

Conduit Holdings: Strong 20% ROE at half the industry risk and 30% growth rate

Company:	Conduit Holdings (CRE)	Market Cap:	\$1.09bn
Industry:	Reinsurance	BSCR Solvency ratio:	381%
Country:	Bermuda	Revenue:	\$764mio*
Date:	20 th August 2024	Net Income:	\$196mio*
Dividend:	-	Return on equity:	20%*
Entry:	\$1.06bn	Target:	\$1.5bn (+42%)

*annualized H1 24 results

Why Conduit Holdings?

- Attractive 5.6x P/E valuation while growing revenues at well over 30% compared to negative, stable or low single digit % growth of competitors
- Industry beating solvency ratio of >381%, which is 100-150% higher than UK listed competitors
- Zero debt compared to ~\$500mio of debt from UK listed competitors with similar P/E ratio
- Lowest valuation premium to tangible book value of only +3% vs. +33%-72% of UK listed competitors
- Lowest natural catastrophe risk in 1:100 years event of 8.4% of TNAV and 9.4% of TNAV in 1:250 event, less than half of its UK listed competitors & no legacy risk
- High interest rates enable investment returns that already provide a 4% return on equity with a very conservative investment portfolio
- Industry is generating record margins despite record claims payouts

Risks

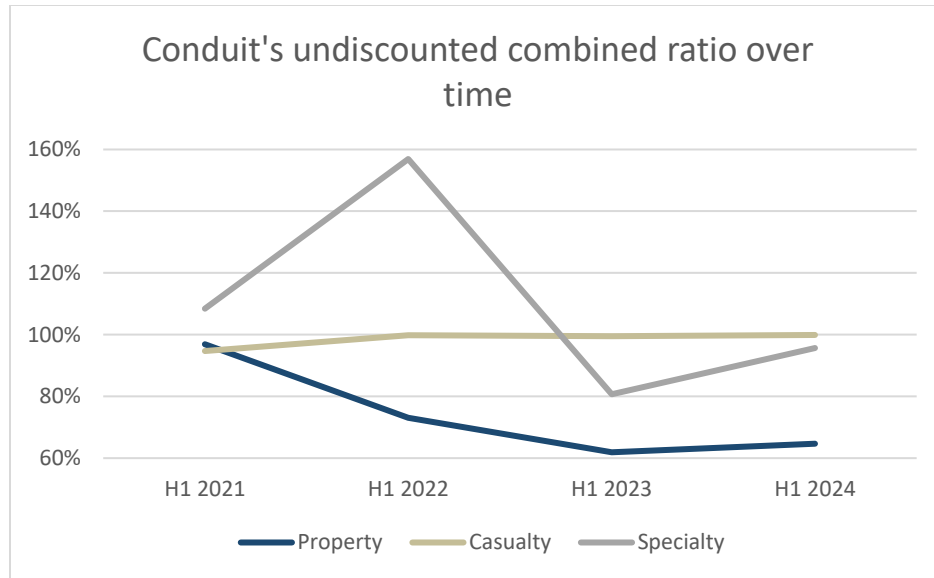
- Hurricane season is expected to be very active with average peak activity around 10th September
- Unexpected natural disasters and events
- Earnings in £ terms could decline if the US\$ were to weaken

Conduit Holdings

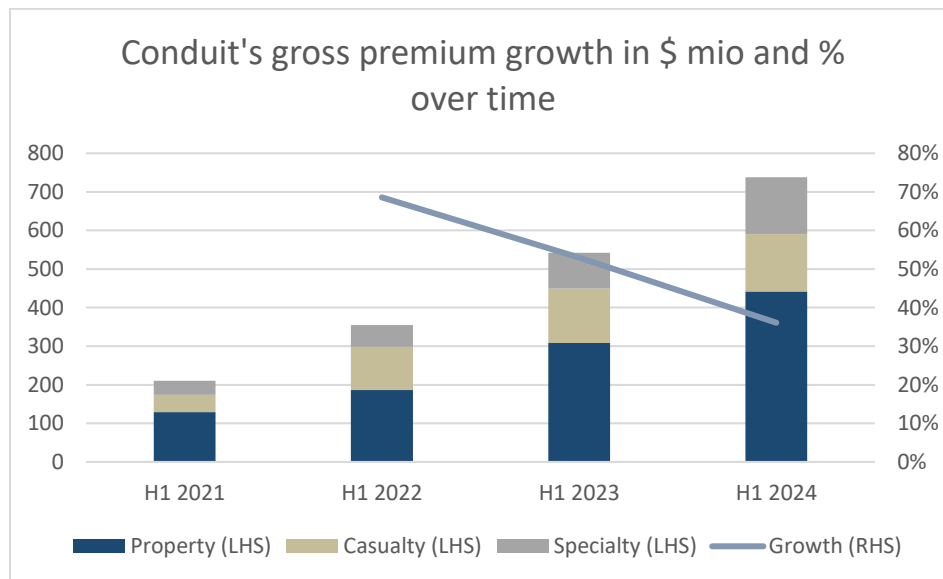
Conduit Holdings is a UK listed, Bermuda domiciled reinsurance company that focuses on three main subsectors:

- Property (1-2 years reinsurance duration, covering hurricane, fire, flooding, etc.)
- Casualty (5-7 years duration, covering litigation from accidents except auto/motor reinsurance, professional, financial or general liability, medical malpractice, etc.)
- Specialty (varying duration, covering aviation, energy, construction, terrorism, etc.)

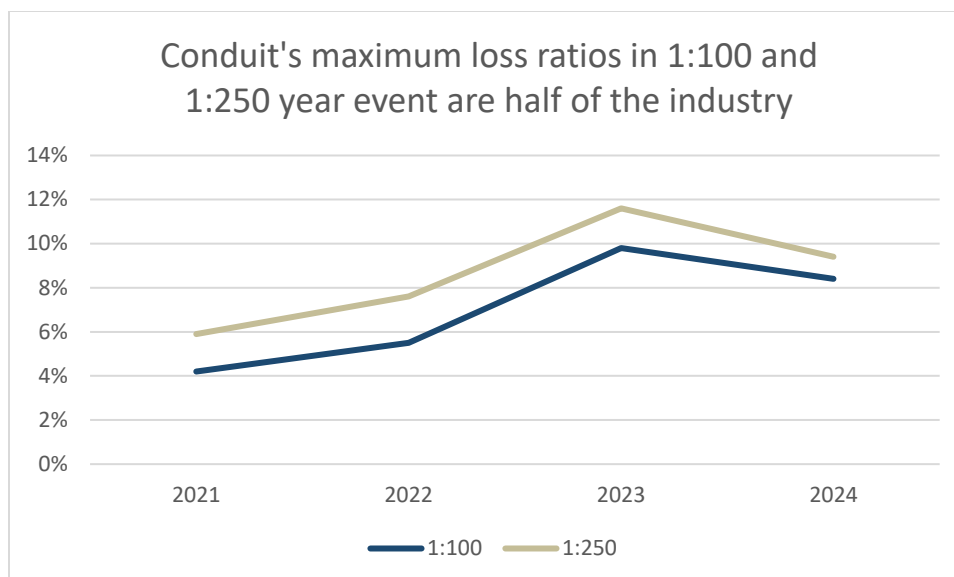
Conduit was founded in 2020 by its Chairman, Neil Eckert, together with its CEO, Trevor Carvey, by having raised \$1bn from investors, including from Fidelity and Aviva. The firm has since written over \$2.6bn in gross premiums, and while analysts expect gross premiums to grow to \$1.175bn in 2024, I expect gross premiums to reach \$1.25bn to be in line with historic H2 growth. What makes Conduit stand out over its competitors are the strong 20% margins while limiting downside risks to only around half of the industry in a 1:100 or 1:250 year's event to 8.4% or 9.4% TNAV respectively. Conduit generally bids on multiple line items, but then cedes around half of those items that do not meet their risk/reward appetite – a larger amount when compared to competitors. The risk-sensitive nature of Conduit is important due to its high exposure to US property, which accounts for around 30% of the firm's net reinsurance revenue, but well over half of the firm's profit. While profitability from casualty has so far not materialized, this sector enables attractive investment returns on the premiums as claims generally take many years to be paid out. The actuaries are also likely more conservative when it comes to estimating Conduit's losses in this sector due to the long-winded process of claims and the short history of Conduit as a business. The heavy losses in specialty in 2022 were mostly related to the Ukraine war due to Russia's confiscation of airplanes and a few Ukrainian windfarms, hence are unlikely to occur soon again. In fact, despite the \$19.8mio loss from the Baltimore bridge collapse, a \$3.5bn event, a 95.7% undiscounted combined ratio was achieved in H1 2024. These were the only two large loss events over the 4-year life of Conduit (apart from Hurricane Ian in property).



Source: Conduit Holdings H1 2024 presentation



Source: Conduit Holdings H1 2024 presentation



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A valuation that appears illogically low

The previously mentioned maximum losses that could occur in a 1:100 and 1:250 event do not only indicate the strong risk aversion, but also show the potential growth Conduit has left with its current strong balance sheet. For instance, for a 1:250 year event, Conduit would lose 9.4% of its tangible net asset value (TNAV), this compares to 15.3%-27.5% for its UK listed competitors. Conduit's solvency ratio at 381% as of FY 23 is also around 100-150% higher than its UK listed competitors, while the company has zero debt compared to around \$500mio of debt for each of these competitors. The market basically values Conduit at the same multiple as its competitors, but completely ignores the much stronger balance sheet that either enables higher growth in the future or large shareholder returns. Conduit is trading at a 3% premium to TNAV vs. a 33%-72% premium to TNAV of its UK listed competitors. The tables below compare most of the key metrics. The main takeaway is that Conduit is able to double its exposure based on its strong balance sheet, but is valued as if its growth has completely stalled.

Conduit trades at a similar P/E valuation to its UK listed competitors

Company	Valuation in \$ mio	Reinsurance revenue H1 24 in \$ mio	Net income	P/E
Conduit	1,090	382	98	5.6
Lancashire	2,062	854	201	5.1
Beazley	6,544	2,731	572	5.7
Hiscox	5,336	2,058	259	10.3

Source: Annual/Interim reports/presentations of individual companies

Conduit's ROE is lower, combined ratio average, but potential loss scenarios much lower

Company	Premium to TNAV	Return on equity (annualised)	Combined ratio (undiscounted)	1:100 event impact to TNAV	1:250 event impact to TNAV
Conduit	3%	19.8%	85.7%	8.4%	9.4%
Lancashire	33%	28.0%	82.2%	18.5%	26.9%
Beazley	57%	28.0%	81.0%	10.5%	15.3%
Hiscox	72%	16.5%	90.4%	11.3%	27.5%

Source: Annual/Interim reports/presentations of individual companies

Conduit's balance sheet is far stronger and has no legacy liabilities

Company	Solvency ratio	Debt	Investment, cash & reinsurance assets / reinsurance liabilities
Conduit	381%	-	2.73
Lancashire	280%	447	1.95
Beazley	245%	554	1.40
Hiscox	206%	689	1.52

Source: Annual/Interim reports/presentations of individual companies

Conduit has the longest duration, yet safest investment book

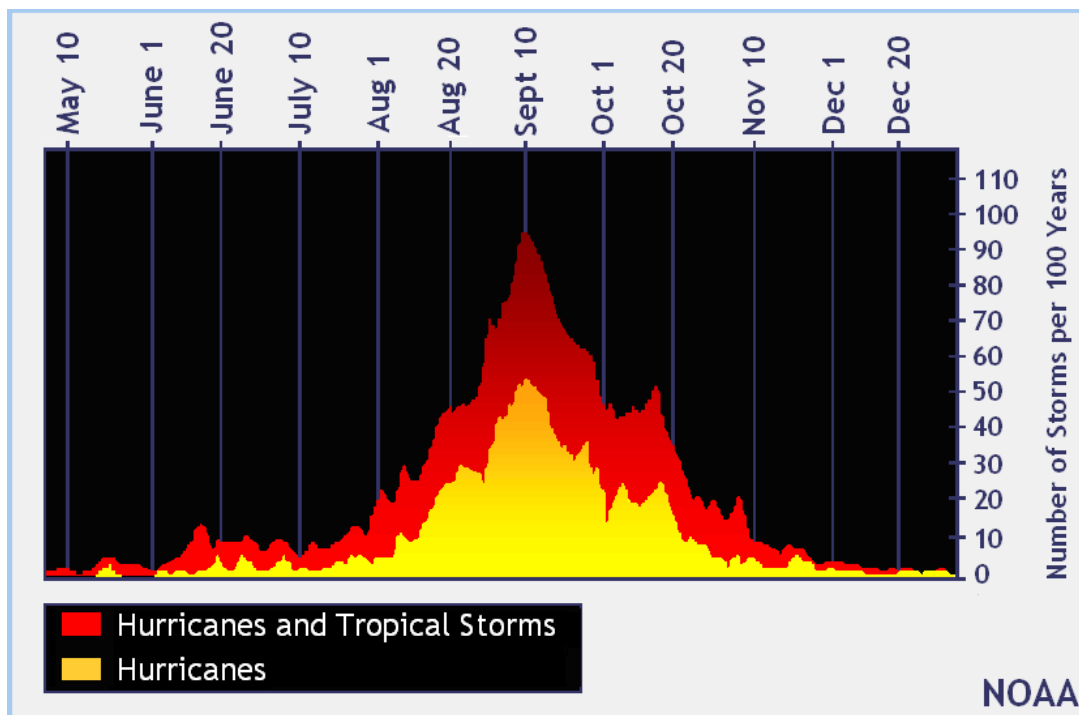
Company	Net investment return	Book yield	Average duration in years	High yield/Equity, illiquids?
Conduit	1.5%	4.1%	2.5	No
Lancashire	2.3%	4.7%	1.9	Yes, >7%
Beazley	2.4%	5.0%	1.6	Yes, 12%
Hiscox	1.9%	4.8%	1.9	Yes, >6.2%

Source: Annual/Interim reports/presentations of individual companies

The reinsurance industry is vulnerable, but pricing is adjusted accordingly

Generally, the best time to invest in the (re)insurance industry is when large claims occurred, because the pricing will adjust and lead to higher margins in the following year, unless you have inflation running at a faster pace and even larger amounts of claims in the following year. 2022 was a bad year for the reinsurance sector, mostly due to the Ukraine war and the third costliest hurricane in history, Hurricane Ian, which has cost Conduit \$24.6mio and \$40.9mio respectively. This has led to a repricing of the market and record margins in 2023. 2024 has largely maintained the elevated pricing as expectations are for an active hurricane season due to warmer than usual ocean temperatures. At the same time, you had elevated inflation throughout 2023, but lower inflation in 2024. The combination of declining inflation, high interest rates and near record pricing makes the reinsurance industry a very attractive investment in 2024. On the flip side, this year's hurricane season is expected to be 90% above normal activity¹, and this is why the prudent risk-taking from Conduit compared to competitors in 2024 is so important.

Timeline of peak hurricane season



Source: <https://www.noaa.gov/stories/peak-of-hurricane-season-why-now>



¹ <https://noaa.gov/news-release/highly-active-hurricane-season-likely-to-continue-in-atlantic>

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