IS STEPHEN WAY'S HOUSTON INTERNATIONAL INSURANCE GROUP (HIIG) NOW IN PLAY? Controlling Shareholder (Westaim) "May Consider" Opportunities To Enhance Growth & Value Following Receipt Of "Several Unsolicited Enquiries" For Specialty Insurer HIIG = Let The Kabuki Dance Begin.

Against a backdrop of disappointing property/casualty (re)insurance pricing levels, but a very active/"hot" M&A market, Canadian investment company **Westaim** disclosed that "in view of the ongoing industry consolidation and the receipt of several unsolicited enquiries," it "may consider opportunities to enhance the growth and value of HIIG." We take this as a euphemism that the Stephen Way led, Texas-based, specialty insurer Houston International Insurance Group (HIIG) is now *"in play."* This said, while Westaim is calling the shots as the GP of the controlling shareholder, any buyer would be well served to structure a transaction acceptable to Stephen Way/ HIIG's senior managers (with continuing roles). According to the press release, there is no definitive schedule for the consideration of alternatives or any related process (and no mention of an I-Banker yet hired to facilitate any process).

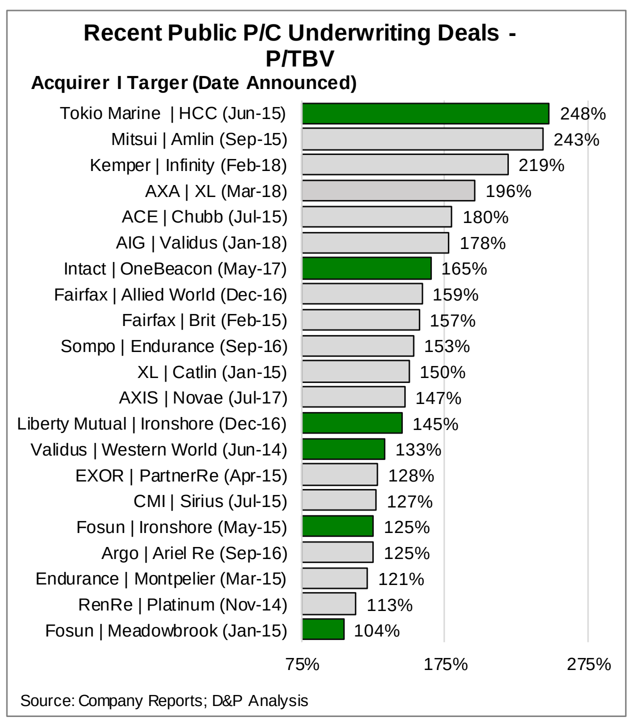
> *"Westaim's mandate is to align our capital with experienced management teams in order to build great businesses. Under Stephen Way's leadership for the past four years, HIIG has significantly improved its financial position, acquired and established new business lines, prepared the organization for larger scale and assembled a highly skilled and experienced management team. As a result,* ***HIIG is currently in an excellent position to accelerate the growth of its business, particularly in an improving industry environment."***
> **- Westaim President & CEO, J. Cameron MacDonald**

HIIG has been growing at an annual clip of 9% since 2013, ending 2017 with $575M of gross premiums ($258M net). As was the case at Houston Casualty (which Mr. Way founded and was sold to Tokyo Marine for 2.5x tangible BV in 2015 – IBNR#21_2015) HIIG makes extensive use of reinsurance -- see latest financials below. HIIG was formed out of a merger of Mr. Way's Southwest Insurance Partners and Lightyear owned holding company of troubled Delos Insurance Co and E&S carrier Naxos (IBNR#38_2010). At the time of the announced merger, Delos' and Naxos' AM Best "A-" financial strength rating had been placed under review with negative implications following (among other things) material reserve strengthening (IBNR#40_2010). Since then, Delos historical book/reserves have dragged HIIG results leading to a significant % of the legacy book being put into runoff and management attempting to wall off its exposures through reinsurance and adverse development covers. Clearly, the workers comp results were far worse than Mr. Way or the myriad consulting actuaries envisioned. See more details below on HIIG background. Per a recent AMB report, *"of all the programs written prior to the December 2010 merger … only one was retained as a part of its ongoing portfolio. Approximately two dozen other programs were canceled."*

Meanwhile, HIIG formed a new E&S co and went on to acquire several managing agents – not unlike the strategy Stephen Way employed at HCC. As such, **the book today is likely far different than historical financials would suggest**.

Westaim owns 58.5% of HIIG Partnership which owns 75% of the common shares of HIIG = Westaim has a 43.9% indirect ownership in HIIG. Other investors in HIIG include a management group led by HIIG's founder and CEO Stephen Way (also founded **HCC**), **Everest Re** and **Catlin (XL)** = soon to be **AXA**.

As of YE'17, per the 2017 Annual Report, Westaim carries the fair value of its investment in HIIG to be $157.1M or 1.1x of HIIG's adjusted S/E, up from 1.0x at YE'16, reflecting a general improvement in P&C industry conditions, improved investment outlook (higher short-term interest rates) and a reduction in the U.S. corporate tax rate. **HIIG's GAAP S/E stood at $318.9M at YE'17.**

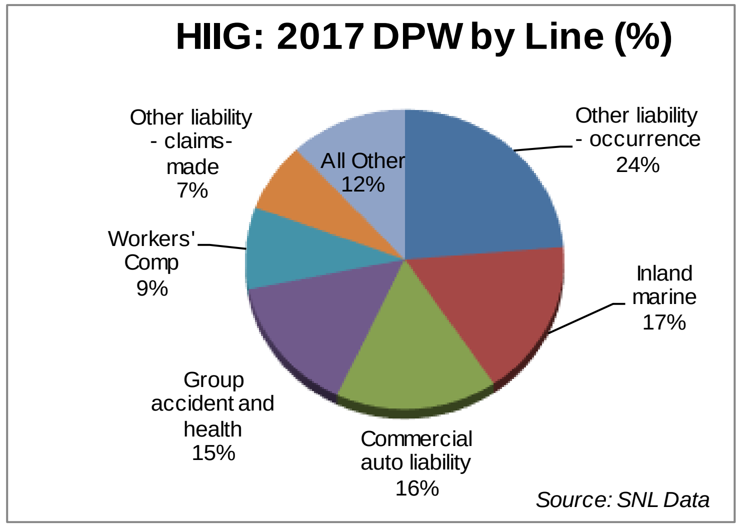


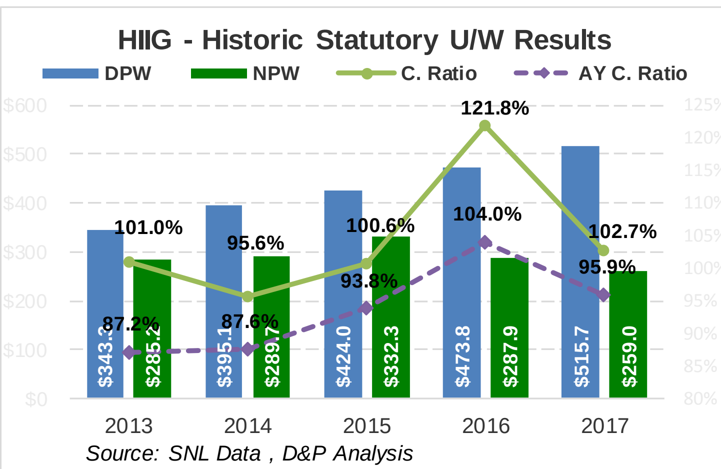
Return to top

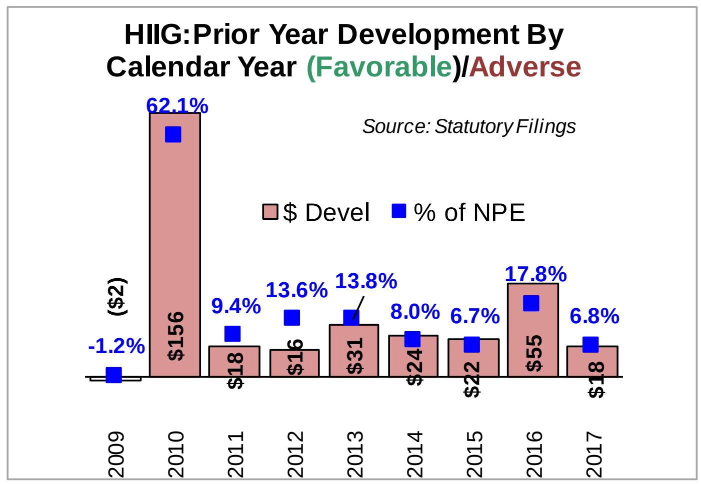
Who Is Houston International Insurance Group (HIIG)? … HIIG writes on both a non-admitted and admitted basis and operates through 5 subs: E&S carrier (admitted in TX) Houston Specialty (A- by A.M. Best), TX-only E&S carrier Oklahoma Specialty (A-), admitted insurer Imperium Ins Co (A-), admitted insurer Great Midwest Ins Co (A) and HIIG Underwriters Agency (represents unaffiliated insurance cos & Lloyd's u/writers)

The company has 286 full time employees and its reporting segments include **Commercial** (standard P&C lines underwritten on an admitted basis, including workers' comp, construction, security firms and pest control operations), **Specialty** (E&S lines including energy, professional lines, transportation property, hospitality and commercial auto), **MGU Partners** (premiums from contracted MGUs in specialty lines including artisan contractors, lawyers E&O and auto dealers), **A&H** (medical stop loss) and discontinued lines.

HIIG's select historic statutory data is shown below. **Since 2013, DPW has been growing at 11% annually, while NPW has been down slightly, reflecting increasing use of reinsurance**.







HIIG's select U.S. GAAP financials are shown below (per Westaim's Annual Report). **GPW was up 8% in 2017**, driven by Commercial and Specialty, while **NPW declined 10%** due to an increase in proportional reinsurance across all segments (net to gross was 45% vs. 54% YOY).

Prior year reserve additions improved to $8.8M in 2017 on a GAAP basis (vs. $58.2M YOY) and included $5.1M in Commercial, $1.5M in MGU Partners, $2.8M in A&H, partly offset be releases of $0.6M in other segments. In 2016, the majority of adverse development was due to 3rd party TPA mishandling of claims. In response, the company replaced the TPA and brought all claims in house other than auto, workers' comp and legacy runoff.

The **underlying ex cat AY combined ratio improved to 97.5% in 2017 from 102% in 2016, driven largely on expense ratio improvements (-5.1pts to 31.7%** - we assume increased QS reinsurance / ceding commissions helped). **Overall, the underlying loss ratio deteriorated by 0.6pts in 2017 to 65.8%.** HIIG largely avoided losses from HIM/CA wildfires through the use of significant reinsurance (net cats were $1.9M in 2017 vs. none YOY).

HIIG's investments are partly managed by Arena, a specialty finance company wholly owned by Westaim.

Houston International Insurance Group US GAAP, $, M	2017	2016	Chg
Gross Premium Written	**$575.3**	**$534.2**	**7.7%**
Net Premium Written	**$257.7**	**$286.5**	**-10.1%**
Net/Gross	*44.8%*	*53.6%*	*(8.8)*
Net Premium Earned	$265.7	$310.4	-14.4%
Loss Ratio	69.8%	83.9%	(14.1)
Expense Ratio	31.7%	36.8%	(5.1)
Combined Ratio	**101.5%**	**120.7%**	**(19.2)**
Cats	0.7%	0.0%	0.7
Prior Year Development	3.3%	18.8%	(15.4)
Ex. Cat AY Combined Ratio	**97.5%**	**102.0%**	**(4.5)**
Ex. Cat AY Loss Ratio	***65.8%***	***65.2%***	***0.6***
Net Income Before US Tax Reform	$16.6	($7.3)	NM
Impact of US Tax Reform	($22.1)		
Net Income	($5.5)	($7.3)	
Cash & Investments	$613.2	$635.8	-3.6%
Shareholders' Equity	**$318.9**	**$324.7**	**-1.8%**

Source: Westaim Annual Report

Segment Information	2017	2016	Chg.	2017 Mix
Commercial	$96.5	$83.2	16.0%	17%
Specialty	$268.4	$230.2	16.6%	47%
MGU Partners	$131.9	$134.8	-2.2%	23%
A&H	$78.5	$86.0	-8.7%	14%
Discontinued	$0.0	$0.0	NM	0%
Total	$575.3	$534.2	7.7%	100%

Net Loss/LAE Ratio	2017	2016	Chg.
Commercial	91.2%	124.6%	(33.4)
Specialty	55.7%	77.6%	(21.9)
MGU Partners	66.6%	64.5%	2.1
A&H	89.0%	86.0%	3.0
Discontinued	NM	NM	NM
Total	69.8%	83.9%	(14.1)

HIIG's top reinsurers (based on 2017 ceded premiums) are shown in the table below – it's no surprise to see Everest at the top of the list given its investment in HIIG:

Top Reinsurers of Houston Int'l Grp ($, M) Reinsurer Group	2017 Ceded Premium	2016 Ceded Premium	YOY Chg	2017 % of Total
Everest Re Group, Ltd.	$94.7	$75.1	26%	30%
Lloyd's of London	$32.1	$27.0	19%	10%
Munich Re	$23.4	$21.7	8%	7%
Reinsurance Group of America, Incorporated	$17.1	$0.0		5%
MS&AD Insurance Group Holdings, Inc.	$14.8	$17.1	-13%	5%
Maiden Holdings, Ltd.	$14.3	$1.8	685%	5%
Enstar Group Limited	$12.6	$0.0		4%
Chubb Limited	$11.0	$9.1	21%	4%
Eurasian Financial Company JSC	$10.8	$9.6	13%	3%
Alleghany Corporation	$10.7	$2.4	353%	3%
Swiss Re AG	$10.1	$6.3	62%	3%
SCOR SE	$9.8	$6.5	51%	3%
Bank of Cyprus Holdings Public Ltd Company	$9.7	$10.7	-9%	3%
Nestle S.A.	$8.3	$33.0	-75%	3%
Fairfax Financial Holdings Limited	$8.3	$1.4	508%	3%
Hannover Re	$6.0	($0.3)	-2436%	2%
Arch Capital Group Ltd.	$4.2	$4.3	-1%	1%
China Reinsurance (Group) Corporation	$4.0	$0.5	644%	1%
Tehua Investment Holding Co., Ltd.	$2.6	$2.8	-6%	1%
Berkshire Hathaway Inc.	$1.7	$0.3	573%	1%
Argo Group International Holdings, Ltd.	$1.6	$1.4	18%	1%
Greenlight Capital Re, Ltd.	$1.0	$2.8	-64%	0%
Validus Holdings, Ltd.	$0.8	$0.0		0%
QBE Insurance Group Ltd.	$0.6	$2.5	-76%	0%
Qatar General Insurance & Reinsurance Company Q.P.S.C.	$0.6	$0.6	2%	0%
Top 25 Reinsurers	**$310.8**	**$236.4**	**31%**	**99%**
All Other	**$4.1**	**$5.0**	**-19%**	**1%**
TOTAL	**$314.9**	**$241.4**	**30%**	**100%**

Source: SNL, D&P Analysis

Return to top

HIIG Background…

2007	**Southwest Insurance Partners (SWIP) Was Formed To Make Strategic Acquisitions: In 2007**, following his departure from **HCC** (IBNR#46_2006) a public specialty insurer he founded and led as Chairman/CEO, Stephen Way, and a group of investors established Houston-based Southwest Insurance Partners (SWIP) to make strategic acquisitions and investments in insurance companies. The investor group included: **Argo**, American Safety (now part of **Fairfax**), International General Ins Co Ltd (Dubai), SureTec Financial (now owned by **Markel**) and several high net worth individuals.
2008	**1st Acquisitions:** SWIP acquired Great Midwest Ins Co and its affiliated MGA, Bunker Hill Insurance Agency, in February and National Health Insurance Co (NHIC) in September.
Dec. 2010	**Merger With Lightyear Delos To Form Houston International Insurance Group (HIIG)** (IBNR#38_2010)**:** SWIP and Lightyear Delos Acquisition Corp (LYDAC) merged to create Houston International Insurance Group, a new insurance holding company headquartered in Houston. LYDAC was formed by private equity investors Lightyear Capital and Trilantic to be a holding co of two DE-domiciled P&C insurers: Delos Insurance Co and E&S carrier Naxos. Note Delos was the #20 writer of CA workers' comp with $85M of DPW (~60% of the co's total CA DPW), having grown in CA at exactly the wrong time leading to significant reserve charges in this line & others. At the time of the announced merger, Delos' and Naxos' AM Best "A-" financial strength rating had been placed under review with negative implications. HIIG later renamed Delos to Imperium Ins Co (IIC), Naxos to Houston Specialty Ins Co (HSIC), and Bunker Hill to HIIG Underwriters.
2010	**Delos/IIC Runoff Reserve Charges & Business Transformation Begins:** Upon the closing of the merger in 2010, LYDAC took a reserve charge related to **Delos'** (now IIC) business put into runoff (only one program was retained by IIC and ~ two dozens cancelled). **IIC was transformed from a program business writer into a specialty admitted niche company. *Despite the charge, adverse development on the IIC legacy book continued to negatively impact HIIG results.***
2011	**New E&S Company Launched:** HIIG launched Oklahoma Specialty Ins Co to write E&S business in TX (100% reinsured by HSIC).
2011-2015	**Several Managing Agents Were Acquired:** HIIG completed acquisitions of several managing agents including Casualty & Surety (AL-based MGU specializing in small to medium-size mining and energy risks) in 2011, Axiom Insurance Managers (Chicago-based underwriting manager specializing in the hospitality industry) in 2013, Compass Group Partners (FL-based MGU specializing in title agents and insurance agents E&O) in 2014, Elite Underwriting Services (PA-based MGU specializing in medical stop loss and other A&H with ~$100M of GPW) in 2015, a 20% investment in RISCOM (LA-based MGU specializing in underwriting, processing services and claims management) in 2015, Capital Risk Underwriters (FL-based MGU specializing in pest control) in 2015. In 2012, HIIG sold NHIC .
Aug. 2014	**Westaim Partnership Acquires Majority Ownership Of HIIG:** The Partnership led by Westaim completed the acquisition of ~70.8% of HIIG shares for an aggregate price of $138.7M, including $53.7M from certain selling shareholders (including Lightyear Capital and Trilantic) and $85M of newly issued shares by HIIG. The funding included $75.7M from Westaim, $24.3M from Everest Re, $22.9M from Catlin, $10M from Stephen Way (and/or certain investors affiliated with Mr. Way) and $8.2M from certain other existing shareholders of HIIG and other investors. Per Westaim, the acquisition valued HIIG at ~87% of its YE'13 adjusted S/E.
Jan. 2015	**Additional Capital Raised To Fund Managing Agent Acquisition & Growth:** HIIG raised $70M in additional capital from Westaim and other Partnership investors (including Everest Re, Catlin and Mr. Way himself) to fund the acquisition of Elite Underwriting Services and provide capital contributions to HIIG's insurance subs to fund growth (A.M. Best affirmed its ratings with stable outlooks).
2016 & 2017	**Purchase Of Reserve Covers On Delos / IIC runoff books:** To mitigate risks related to IIC's runoff book, the group purchased adverse development covers in both 2016 and 2017. Per IIC's statutory filing, effective 1/1/17 there was a retroactive reinsurance agreement in place that protects against adverse development from discontinued lines for the annual period 1/1/2017-12/1/2017. Other income related to this agreement was $5.6M in 2017. HIIG maintains indemnification from **White Mountains** for certain reinsurance recoverables and for loss reserves for all AYs prior to 1998, including A&E. HIIG also has accident year stop loss reinsurance protection from **Sirius International** (a former subsidiary of White Mountains). *Note, White Mountains sold Sirius America (a U.S.-based insurer focused on primary insurance programs) to an investor group led by **Lightyear** for 1.14xBV in August 2006 = the company was renamed Delos Insurance Company on 8/3/2006.*

Source: Company Reports