

## Major acceleration of strategic refocus

6 April 2023

Momentum behind the group's strategic refocus is gathering pace. This year R&Q has sold its minority (40%) stake in Tradesman and set up a new JV with OBRA Capital to acquire non-insurance legacy liabilities. That builds on the creation in 2021 of Gibson Re to transform its legacy operations onto a less capital intensive, fee-based model. The latest proposal is the most material transformation from a group perspective. It would create two separate standalone entities from its core operations, program management and legacy.

R&Q expects the separation to establish its program management (Accredited) and legacy insurance operations with appropriate individual capital structures on a more favourable basis for profitable growth. Accredited relies on an 'A' credit rating which has historically been supported by the broader group's financial strength. R&Q believes Accredited now has the scale to stand alone.

The decision has thus been taken to undertake a legal reorganisation followed by strategic transactions with third parties to achieve the proposed separation. Post that, R&Q expects both Accredited and Legacy Insurance to be better placed to achieve profitable growth, each with their own appropriate capital structures. The legal reorganisation is subject to regulatory and lender consents which it expects to obtain during the current quarter (Q2 23).

This potentially transforms the business from both operational and valuation perspectives. Subject to detail including proposed capital structures, each business could be reappraised independently without the material discount which we believe has negatively affected sum-of-the-parts assessments of the combined entity. It could also address the discount related to a perceived equity overhang after the dust settled on last year's unsuccessful bid.

### Trading update: program management on track, legacy slower

The FY22 trading update reinforces the logic. Legacy completed fewer transactions than expected, which essentially reflects the difficulty inherent in forecasting this business and reported a 3-4% adverse shift in value of net reserves. It is the full explanation for a weaker group result than anticipated, as program management performed strongly and on track.

Our long-term forecasts are suspended pending full detail of the plan. An overview was set out in the latest announcement, all subject to regulatory and lender consents and to include a review of alternatives to separate the divisions via a legal reorganisation and strategic transactions with third parties. No further information has been provided regarding the proposed status of the new entities post separation i.e., their listing or sale, or the requirement for an injection of new capital. Our fair value will also be reviewed then, and we expect any split to better highlight inherent group worth.

#### Company Data

EPIC	RQIH
Price (last close)	62p
52 weeks Hi/Lo	158p/55p
Market cap	£234m

#### Share Price, p



Source: ADVFN

#### Description

R&Q Insurance Holdings Ltd. Is a long-established UK and US insurance business, led by experienced management.

It is focused on two core strategies:

**Program Management (PM)** is a fully regulated commission fee-based business, which acts as a conduit between reinsurers and MGAs (insurance distributors).

**Legacy Insurance** provides exit solutions for legacy/run-off insurance assets to vendors in the US, Europe, and Bermuda.

#### Summary Financials (US\$m unless specified)

Year end 31 Dec	2020A	2021A	2022E*
Group Pre-Tax Op. Profit	20.6	(21.0)	(30-40)*
PM Fee Income (incl. minority stake)	24.1	56.1	80.0*
PM PTOP	3.4	20.6	55.0*
Legacy Insurance PTOP	49.0	(5.7)	(55.0)*
EPS (c)	14.2	(46.9)	-
Yield on distribution (%)	2.4	2.8	-
Tangible NAV per share (c)	173	131	-

Source: Group report & accounts and ED estimates \*Indicative, per R&Q trading update

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## Outline proposal has compelling logic

R&Q operates two distinct, complementary businesses which access different trends within the global insurance industry. Both have leveraged the group balance sheet to grow but have now attained the maturity and scale necessary to operate on a standalone basis.

Program Management (Accredited) has **grown substantially** over the last three years into one of the largest global PMs. In FY22 it will report record \$1.8bn Gross Written Premium and US\$80m Fee Income (excluding minority stakes in MGAs). Accredited's strong AM Best credit rating has relied on the financial strength of the R&Q group, but it has the scale to stand alone.

Legacy continues its transition onto a fee-based, capital efficient, more sustainable and profitable business model. Although FY22 saw fewer transactions than in prior years, R&Q attributes this to a prudent approach to identifying deals profitable for both it and Gibson Re. In January it reported that Reserves Under Management (RUM) had reached US\$1bn from a standing start in Q4 21.

## Preliminary FY 22 trading update

R&Q reported based upon preliminary, unaudited information, that it expects to realise a US\$30-40m FY22 pre-tax operating loss. A positive US\$55-60m contribution from Program Management is offset by US\$55-60m of losses from Legacy Insurance and c US\$35m of corporate/other, principally interest expense.

PM's strong performance is built by on end FY22, \$1.8bn of GWP and US\$80m of Fee Income (excluding minority stakes in MGAs), respective y-o-y increases of 80% and 78%. PTOP includes US\$12m from the 40% stake in Tradesman Program Managers, which R&Q sold to its controlling shareholder in Q1 23.

Legacy's weaker than anticipated contribution reflected lower levels of completed transactions; it acquired c US\$70m of gross reserves and reported a c 3-4% net adverse development of group net reserves. End FY22 RUM is expected to be c US\$400m (c US\$1bn as of January 2023).

Although the Q4 22 actuarial review process identified a need to strengthen reserves, the IFRS accounting regime recognised a large portion of total lifetime earnings at transaction close. These are a significant component of the assessment of the overall profitability of historical legacy transactions.

This will be affected by new accounting rules from 1 January 2023. The IFRS accounting regime previously permitted 'Day-1 gains', whereby the majority of a transaction's profits could be recorded upfront when a transaction closed. That meant that any net reserve development after a transaction closed added volatility to earnings, but the underlying returns from the transaction would meet expectations including Day-1 gain and investment income.

Corporate costs of c US\$35m comprise debt interest expense, unallocated expenses and forex effects on net asset revaluations.

## Appointment of new Chairman strengthens management team

The group has appointed of Jeffrey Hayman as Non-Executive Chairman with immediate effect. He has spent nearly 40 years in the insurance industry including long tenures at The Travelers and American International Group, CEO of Global Consumer Insurance and President & CEO of AIU Far East Holdings. He was also recently a Board member and committee chair of Zurich Insurance Group Ltd.

William Spiegel will assume the role of Group CEO and Alan Quilter, R&Q's current CEO, will work exclusively with the Program Management teams in the US and UK/Europe before he retires at the end of December 2023.



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