

Skyward Specialty Insurance Group, Inc.

4Q22 Review: Tilting “Skyward”

SKWD is off to a good start in its first reporting season as a public company. We can envision greater upside for the stock as long as we continue to see GWP growth, improvements in its AYLR and no adverse PYD.

Our first impressions of the 4Q print were better than expected expense ratio and higher NII. Following the earnings call, we gained greater clarity of its ceded Re strategy where SKWD is weighing in the merits of reinsurance by each risk class and is not constrained. While Global Property GWP was a lesser standout than other business classes this quarter, we expect to see more momentum through the course of the year. The degree of AYLR improvements from here will predicate upon rates remaining ahead of loss trend, which SKWD is still seeing, just not at the same high watermark as 2-3 quarters ago.

Rates vs. Loss trends: Pure rates in high single digits are “meaningfully” above loss cost inflation. Pricing came up a few ticks in 4Q22 vs 3Q22.

Mid teens submission flow y/y.

Premium Growth >35% is select segments: Transactional E&S, professional lines, captives and Surety divisions. Transactional E&S remains a greenfield operation for SKWD, as it is not at scale yet, expect hyper growth to continue. SKWD is scaling up its surety business, in which it acquired Aegis Surety in 2021. Captive business (where a large portion of risk is self-insured) is chunky/more opportunistic. Finally, on professional lines, SKWD does not play a heavy hand within the public D&O space, it is holding the line into 2022. SKWD is finding miscellaneous classes of professional lines business to be attractive on a risk-adjusted return basis, like cannabis.

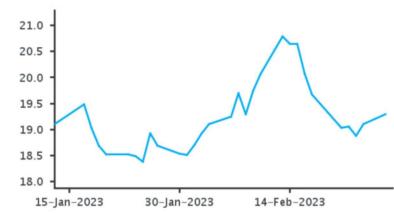
Ceded Re Strategy: At 1/1 renewals, SKWD entered into a whole account QS treaty for commercial auto with some optionality on changing the structures of its the portfolio specific auto liability reinsurance covers during 2H23. On the flipside, at 1/1, SKWD elected to retain more XOL professional lines risk. SKWD’s reinsurance renewals are staggered throughout the year, we expect to hear more iterations. 5/1 is SKWD’s large cat reinsurance renewal. With a larger balance sheet post IPO raise, we think SKWD could retain more risk when it finds it more compelling to do so on an economic basis. SKWD is expecting lower net retained premium for 1Q-2Q23. On a seasonality perspective, net premium retention is lower in 1H and higher in 2H. SKWD is not seeing a compression in ceding commissions since its IPO launch nor is it expecting pressure in 2023. We would not rule out some compression. Quota share heavy businesses are Global Property and Captives.

CORE Earnings Review

| | |
|-----------------------------|------------|
| SKWD | OVERWEIGHT |
| | Unchanged |
| U.S. Insurance/Non-Life | POSITIVE |
| | Unchanged |
| Price Target | USD 22.00 |
| | Unchanged |
| Price (28-Feb-23) | USD 19.52 |
| Potential Upside/Downside | +12.7% |
| Market Cap (USD mn) | 734 |
| Shares Outstanding (mn) | 37.60 |
| Free Float (%) | 23.81 |
| 52 Wk Avg Daily Volume (mn) | N/A |
| Dividend Yield (%) | N/A |
| Return on Equity TTM (%) | 10.51 |
| Current BVPS (USD) | 25.42 |

Source: Bloomberg

Price Performance Exchange-Nasdaq
52 Week range USD 21.39-17.50



Source: IDC
[Link to Barclays Live for interactive charting](#)

U.S. Insurance/Non-Life

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Completed: 01-Mar-23, 21:15 GMT Released: 01-Mar-23, 21:20 GMT Restricted - External

We reiterate our Overweight rating and price target of \$22 which is based on a 50/50 weighted 10.0x (unchanged) P/E multiple on our '24 EPS estimate of \$2.07 (from \$2.03) and 1.5x (unchanged) P/TBV excluding AOCI on our '24 TBVPS excluding AOCI of \$15.41 (from \$15.34).

SKWD: Quarterly and Annual EPS (USD)

| | 2022 | 2023 | | | 2024 | | | Change y/y | |
|---------------|---------------|-------------|------------|-------------|-------------|------------|-------------|-------------------|-------------|
| FY Dec | Actual | Old | New | Cons | Old | New | Cons | 2023 | 2024 |
| Q1 | N/A | 0.41E | 0.40E | N/A | 0.55E | 0.55E | N/A | N/A | 38% |
| Q2 | N/A | 0.45E | 0.46E | N/A | 0.53E | 0.54E | N/A | N/A | 17% |
| Q3 | N/A | 0.32E | 0.34E | N/A | 0.35E | 0.37E | N/A | N/A | 9% |
| Q4 | 0.36A | 0.55E | 0.56E | N/A | 0.60E | 0.61E | N/A | 56% | 9% |
| Year | N/A | 1.82E | 1.85E | 1.80E | 2.03E | 2.07E | 2.18E | N/A | 12% |
| P/E | N/A | 10.5 | | | 9.4 | | | | |

Consensus numbers are from Bloomberg received on 01-Mar-2023; 13:50 GMT

Source: Barclays Research

| U.S. Insurance/Non-Life | | | | | | POSITIVE |
|---|-----------|-----------|-----------|-------|---------|----------------------------------|
| Skyward Specialty Insurance Group, Inc. (SKWD) | | | | | | OVERWEIGHT |
| Income statement | 2022A | 2023E | 2024E | 2025E | CAGR | Price (28-Feb-2023) USD 19.52 |
| Net premiums earned (\$k) | 615,993 | 758,554 | 829,689 | N/A | N/A | Price Target USD 22.00 |
| Net investment income (NII) (\$k) | 36,931 | 41,645 | 51,271 | N/A | N/A | |
| Underwriting income (\$k) | 31,311 | 49,608 | 54,911 | N/A | N/A | |
| Operating income (\$k) | 49,783 | 79,019 | 99,878 | N/A | N/A | |
| Net income (\$k) | 39,396 | 62,425 | 78,903 | N/A | N/A | |
| Effective tax rate (%) | N/A | N/A | N/A | N/A | N/A | |
| Combined ratio (%) | 94.9 | 93.5 | 93.4 | N/A | N/A | |
| Combined ratio (ex cats & py development) (%) | N/A | N/A | N/A | N/A | N/A | |
| Per share data (\$) | 2022A | 2023E | 2024E | 2025E | CAGR | |
| EPS (adj) | N/A | 1.85 | 2.07 | N/A | N/A | |
| EPS (reported) | N/A | 1.75 | 2.07 | N/A | N/A | |
| DPS | 0.00 | 0.00 | 0.00 | N/A | N/A | |
| BVPS | N/A | 14.49 | 16.56 | N/A | N/A | |
| BVPS (ex AOCI) | N/A | 15.63 | 17.70 | N/A | N/A | |
| Diluted shares (k) | N/A | 35,666 | 38,041 | N/A | N/A | |
| Balance sheet and capital return | 2022A | 2023E | 2024E | 2025E | CAGR | |
| Total investments (\$k) | 1,082,367 | 1,302,008 | 1,354,874 | N/A | N/A | |
| Common shareholders' equity (ex AOCI) | N/A | N/A | N/A | N/A | N/A | |
| Share buybacks (\$k) | N/A | 0 | 0 | N/A | N/A | |
| Dividends paid (\$mn) | 0 | 0 | 0 | N/A | N/A | |
| Balance sheet and capital return metrics | 2022A | 2023E | 2024E | 2025E | Average | |
| Debt leverage (%) | 0.0 | 0.0 | 0.0 | N/A | 0.0 | |
| Financial leverage (%) | N/A | N/A | N/A | N/A | N/A | |
| Total capital return as a % of op. earnings | 0.0 | 0.0 | 0.0 | N/A | 0.0 | |
| Valuation metrics | 2022A | 2023E | 2024E | 2025E | Average | |
| P/BV (ex AOCI) (x) | N/A | 1.25 | 1.10 | N/A | 1.18 | |
| P/E (adj) (x) | N/A | 10.5 | 9.4 | N/A | 9.9 | |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | N/A | 0.0 | |
| ROE (%) | 13.8 | 13.7 | 13.5 | N/A | 13.7 | |

Note: FY End Dec
Source: Company data, Bloomberg, Barclays Research



4Q22 Highlights

Operating earnings Beat: SKWD reported 4Q22 adjusted net operating earnings of \$11.6mn which was better than our estimate of \$10.9mn. The beat was driven by better than expected net investment income.

4Q22 GWP growth: SKWD GWP grew/declined by 18.1% y/y (vs. our 18.6% estimate). SKWD's continuing business GWP was up 21.4% y/y vs. our estimated 22.3%.

According to Andrew Robinson, CEO: “*We continue to realize strong pure rate in excess of expected loss cost trends, and our double-digit growth in each and every one of our eight underwriting divisions during 2022 provides us a terrific launch point for continued growth and margin expansion in 2023.*”

We think SKWD's greatest opportunity for premium growth is within its transactional E&S and Global property segments.

Better than expected Expense Ratio: SKWD's expense ratio in 4Q22 of 28.4% was below its 3Q22 result of 29.1% and better than our estimate of 29.1%. Underwriting performance: SKWD combined ratio was 92.4% vs. our estimate of 93.3%. AYLR (ex LPT and non-LPT) was 63.2% vs. our estimated 63.3%. Total company AYCR ex cats was 91.6% vs. our 92.4% estimate, also ex LPT and non-LPT.

SKWD reported \$5.3mn of net investment income vs. our estimate of \$4mn. The average duration fo assets is 4 years and SKWD's reinvestment rate is 5% on its core fixed income portfolio. We had expected SKWD's NII contribution from its opportunistic fixed income to be a greater drag to overall NII. SKWD's opportunistic fixed income piece hurt overall NII by \$2.3mn and its core fixed income portfolio yield was 3.7% in 4Q22 vs. 2.2% in 4Q22.

FIGURE 1. 4Q22 Key Results

| Skyward (\$ thousand) | 4Q22A | 4Q22E | Variance |
|---|-----------|-----------|----------|
| Gross written Premiums | \$264,832 | \$265,881 | -0.4% |
| Ceded written premiums | -\$84,876 | -\$90,946 | -6.7% |
| Net written premiums | \$179,956 | \$174,935 | 2.9% |
| Net earned premiums | \$170,143 | \$173,265 | -1.8% |
| Combined ratio | 92.4% | 93.3% | -0.9% |
| AYCR ex Cat | 91.6% | 92.4% | -0.8% |
| Loss ratio | 64.0% | 64.2% | -0.2% |
| Accident year loss ratio ex cats | 63.2% | 63.3% | -0.1% |
| Expense ratio | 28.4% | 29.1% | -0.7% |
| Cat pts | 1.2% | 1.2% | 0.0% |
| PYD pts (LPT and non-LPT) (Favorable)/unfavorable | -0.4% | -0.3% | -0.1% |
| Net Investment Income | \$5,264 | \$4,000 | 31.6% |
| Net (loss) income | \$20,419 | \$20,365 | 0.3% |
| Adjusted operating income | \$11,641 | \$10,885 | 6.9% |
| Annualized adjusted ROE | 11.3% | 10.6% | 0.7% |
| Annualized adjusted ROTE | 14.5% | 13.6% | 0.9% |

Source: Barclays Research, Co. Filings

FIGURE 2. Model Summary Income Statement

| (\$ in thousands, except per share amounts) | FY 2020 | FY 2021 | FY 2022 | FY 2023E | FY 2024E |
|--|-----------------|----------------|----------------|-----------------|-----------------|
| Revenues | | | | | |
| Gross written premiums | 873,613 | 939,859 | 1,143,952 | 1,298,479 | 1,434,720 |
| Premiums ceded | (412,090) | (410,716) | (468,410) | (488,716) | (540,000) |
| Net written premiums | 461,523 | 529,143 | 675,542 | 809,763 | 894,720 |
| | - | | | | |
| Net earned premiums | 431,911 | 499,823 | 615,993 | 758,554 | 829,689 |
| Losses and loss adjustment expenses | 362,182 | 354,411 | 402,512 | 492,111 | 537,606 |
| Underwriting expenses | 119,818 | 138,498 | 182,170 | 216,835 | 237,172 |
| Underwriting earnings | (50,089) | 6,914 | 31,311 | 49,608 | 54,911 |
| | - | | | | |
| Commission and Fee Income | 5,664 | 3,973 | 5,199 | 3,600 | 3,600 |
| Other income | 128 | 4,632 | 1 | (4,680) | - |
| Other Operating Income | 5,792 | 8,605 | 5,200 | (1,080) | 3,600 |
| | - | | | | |
| Net Investment income | 14,130 | 24,646 | 36,931 | 41,645 | 51,271 |
| Net un/realized gains (losses) on investments | 139 | 17,107 | (15,704) | - | - |
| Impairment Charge | 57,582 | 2,821 | - | - | - |
| Interest expense | 5,532 | 4,622 | 6,407 | 9,688 | 8,831 |
| Amortization of intangible assets | 1,390 | 1,520 | 1,548 | 1,466 | 1,074 |
| | - | | | | |
| | 1 | | | - | - |

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Skyward Specialty Insurance Group, Inc. (SKWD, 28-Feb-2023, USD 19.52), Overweight/Positive, A/CE/D/FA/J/L

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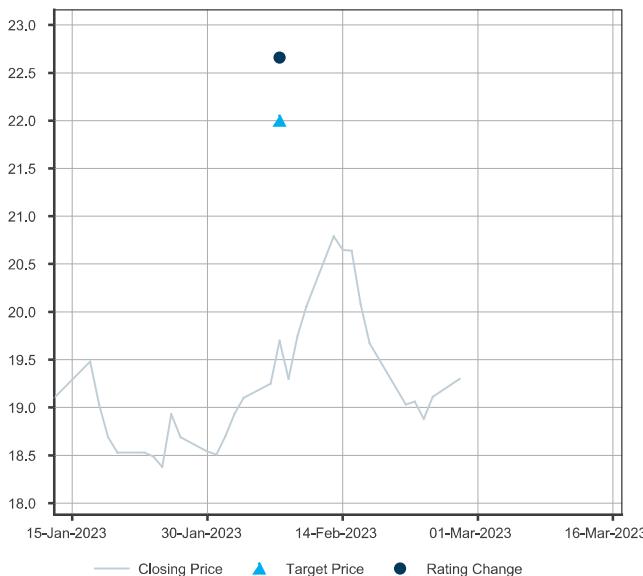
Stock Rating: **OVERWEIGHT**

Industry View: **POSITIVE**

USD 19.52 (28-Feb-2023)

Rating and Price Target Chart - USD (as of 28-Feb-2023)

Currency=USD



Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

| Publication Date | Closing Price* | Rating | Adjusted Price Target |
|------------------|----------------|------------|-----------------------|
| 07-Feb-2023 | 19.25 | Overweight | 22.00 |

Source: Bloomberg, Barclays Research

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Valuation Methodology: We are using a 50/50 weighted 10.0x P/E multiple on our '24 EPS estimate and 1.5x P/TBV excluding AOCI on our '24 TBV ex AOCI.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Greater variability of net investment income stemming from its "opportunistic fixed income fund" (i.e. 19% of its investment portfolio and 60% of NII for YTD3Q22). This fund is originated and managed by Arena, another Westaim subsidiary. Albeit, SKWD is winding down the opportunistic fixed income fund. Higher dependence on reinsurance than established peers. SKWD is not immune to the secular challenges posed by the commercial auto insurance market (25% DPW for YTD3Q22). SKWD was able to achieve sub 30% GWP growth in its core businesses over the last 2 years, with a notable step down in growth to sub 10%

level anticipated in 2023E. As the bulk of IPO proceeds are pushed down to the operating companies it remains to be seen if these proceeds are truly funding future growth or back filling historical growth that had already consumed statutory capitalization.

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