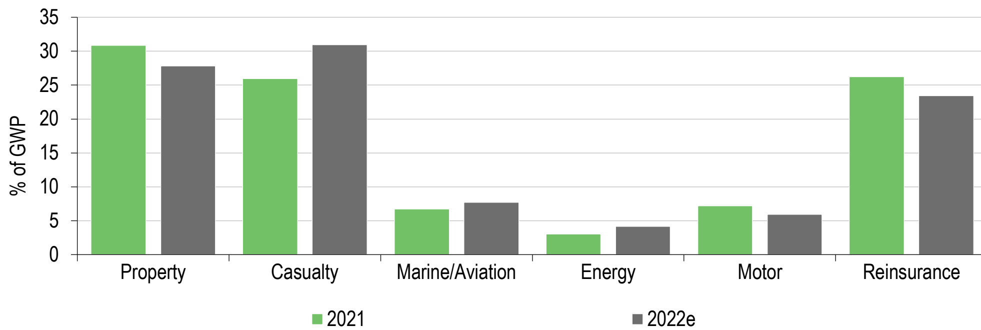
Syndicate	Managing agent	2020 capacity	% of total	Capacity added in 2021	2021 capacity	% of total	% change
510	Tokio Marine Klin Ltd	16.8	15.2	15.5	32.3	13.9	(1.3)
5886	Blenheim Underwriting		0.0	22.5	22.5	9.7	9.7
623	Beazley Furlonge Ltd	13.0	11.8	8.6	21.6	93	(2.5)
33	Hiscox Syndicates Ltd	8.7	7.9	5.1	13.8	5.9	(1.9)
4242	Beat/Asta	8.0	7.3	4.6	12.6	5.4	(1.8)
609	Atrium Underwriters Ltd	6.8	6.1	5.3	12.1	5.2	(1.0)
Subtotal		**53.3**	**48.3**	**61.7**	**114.9**	**49.4**	**1.1**
Other		**57.0**	**51.7**	**60.7**	**117.7**	**50.6**	**(1.1)**
Total		**110.3**		**122.4**	**232.7**		

Source: Helios, Edison Investment Research

The second reason Helios outperformed Lloyd's on both combined ratio and RoC metrics in recent years has been its tactical use of quota share reinsurance, reducing its capital needs and allowing it to add additional capacity in attractive areas. The solvency efficiency it increasingly derives from diversification provides the company with more options for such selective capacity additions.

Helios's relative size and market position allows it access to quota share reinsurance deals that may not be available to all other Lloyd's participants. As market conditions improved, Helios has reduced the proportion of business ceded to its quota share reinsurers and retained more risk. For 2022, it is retaining £172m of its capacity, compared to £63m in 2021 (an increase of 173%). A component of mitigating the effect of losses on the Helios portfolio has been the use of stop-loss reinsurance. For 2022, Helios purchased stop-loss reinsurance for its retained capacity of £172m, with an indemnity of 10% of its share of the capacity; a claim can be made if the loss for the YOA at 36 months exceeds 107.5% of capacity, with provision for funding solvency deficits as they arise. This gives the portfolio an added measure of protection.

Exhibit 5: Helios's exposure to different insurance risk classes



Source: Helios, Edison Investment Research

With the meaningful growth in capacity delivered by Helios in FY21, its risk exposure has shifted somewhat from Property and Reinsurance to Casualty (reflecting syndicates' focus on specialist liability risks).

The Lloyd’s market is unlike others

Lloyd’s is a unique insurance market, underwriting (re)insurance since the late 17th century. Please see the appendix at the end of this note for a more detailed description of Lloyd’s, its market structure, its capital providers and its capital structure and links for further information.

Three-year accounting

The internal financial accounting at Lloyd’s, determining the timing of profit distributions, continues to be on a three-year accounting basis, despite the Corporation of Lloyd’s and the quoted Lloyd’s underwriting sector moving to annual accounting for external reporting.

Members join a syndicate for each calendar year, referred to as the YOA. All risks written during the year are allocated to that YOA, along with all related premiums and claims. Policies are written throughout the year and it takes more than 18 months before all premiums have been earned and longer still for all claims to materialise. By leaving the YOA open for another two years, the managing agent can calculate a truer picture of premiums, claims and earnings for that YOA.

It is important that profits are allocated as accurately as possible to a YOA because syndicates are annual ventures (that may continue for many years) and capital providers may change from year to year. Hence three-year accounting ensures the fair attribution of profit/losses to capital providers.

The typical profit profile that is targeted, priced for and reserved for is:

- 0% RoC in year one of the YOA (a high expense allocation of c 50% to acquire business and a higher claims ratio, mostly related to setting up very conservative reserves);
- 50% in year two (a lower expense allocation of c 40%, but still stringent reserving); and
- 50% in year three (very little premium contribution of c 2%, but a release of surplus reserves (varying wildly based on YOA profitability and year two reserve strengthening), which is more than enough to cover a much lower expense allocation of c 10%).

Exhibit 7 below shows how the three-year accounting has developed for Helios over recent years and our forecast to FY25 (the 2023 YOA).

Lloyd’s underlying market performance in 2020 improving

FY20 showed an improving outlook for the Lloyd’s market, with H121 adding support. While Lloyd’s generated a -2.8% return on capital in FY20, the underlying profitability excluding COVID-19 claims was an improvement year-on-year. Major claims contributed 23.0% to the combined ratio (FY19: 7.0%), with COVID-19 related claims accounting for 13.3% of this. The Lloyd’s market continued its trend of prior-year releases, contributing positively to the combined ratio with a benefit of 1.9% (FY19: 0.9%). There have been prior-year releases across all lines of business bar casualty, which was strengthened. H121 annualised return on capital improved to 8.3%.

Adjusting the combined ratio for the contributions from major claims, the Lloyd’s market reported an underlying accident year ratio of 87.3% in FY20 versus 95.1% for FY19, followed by a further improvement to 85.4% in H121. The main contributor to the improvement in the underlying accident year ratio is the reduction in the attritional loss ratio from 57.3% in FY19 to 51.9% in FY20 and 50.5% in H121, a 6.8% reduction over the period. The improvement in the attritional loss ratio is the result of sustained risk adjusted rate increases on renewal business and the market’s actions to drive sustainable profitable performance. There has also been an improvement in the market’s overall expense ratio, which reduced to 37.2% from 38.7% in 2019, and fell further to 35.8% by H121. Lloyd’s targets a reduction to 30%.

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Exhibit 6: Lloyd's market combined ratios for FY20 and H121							
	Accident year		Prior-year reserve movement		Calendar year		
	2019	2020	2019	2020	2019	2020	H121
Reinsurance	106.5%	112.8%	(0.3%)	(2.8%)	106.0%	108.0%	96.0%
Property	106.5%	112.8%	(0.3%)	(2.8%)	106.2%	110.0%	
Casualty	102.4%	113.0%	1.7%	(2.3%)	104.1%	110.7%	
Insurance							
Property	101.5%	135.4%	(1.7%)	(3.5%)	99.8%	131.9%	90.8%
Casualty	103.8%	105.2%	1.9%	5.1%	105.7%	110.3%	101.4%
Marine/Aviation	113.3%	98.2%	(4.8%)	(8.5%)	108.5%	89.7%	80.7%
Energy	107.5%	99.2%	(10.2%)	(8.2%)	97.3%	91.0%	84.8%
Motor	100.6%	95.5%	(1.8%)	(2.2%)	98.8%	93.3%	98.0%
Total market	**103.0%**	**112.2%**	**0.9%**	**1.9%**	**102.1%**	**110.3%**	**92.2%**
Total market (ex-major-claims)					**95.1%**	**87.3%**	**85.4%**

Source: Lloyd's

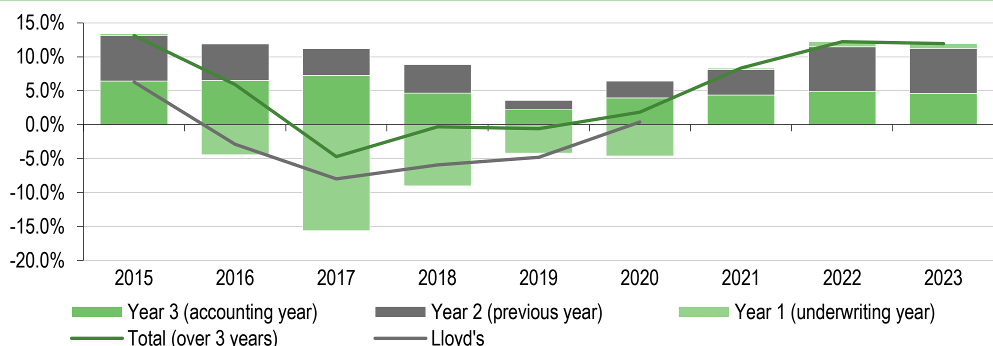
Key drivers of value: What makes Helios attractive

A unique vehicle for Lloyd's participation

Originally, Lloyd's was an exclusive club, requiring (individual) Names participating in its market to be wealthy, primarily due to their unlimited liability exposure. Significant changes undertaken in the 1990s introduced the concept of corporate capital and limited liability for Names through the use of LLVs. However, participation remained limited to Names with the means to provide the significant capital required as FAL deposits and the ability to trade capacity for Names remains restricted. Even today, Lloyd's is a very illiquid market that only trades syndicate capacity three times a year, with a limited number of individual transactions (in 2021 there were only 442 transactions) and a large average transaction size.

Underwriting participation at Lloyd's has shifted from Names to corporate entities, but remains pretty much out of reach to the average individual investor. UK-listed Lloyd's insurers, such as Beazley, Hiscox and Lancashire, provide investors with access to their own syndicates, but they all have diversified their businesses, diluting their Lloyd's exposure. Many syndicates have a corporate parent that is often publicly listed, but once again, their underwriting exposure is often not confined to Lloyd's. Helios is unique in that it is an AIM-listed company providing its shareholders with direct and diversified access to Lloyd's syndicates only. Although an investment in Helios comes at a price in the form of holding company corporate and reinsurance costs, the structure allows for a curated portfolio of exposures to syndicates, while employing reinsurance allows it to reduce capital requirements, especially during challenging times or when attractive acquisitions are available.

Exhibit 7: RoC by underwriting YOA



Source: Helios, Edison Investment Research

The diversification benefits that Helios experiences are quantifiable and have consistently emerged in an RoC that has outperformed the Lloyd's market as a whole in all closed underwriting years

since 2013. We forecast significant RoC improvements over coming years, with 2022 and 2023 YOAs expecting to generate c 9% after tax (seen in FY24 and FY25). Considering Helios deposits FAL with Lloyd's at c 46% of capacity, the implied return on capital employed is attractive at the 20% to 21% level.

In addition to providing equity investors with a unique asset, Helios also offers exiting LLV owners a rare opportunity to either exit the Lloyd's market completely, by selling their LLV to Helios in a tax-efficient way, or to swap their illiquid exposure to the Lloyd's market for a much more liquid shareholding in Helios.

Demonstrable track record of growth

What adds to the attraction of Helios is that it is actively growing its portfolio and managing its risk exposure and working capital through the use of reinsurance. Helios has increased its capacity sixfold since FY16, from £32.6m to £232.8m in FY21. The largest contributor has been the acquisition of LLVs, an area where Helios has been particularly strong. The management team has effectively used its industry network and deep experience of the Lloyd's market to increase the LLVs acquired (including various **Namecos** and **LLPs**) from 30 in FY17 to over 70 in FY21. In 2021 it embarked on an ambitious project and wrote letters to each of the 1,100 UK owners of LLVs that remain with Lloyd's. Of the members approached, 100 responded (which we consider a high hit rate) and 28 transactions were concluded on the back of this. This amounted to half of the total LLV sales that were concluded in 2021 and we do not expect the company to exceed this, even if it had sufficient working capital to fund it.

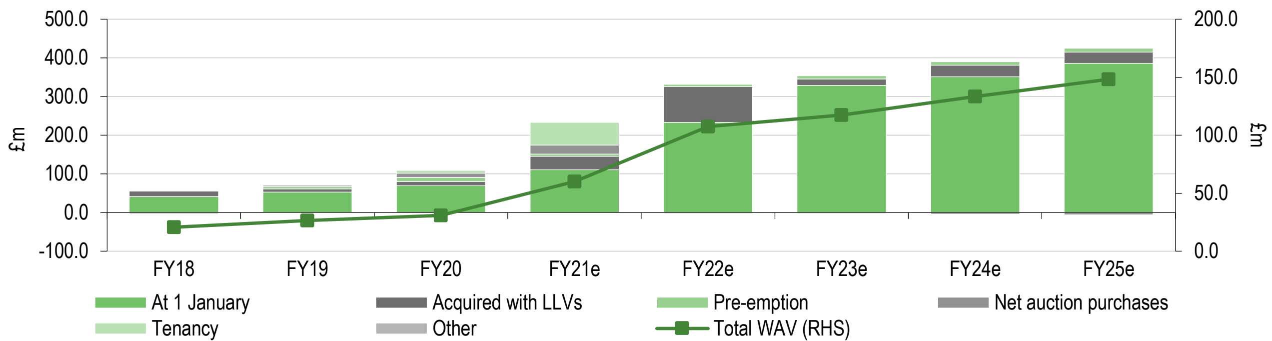
Helios considers the remaining Members with LLVs as fertile ground for further consolidation, largely due to demographic realities this group faces. Individual participation in Lloyd's has grown at less than half the rate of the market as a whole over the past decade, even as LLVs proliferated. With genuine new money entering LLVs at such a slow rate, the average age of the existing membership is rising and inevitably leads to exit pressures (either through death, retirement or the need for more liquid investments). The 1,472 LLVs trading at Lloyd's in 2022 account for over £3bn in capacity and provide meaningful runway for Helios from the 5% of this market it has tapped into to date. Helios's outreach to UK members will continue and will be expanded to the c 400 US members. Even if Helios were to grow capacity at 15% pa over the next five years through LLV acquisitions, it would amount to less than 10% of the estimated remaining LLV capacity.

A very attractive characteristic of Helios's portfolio of syndicate exposures, carried at an FY21 WAV of £60.1m on the company balance sheet, is that it allows the company to access organic growth through pre-emptions. A pre-emption presents itself when syndicates in which Helios has exposure increase their capacity at the Lloyd's auction. Helios has the option at this point to participate in the increased capacity in proportion to its stake in the syndicate and can do this without any acquisition capital outlay. All it has to do is to provide the FAL to back its share of the increased capacity.

Pre-emptions have value for Helios as they entitle the company to the underwriting profit generated from employing the increased capacity owned. As such, pre-emptions result in a NAV uplift equivalent to their WAV, which is added to the Helios WAV fund. From FY18 to FY21, 16% (£7.2m) of the £45m increase in the WAV fund came from pre-emptions, contributing to a 25% increase in Helios's NAV. Although pre-emptions are not guaranteed to occur every year, we expect them to provide a sustainable and on balance repeatable boost to RONAV.

Another tool that Helios used in FY20 and FY21 to grow capacity was directly participating in the Lloyd's auctions and increasing its participations by a total of £36m. This mechanism was only employed because of the large cash balance that it built up through a cumulative £76m in capital raised from FY19 to FY21. Purchasing capacity at auction is the most capital-intensive growth mechanism because Helios has to pay an auction price equal to WAV and provide additional FAL to back the capacity bought. There is no change to NAV, but working capital reduces by the purchase price plus FAL contribution.

Exhibit 8: Capacity build up and organic growth forecast assuming no capital events (£m)



Source: Helios, Edison Investment Research

An LLV acquisition is much less capital hungry as the acquired business already has FAL (usually more than is needed after benefiting from Helios's reinsurance programme, allowing surplus FAL to be released to working capital of up to 30% of capacity acquired) and carries cash balances, which have ranged between 18% and 32% of the cost of transactions over recent years. LLV transactions have also been conducted at discounts (10% plus) to the NAV they added to Helios's balance sheet, which means the cash impact of creating the WAV has been less than the value of the WAV. The actual working capital impact of an LLV acquisition would depend on the exact terms and composition of the business, but has been as low as 62% of the purchase price and could even contribute to working capital if all or part of the consideration is in the form of Helios shares. As a result, we believe that as Helios is presented with attractive LLV acquisition opportunities, it may consider disposing of capacity in the auction to boost its working capital.

The final tool that Helios used to raise its capacity by a further £58m in FY21 was the addition of tenancy capacity. This form of capacity provides short-term access to underwriting performance without entitling Helios to long-term capacity rights. While the take-up of this capacity had no cost to Helios, it also has no value-add within the WAV. As with any additional capacity, Helios does need to provide the FAL to back the solvency capital for this capacity. The addition of tenancy capacity at the end of 2021 was an important tool to make sure the company used its excess working capital and gained increased exposure to the 2022 YOA, which is expected to generate strong underwriting profits. However, when there are LLV acquisition opportunities that cannot be funded by working capital and other mechanisms for boosting working capital are unavailable or undesirable, if required the company could, in theory, shed some of this capacity and use the FAL releases to fund acquisitions. This is unlikely to occur until the underwriting cycle turns down as we estimate it takes £2 to £3 of tenancy capacity shed to acquire £1 of LLV capacity, which is not sensible while expected RoC is strong.

Although capacity growth for Helios is likely to slow in the near term due to limited working capital and an expected delay in the recognition of the forecast strong working capital generation from its portfolio, we expect LLV acquisitions to continue and mechanisms to be employed to generate the working capital to achieve this.

Continued growth is all about managing working capital

Because of its acquisition strategy, Helios has a very capital-intensive business and working capital is quickly eroded by the addition of capacity, with replenishment taking time, especially at this point in this underwriting cycle where even if 2022 and 2023 were spectacular underwriting years, underwriting profit will only start flowing in the second YOA (ie, at 24 months). This means the capacity employed for the 2022 underwriting year will only start yielding returns in FY23 when the 2023 underwriting YOA will offer no, limited or negative return at the 12-month stage. The proper payback only occurs in FY24.

The capital-intensive nature of Helios is due to capacity acquired immediately requiring assets being either locked up at Lloyd's or in the WAV fund. The capital intensiveness of the various mechanisms for adding capacity can be ranked as below, from most to least intensive:

- Buying capacity at the auction results in both an acquisition and a capital strain.
- Taking on tenancy capacity causes a capital strain.
- Taking on pre-emption capacity causes a similar capital strain, but at least it provides WAV growth.
- Acquiring LLVs, as the acquisition price already includes the capital strain and may lead to a release of excess LLV FAL. It will also include LLV cash, which will reduce the working capital impact. In addition, if LLV acquisitions are funded even in part through equity, they can enhance working capital. Hence, this is the least capital intensive of the four mechanisms.

Due to a combination of the above mechanisms for capacity acquisition in FY21, Helios fully used the £54m of capital it raised in the year. In the near term, working capital generation will be limited with solvency capital releases (from improvements in syndicate equity positions as their underwriting results improve) and profit likely not leaving much to spare after funding the dividend and higher capital requirements (the capacity increase at the end of FY21 will result in a large premium growth in FY22, which carries a higher capital requirement).

Exhibit 9: Summarised working capital build-up, £m

	FY17	FY18	FY19	FY20	FY21e	FY22e	FY23e	FY24e	FY25e
Opening balance (free cash)	7.2	1.1	9.7	3.0	5.0	7.8	4.6	7.9	8.5
Changes in FAL	(6.4)	2.2	(5.0)	(7.4)	(48.4)	(3.1)	6.6	4.2	(3.0)
Free float changes	(4.0)	(4.4)	3.0	(3.3)	11.5	1.5	1.3	2.6	2.8
Gearing changes	1.1	8.1	(7.2)	2.0	11.0	0.0	0.0	0.0	0.0
Capital items	(0.8)	(0.4)	3.0	18.1	52.2	0.9	(2.1)	(4.3)	(9.1)
Profit	(0.7)	0.5	4.1	(1.3)	(1.0)	4.3	11.5	17.6	20.6
Acquired LLVs	(2.1)	(4.2)	(3.6)	(5.0)	(17.7)	(2.3)	(4.2)	(9.5)	(10.4)
Other	6.8	6.9	(1.0)	(1.1)	(5.7)	(5.4)	(10.7)	(10.9)	(3.3)
Closing working capital	1.0	9.7	3.1	5.0	6.9	3.7	6.9	7.6	6.0

Source: Helios, Edison Investment Research

However, we do not expect Helios will turn away any LLVs that approach it as sellers and will instead take one of a number of actions to free up working capital or reduce the cash outlay of the transaction. The most desirable outcome for Helios would be to fund the transactions through share issuance, which would be accretive to working capital. An alternative to this would be a mix of cash and shares with the share-funded portion used to back the FAL and WAV acquired, and the cash portion paying for any cash resources acquired in the transaction. Any amount paid in cash over the cash value of the LLV would be a drain on working capital.

Other mechanisms that could be used are tapping into its remaining £10m revolving credit bank facility (potentially increasing the facility on the back of its larger balance sheet); buying more quota share reinsurance, which would release FAL, but reduce Helios's share of underwriting result; selling capacity at the auction, which would result in cash proceeds and release working capital from FAL; and forfeiting a portion of tenancy capacity, which would not generate proceeds, but would release working capital from FAL.

We have taken a conservative view on acquisitions in our base case, but have prepared a number of sensitivities below to explore various growth options. We expect the company to continue on its path of LLV acquisition.

EDISON

Financials

Meaningful earnings growth forecast

We forecast a combined ratio improvement to 95% in FY21, from a weak base in FY20, still reflecting a bottom-of-the-cycle hangover with the claims ratio for YOA 2020 elevated and profit for closed YOA 2019 depressed.

Exhibit 10: Helios's segmental forecasts and key metrics

£m	FY19	FY20	FY21e	FY22e	FY23e	FY24e	FY25e
Capacity (for deployment in the next year)	69.1	110.4	232.8	240.9	253.9	276.7	300.6
Capacity added through LLV acquisitions	8.5	10.9	34.9	4.7	8.4	19.0	20.7
Key parent company assets							
FAL (required capital)	13.5	19.7	69.1	72.2	65.6	61.5	64.5
WAV (intangible assets)	26.4	30.8	60.2	64.1	69.7	80.2	91.1
Free working capital	3.0	5.0	6.9	3.7	6.9	7.6	6.0
Key syndicate assets							
Insurance assets	53.6	65.6	77.5	187.5	221.1	252.5	281.9
Equity (members' balances at Lloyd's)	(8.2)	(5.7)	(3.6)	2.0	12.6	23.8	28.1
Group NAV (syndicate plus parent equity)	7.0	18.9	48.4	52.4	58.3	63.4	66.4
Syndicate level results*							
GWP	61.6	76.1	137.5	220.3	240.9	264.1	288.0
Net earned premiums	47.5	55.7	91.4	134.4	174.1	194.2	212.1
Claims	(28.2)	(37.9)	(55.4)	(77.1)	(96.5)	(102.9)	(111.9)
Expenses	(17.1)	(19.5)	(31.7)	(44.9)	(58.3)	(65.7)	(71.0)
Underwriting result	2.1	(1.7)	4.4	12.5	19.3	25.6	29.3
Investment income on financial assets	2.5	2.4	1.2	1.9	5.1	7.0	8.4
Quota share reinsurance	(1.4)	(0.1)	(2.2)	(5.0)	(6.8)	(7.8)	(8.9)
Underwriting Operating result	3.3	0.6	3.4	9.3	17.6	24.9	28.7
Parent level results							
Reinsurance income**	(0.1)	0.1	0.8	0.9	1.8	2.4	2.5
Investment income on FAL	1.0	1.6	0.1	0.7	1.3	1.7	2.1
Stop loss costs	(0.2)	(1.1)	(2.5)	(2.6)	(2.7)	(3.0)	(3.2)
Operating costs	(2.3)	(2.0)	(2.1)	(2.2)	(2.2)	(2.3)	(2.3)
Other***	0.8	1.2	1.5	0.1	0.0	0.1	(0.0)
Combined pre-tax profit	2.4	0.3	1.2	6.3	15.8	23.8	27.8
Tax	(0.2)	(0.0)	(1.4)	(1.5)	(3.8)	(5.7)	(6.6)
Profit after tax	2.2	0.3	(0.2)	4.8	12.0	18.2	21.2
WAV revaluation after tax	0.0	4.0	6.7	1.5	1.6	1.7	1.8
Total comprehensive income	4.1	4.3	6.5	6.3	13.6	19.9	23.0
NAV/share (p)	161.0	153.1	159.8	166.1	182.4	204.6	224.5
WAV/share (p)	150.7	93.4	88.0	91.4	99.3	114.2	129.8
EPS (p)	25.6	1.6	(0.4)	6.9	17.0	25.8	30.0
DPS (p)	0.0	3.0	3.0	3.0	6.0	12.8	14.9
Capacity growth	31.4%	59.8%	110.9%	3.5%	5.4%	9.0%	8.6%
EPS growth	717.9%	-93.8%	-123.5%	-1940.8%	147.4%	51.6%	16.6%
RONAV/share	17.1%	1.0%	-0.2%	4.3%	10.2%	14.0%	14.6%
RONAV/share plus WAV revaluations	12.5%	-4.9%	6.3%	5.8%	11.6%	15.5%	15.9%
Group insurance ratios****							
Claims ratio	64.7%	69.9%	64.5%	60.8%	58.2%	55.3%	55.3%
Expense ratio	45.2%	43.0%	41.7%	38.4%	37.8%	38.1%	37.6%
Combined ratio	109.9%	112.9%	106.2%	99.1%	95.9%	93.4%	92.9%
Underwriting portfolio insurance ratios*****							
Claims ratio	59.5%	68.0%	60.5%	57.3%	55.4%	53.0%	52.7%
Expense ratio	36.1%	35.0%	34.7%	33.4%	33.5%	33.8%	33.5%
Combined ratio	95.6%	103.1%	95.2%	90.7%	88.9%	86.8%	86.2%
RoC (closed YOA)	(4.4%)	(0.2%)	(0.6%)	1.8%	9.6%	12.4%	12.0%
Year 3 (accounting year)	7.2%	4.7%	2.2%	3.9%	4.4%	4.9%	4.6%
Year 2 (previous year)	3.9%	4.2%	1.3%	2.5%	5.0%	6.6%	6.6%
Year 1 (underwriting year)	(15.6%)	(9.0%)	(4.2%)	(4.6%)	0.2%	0.9%	0.7%

Source: Helios, Edison Investment Research. Note: *Syndicate results before pre-acquisition & other parent items & after quota share reinsurance. **Quota share fees & profit commission. ***Goodwill on bargain purchase & pre-acquisition impact. ****Using consolidated premiums (after pre-acquisition impact) & including parent items. *****Using syndicate accounts excluding pre-acquisition & parent impacts. Syndicate revenue is higher than consolidated revenue, but so are claims & expenses (pre acquisition impact).

EDISON

The record LLV acquisitions in the year are expected to produce healthy goodwill on bargain purchases to offset the large spike in stop-loss reinsurance costs (put in place to protect against adverse claims experience) and very weak investment returns.

We expect a small loss of 0.4p/share, affected by a one-off deferred tax charge relating to the increased UK corporate tax rate from April 2023, which affects all companies. However, after a NAV/share decline in FY20, the company is forecast to deliver an increase to 160p/share for FY21. EPS can be a very volatile metric due to the potential for large catastrophe claims shifting results in any given year. NAV growth and DPS are more stable metrics on which to assess the company.

FY22 should produce better results as the new capacity comes online and the hardening premium cycle starts moving the company back to a break-even position during the first year of the 2022 YOA, although the 2020 and 2021 YOAs will still add softer-cycle contributions. We expect underwriting operating profit of £9.3m and earnings of £4.8m (EPS of 6.9p/share) with a recovery in investment income and fewer one-off items in the holding company P&L. NAV/share is forecast to grow and we expect it to be 166.1p/share, generating a return of 4.3% for the year. We expect only the basic dividend of 3p/share.

In FY23 Helios should start to see the meaningful benefits of its recent growth, with the 2022 YOA expected to be particularly profitable as it benefits from lower claims and expense ratios. The underwriting portfolio's combined ratio is forecast to decline to 88.9% and the 2021 YOA, which closes off in this financial year, is expected to generate an RoC of 9.6% and drive a underwriting operating profit of £17.6m. Reinsurance income is forecast to recover strongly as quota share profit commission resumes on the back of improved underwriting results and investment income on FAL should benefit from higher assets and an uptick in yields (albeit conservatively forecast at 2%). Earnings of £12.0m (EPS of 17p/share) should contribute to healthy NAV growth (we forecast a 10% return and a value of 182.4p/share) and a sharp pick-up in dividends with a 3p/share special dividend, in addition to the basic dividend of 3p/share forecast.

In the next two years when the 2022 and 2023 YOAs will close out and deliver the full upside of the recent significant capacity increases, we forecast earnings growth of c 52% and 17% on the back of RoCs of 12.4% and 12% and RONAV (including WAV revaluations) of 15.5% and 15.9%. The underwriting cycle will likely have started turning downwards by FY25 and it is reasonable to expect RONAVs to decline from the highs at that stage.

For the purposes of our valuation, we look at an average RONAV from FY22 to FY25 and have excluded revaluations. This results in an average 11.1% return, which is used in our RONAV versus P/NAV valuation.

Valuation: An over-the-cycle return approach

Our base case valuation of 212p/share uses an 11.1% over-the-cycle RONAV, derived as the average return forecast from FY22 to FY25. We tested our RONAV assumption by considering an 11-year average RoC (including our five-year forecast), applying the new UK tax rate, grossing this return up based on a reasonable NAV/capacity assumption (ie, if the company has an NAV of half its capacity, the RONAV would be double the RoC because the same profit amount is divided by a denominator half the size) and making an allowance for the head-office structure.

Exhibit 11: RONAV interrogation by YOA

	Historical average (six years)	2018 YOA historical	2023 YOA forecast	11-year average to 2023 YOA	Used for test
RoC including investment income	7.9%	-0.2%	12.0%	7.4%	7.4%
RoC including investment income (after 25% tax)	5.9%	-0.1%	9.0%	5.5%	5.5%
NAV/capacity	57.9%	45.1%	52.5%	52.8%	50.0%
RoC grossed up allowing NAV/capacity level	10.2%	-0.3%	17.1%	10.5%	11.0%
Holdings leakage/capacity	-1.1%	3.3%	0.3%	0.0%	0.0%
RONAV at average RoC	9.1%	3.1%	17.4%	10.5%	11.0%

Source: Helios, Edison Investment Research. Note: YOA RONAV does not correspond to FY RONAV as it does not allow for the mix of RoC from three YOAs as is disclosed in FY (eg FY25 RONAV would include contributions from 2023, 2024 and 2025 YOA, with only the closed 2023 YOA contribution at the full level).

Our results are summarised in Exhibit 12. This methodology provides strong support for our RONAV assumption. The average RoC is particularly conservative due to the extended four-year period of high combined ratios (including COVID-19 effects) and the historically low interest rates. The average NAV/capacity includes very high capitalisation in the earlier years and our 50% assumption is arguably high relative to current levels. Holding company average leakage allows for high stop-loss costs to continue and remains conservative on investment income.

Our cost of equity of 8.5% is based on a risk-free rate of 1%, a risk premium of 7.5% and a beta of 1x. Although this cost of equity may appear low for a company the size and liquidity of Helios, it is justified, in our opinion, by the asset side of its balance sheet being very robust, consisting primarily of FAL and WAV, with WAV a marked-to-market and very monetisable asset, and by the fact that we apply no terminal growth to our RONAV valuation.

Our fair value for Helios is at a 1.33x multiple of its FY21 forecast NAV of 160p/share and at a 33% premium to the current share price. The valuation is not well supported by expected FY21 and FY22 EPS or dividends, but once the improved underwriting conditions start to emerge from FY23, the forward earnings multiple implied by our valuation is attractive at 12.6x and declines rapidly to 7.1x in FY25. The dividend yield similarly only becomes more attractive from FY23.

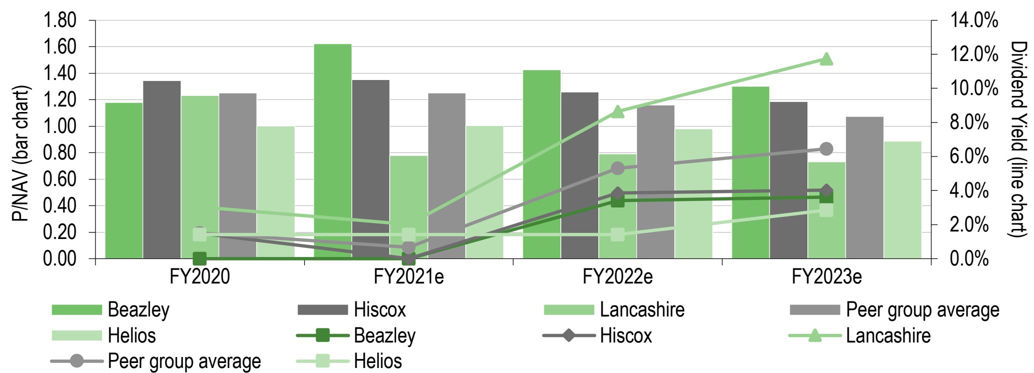
Exhibit 12: Valuation

	FY20	FY21e	FY22e	FY23e	FY24e	FY25e
Over-the-cycle valuation (p)	**212**					
EPS (p)	1.6	-0.4	6.9	17.0	25.8	30.0
DPS (p)	3.0	3.0	3.0	6.0	12.8	14.9
NAV/share (p)	153.1	159.8	166.1	182.4	204.6	224.5
Valuation-implied P/E (x)	133.2	N/M	30.9	12.5	8.2	7.1
Valuation-implied dividend yield (%)	1.4%	1.4%	1.4%	2.8%	6.0%	7.0%
NAV multiple (x)	1.4	1.3	1.3	1.2	1.0	0.9

Source: Helios, Edison Investment Research

We have also calculated a dividend discount model (DDM) valuation based on an explicit forecast period to FY25. This produces a slightly higher valuation, although there is an argument to be made that the WAV/share should also be added to the dividend stream, but maybe at a discount for conservatism (Lloyd's auction prices have been high in recent years). Valuing the dividend stream without any terminal growth and adding it to the FY21 WAV after a 25% discount results in a value of 225p/share.

Exhibit 13: Peer group P/NAV and dividend yield comparison



Source: Refinitiv, Helios, Edison Investment Research. Note: Priced at 22 February 2022. Helios's NAV includes WAV at fair value, while NAV of peers does not.

While our valuation for Helios indicates relative value on an implied forward earnings and NAV multiple basis, the company far undershoots the peer group on dividend yield. This is because the company chooses to retain most of its earnings to fund capacity growth.

Sensitivities

In addition to the standard sensitivities we typically test, including risk discount rate, terminal growth and combined ratio, we have conducted a scenario to test the free working capital effect of more LLV acquisitions every year, two solvency scenarios to see the free working capital they create and four scenarios that unlock free working capital, which is then used to acquire LLV capacity.

Exhibit 14: Sensitivities

	Valuation (p/share)	% change
Base case	212	
0.5% higher cost of equity	200	(5.6)
0.5% lower cost of equity	225	6.3
1.0% higher terminal growth*	230	8.6
1.0% lower terminal growth*	196	(7.2)
2.5% higher combined ratio	175	(17.6)
2.5% lower combined ratio	250	18.0

Source: Helios, Edison Investment Research. Note: *Terminal growth sensitivity tested against our DDM valuation.

Our valuation increases/falls by 6% for every 50bp change in risk discount rate assumption, while increasing our terminal growth rate by 1% has a 9% increase/7% decrease (this was tested using our DDM valuation). The valuation is very sensitive to combined ratio with a 2.5% increase reducing the valuation by 18% and vice versa.

Our calculations show an increase in LLV capacity acquisition of 1% of starting capacity in each year from FY22 onwards will require an additional £13.0m of working capital over and above our base case scenario. This impact is proportional, which means an increase in our capacity growth forecast from 6% to 10% per year would require an additional £54m in funding over four years, either from solvency efficiencies or capital and debt markets. Full or part payment by share issuance will reduce or eliminate the working capital impact. Adding LLV capacity is also value enhancing and under this scenario (without changing other assumptions to fund the additional working capital), it increases our valuation by 4%. We test the combined impacts below.

Helios has benefited recently from a diversification benefit reducing its capital requirements. However, Lloyd's as a whole is still strongly capitalised in line with the entire insurance sector. A move towards lower solvency coverage for the entire insurance sector is possible considering the

very robust performance during COVID-19 (no major insurer ran into solvency issues during this one-in-200-years event) and lower interest rates diluting returns on high surplus capital balances. Such a move could also allow Lloyd's to relax its capital requirements. We demonstrate that for every 2% relaxation of Lloyd's capital requirements, a cumulative £14m in working capital would be released, while increasing the quota share reinsurance from c 27% to 32% would release a similar amount. The capital requirements scenario creates 'free' working capital, which if deployed in 1% higher LLV capacity additions from FY22 onwards would boost our valuation by 3.8%. The higher quota share reinsurance scenario carries cost, resulting in a largely neutral valuation impact.

Exhibit 15: Reducing Helios's net capital requirements (FAL)

	Valuation (p/share)	% change
Base case (p)	212	
2.0% lower Lloyd's capital and 1% additional LLV capacity from FY22	220	3.8
5.0% higher quota share from FY22 and 1.0% additional LLV capacity in FY22 and FY23	212	0.0

Source: Helios, Edison Investment Research

Our final two scenarios relate to tapping into the capital and debt markets. While issuing debt is much more value accretive than raising capital, there is a limit to the debt facilities available to Helios with its capital base. Using the current £10m undrawn debt facility and adding a one-off 10% of LLV capacity increases our valuation by 9%, but more uplift than this would require higher borrowing facilities. A capital raising of £50m or c 40% of the current market capitalisation at FY21 NAV/share would allow a one-off 38% increase in capacity and add c 4% to the valuation, with every 10% premium to NAV/share adding a similar amount.

Exhibit 16: Capital and debt

	Valuation (p/share)	% change
Base case (p)	212	
Raise £50m capital in FY22 at NAV and acquire 38.0% additional LLV capacity	220	4.0
Raise £50m capital in FY22 at 10% premium to NAV and 38.0% additional LLV capacity	228	7.8
Issue £10m debt in FY23 and acquire 10% additional LLV capacity	231	9.0

Source: Helios, Edison Investment Research

Exhibit 17: Financial summary (consolidated at group level)

	2019	2020	2021e	2022e	2023e
Accounts: IFRS; year end 31 December, £000s	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue*	45,872	52,594	76,144	128,533	168,688
Net insurance claims and loss adjustment expenses*	(43,388)	(51,996)	(75,926)	(121,031)	(151,861)
Gross Profit*	2,484	598	219	7,501	16,827
EBITDA	(1,140)	(924)	(1,259)	5,987	15,275
Operating Profit (before amort. and except.)	,720	(924)	(1,259)	5,987	15,275
Intangible Amortisation	1,860	-	-	-	-
Exceptionals	1,707	1,260	2,431	297	538
Other	(1,764)	(1,522)	(1,477)	(1,514)	(1,552)
Operating Profit	4,287	336	1,173	6,284	15,813
Net Interest			-	-	-
Profit Before Tax (norm)	2,580	(924)	(1,259)	5,987	15,275
Profit Before Tax (FRS 3)	4,287	336	1,173	6,284	15,813
Tax	(233)	3,947	5,324	30	(2,238)
Profit After Tax (norm)	2,347	3,023	4,065	6,017	13,036
Profit After Tax (FRS 3)	4,054	4,283	6,496	6,314	13,574
Average Number of Shares Outstanding (m)	16.0	25.3	50.7	69.3	70.2
EPS - normalised (p)	25.6	1.6	(0.4)	6.9	17.0
EPS - normalised fully diluted (p)	24.9	1.6	(0.4)	6.8	16.9
EPS - (IFRS) (p)	24.9	1.6	(0.4)	6.8	16.9
Dividend per share (p)	0.0	3.0	3.0	3.0	6.0
Gross Margin (%)	5.4%	1.1%	0.3%	5.8%	10.0%
EBITDA Margin (%)	-2.5%	-1.8%	(1.7%)	4.7%	9.1%
Operating Margin (before GW and except.) (%)	1.6%	-1.8%	(1.7%)	4.7%	9.1%
BALANCE SHEET					
Fixed Assets	173,901	220,937	385,041	582,642	633,252
Intangible Assets	21,178	31,601	60,912	64,111	69,665
Tangible Assets	85,582	104,059	177,547	258,791	276,823
Investments	67,141	85,277	146,582	259,740	286,764
Current Assets	6,037	8,495	11,487	12,210	12,718
Stocks	-	-	-	-	-
Debtors	-	-	-	-	-
Cash	6,037	8,495	11,487	12,210	12,718
Other	-	-	-	-	-
Current Liabilities	8,320	7,293	19,940	20,433	20,977
Creditors	6,320	3,293	4,940	5,433	5,977
Short term borrowings	2,000	4,000	15,000	15,000	15,000
Long Term Liabilities	143,470	171,590	267,302	457,871	497,004
Long term borrowings	-	-	-	-	-
Other long term liabilities	143,470	171,590	267,302	457,871	497,004
Net Assets	28,148	50,549	109,288	116,547	127,989
CASH FLOW					
Operating Cash Flow	1,720	(11,629)	(29,280)	1,345	13,245
Net Interest	(1,483)	(1,474)	(696)	(1,464)	(3,272)
Tax	(1,119)	(312)	315	(1,497)	(3,819)
Capex	(22)	(186)	(200)	(200)	(200)
Acquisitions/disposals	922	2,889	(29,530)	1,592	(3,313)
Financing	(5,654)	13,170	64,401	3,025	-
Dividends	(529)	-	(2,018)	(2,079)	(2,133)
Net Cash Flow	(6,165)	2,458	2,992	723	508
Opening net (debt)/cash	3,006	4,037	4,495	(3,513)	(2,790)
HP finance leases initiated	-	-	-	-	-
Change in borrowings	7,196	(2,000)	(11,000)	-	-
Closing net (debt)/cash	4,037	4,495	(3,513)	(2,790)	(2,282)

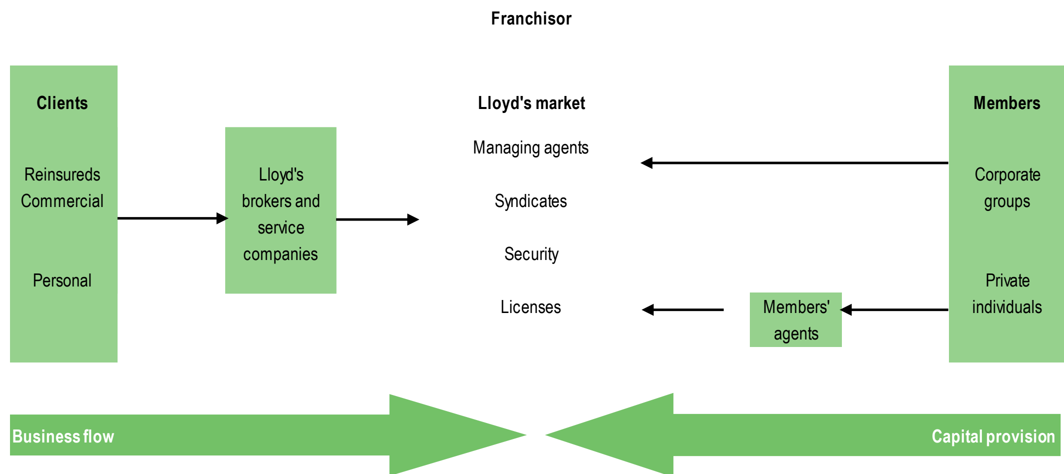
Source: Helios, Edison Investment Research. Note: *Shown after pre acquisition impact and parent reinsurance result, investment income, costs and other items – see Exhibit 10 for a segmental view of Syndicate result and Parent result.

Appendix: The Lloyd's market is unlike others

Lloyd's of London is a unique insurance market, not an insurance company, tracing its roots to a 17th century coffee shop opened by Edward Lloyd in the City of London. Today, Lloyd's is the pre-eminent centre for the underwriting of specialty insurance risks. There are 76 syndicates operating in Lloyd's, underwriting more than £40bn of premiums every year.

The Lloyd's market provides the brand and the legal entity under which the policyholder is insured. It has no shareholders and is governed by the Council of Lloyd's on behalf of its Members. A Member of Lloyd's is eligible to provide capital to a syndicate, which could be used to underwrite insurance risks at Lloyd's. Syndicates are effectively the risk-taking entities in Lloyd's and are organised by a managing agency. One of the key characteristics of Lloyd's is that syndicates are annual ventures, legally formed each year and reforming the next year should the members and the underwriters wish to. Under what is known as the three-year account, syndicates hold their accounts open for (at least) two full years before declaring results in the third year. Any remaining liabilities are reinsured into the subsequent year of account. The maximum premium a syndicate can write in any given underwriting year (GWP minus brokerage) is known as the syndicate's **underwriting capacity**. The Corporation of Lloyd's oversees and supports the Lloyd's market.

Exhibit 18: The Lloyd's market structure

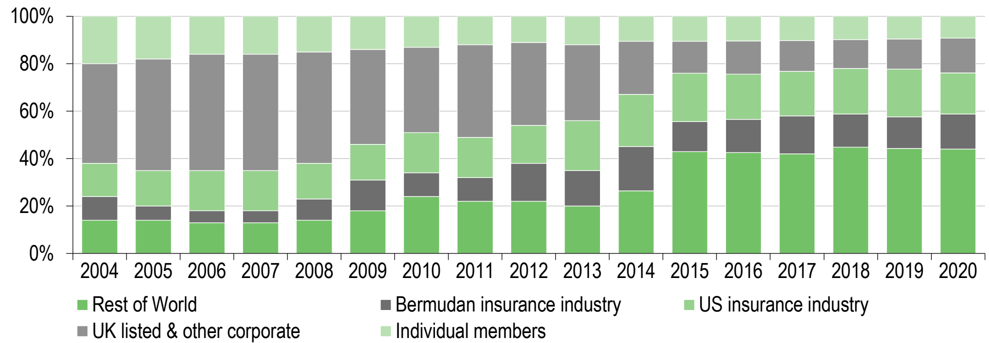


Source: Edison Investment Research

The main capital providers (members) are grouped into three main categories as follows.

- Trade capital: insurance companies from around the world
- Institutional capital: such as pension funds and private equity
- Private capital (via members' agents): such as small companies and Names

Exhibit 19: Lloyd's capacity by source and location

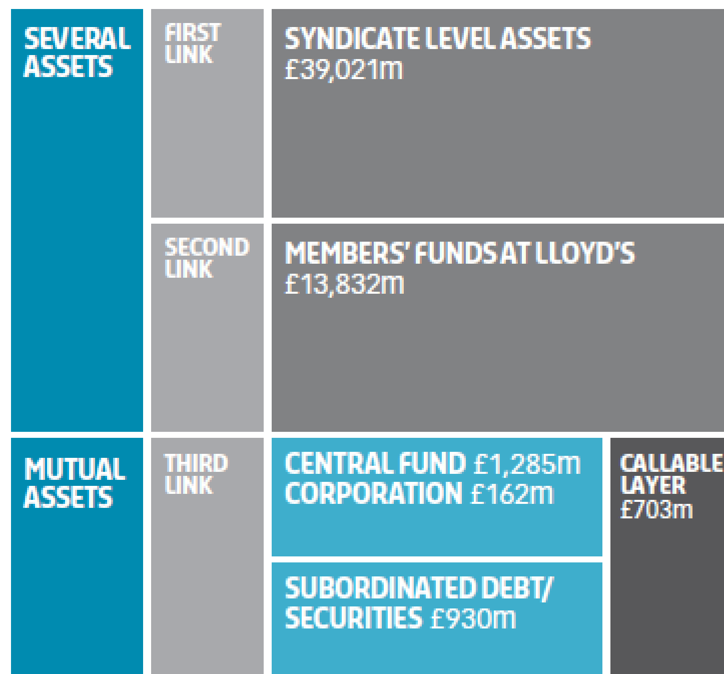


Source: Lloyd's

Lloyd's is the legal insurance entity regulated by the UK Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) rather that the individual syndicates, which presents an advantage for start-up insurers in the form of lower capital needs.

The Lloyd's chain of security and its three links are there to protect the policyholder in case a syndicate fails. The funds in the first two links – syndicate level assets and Members' **funds at Lloyd's** – are held in trust and are primarily for the benefit of the policyholders. In essence these are similar to the total assets and capital of a conventional insurance company. The third link of security is the central guarantee fund.

Exhibit 20: Lloyd's chain of security links strength with stability

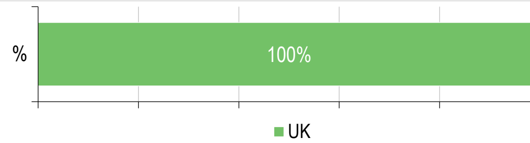


Source: Lloyd's

Glossary

Central guarantee fund	A fund to protect policyholders in case any underwriting member should be unable to meet his or her liabilities out of Syndicate Trust Funds, funds deposited at Lloyd's, reserves and personal assets outside of Lloyd's. Every Lloyd's member makes an annual contribution to this fund.
Council of Lloyd’s	The governing body of Lloyd’s of London
Excess of loss reinsurance (XoL)	Type of loss reinsurance in which the reinsurer indemnifies, or compensates, the ceding company for claims above above an agreed retained loss up to an agreed maximum loss.
FAL	Funds at Lloyd’s. The total capital each Member of Lloyd’s is required to provide as security to support their total Lloyd’s underwriting business (Members’ FAL).
Free working capital	Liquid capital available in the Helios parent company after allowing for its FAL. These are the resources available to Helios for adding capacity.
LLV	Limited liability vehicles are designed specifically for individuals trading at Lloyd’s. The LLV limits the FAL exposure to only those assets used to support underwriting plus the value of any other assets in the LLV.
Lloyd’s auctions	A market where existing syndicate members are able to sell or purchase capacity.
Lloyd’s managing agent	A company set up to manage one or more syndicates on behalf of Members.
Lloyd’s Member/Name	A Member of Lloyd's is any corporation or individual (latter known as Lloyd's Name)
LLP	Limited Liability Partnership. A partnership in which some or all partners have limited liabilities. This is a form of LLV.
Members’ balances	Undistributed profits or losses as well as funds of syndicates. In essence the net assets of a syndicate.
Nameco	A UK private limited company subject to corporation tax and trades as a corporate member of Lloyd’s. This is a form of LLV.
Pre-emption capacity	An invitation by a syndicate to its member to increase their nominal capacity in line with any increase in a syndicate’s capacity
Quota share reinsurance	A reinsurance contract in which the insurer and reinsurer share premiums and losses according to a fixed percentage.
Retained capacity	The capacity remaining after ceding a proportion of total capacity to reinsurers (typically via quota share reinsurance).
RoC	Return on capacity. The cumulative underwriting profits earned on deployed capacity for a particular YOA. The final RoC can only be calculated after the YOA has closed at the end of the third year of accounting.
ROWAV	Return on the weighted-average value of capacity (WAV).
Solvency capital requirement	An internal Lloyd’s measure, that determines the capital required to support the syndicate business written. It is backed by FAL and members’ balances.
Stop loss reinsurance	A type of excess of loss reinsurance wherein the reinsurer is liable for the insured’s losses incurred over a certain period.
Syndicate	An annual underwriting joint venture supported by a single member or group of members at Lloyd’s.

Tenancy capacity	The value of the right to remain in a syndicate. Has no cost or impact on NAV but affects solvency and income stream.
Three-year accounting	A Lloyd's accounting process where each underwriting YOA is tracked and accounted for over 36 months before it is closed and profits determined.
Underwriting capacity	A Lloyd's measure of the maximum amount of business a syndicate can write in a year, excluding acquisition costs.
Underwriting cycle	Refers to the peaks and troughs of (re)insurance prices, alternating between periods of soft market conditions (low premiums) and hard market conditions (high premiums), manifesting in rising combined ratios in the down-cycle and declining combined ratios as the cycle turns. A soft market tends to deplete the capital needed to underwrite new business, while a hard market attracts fresh capital.
WAV	Weighted-average value. Actual carrying value of capacity, based on the weighted-average prices during the Lloyd's auction in the past year.
YOA	Underwriting year of account. The first year during which a new set of capacity is deployed and business is written.

Contact details	Revenue by geography
40 Gracechurch Street London, EC3V 0BT United Kingdom +44(0)20 7863 6655 www.huwplc.com	

Management team

CEO: Nigel Hanbury	FD: Arthur Manners
Nigel was appointed CEO in October 2012. He joined Lloyd's in 1979 as an external member and became a Lloyd's broker in 1982. He later moved to the Members' Agency side, latterly becoming chief executive and then chairman of HAL. He serves on the board of the Association of Lloyd's Members and was elected to the Council of Lloyd's for the 'Working Names' constituency, serving on that body between 1999 and 2001 and then 2005 to 2008, as well as participating on the market board and other Lloyd's committees. In December 2009 he ceased being chairman of Hampden and in 2011 acquired a majority stake in HIPCC, a Guernsey cell company, formerly wholly owned by Hampden plc.	Arthur has over 20 years' experience in the insurance industry. He has been a consultant to Helios since June 2015 and joined the board in April 2016. His role as finance director at Helios is part time. He previously worked for Beazley Group from 1993 to 2009 as finance director and latterly as company secretary. He remains chairman of the Trustees of the Beazley Furlonge Pension Scheme.

Principal shareholders	(%)
ILS Capital Management	19.4
Hudson Structured Capital Management	18.2
Polar Capital Funds	13.9
N J Hanbury (either personally or has an interest in)	13.9
Will Roseff	7.5
Ardnave Capital	4.3

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