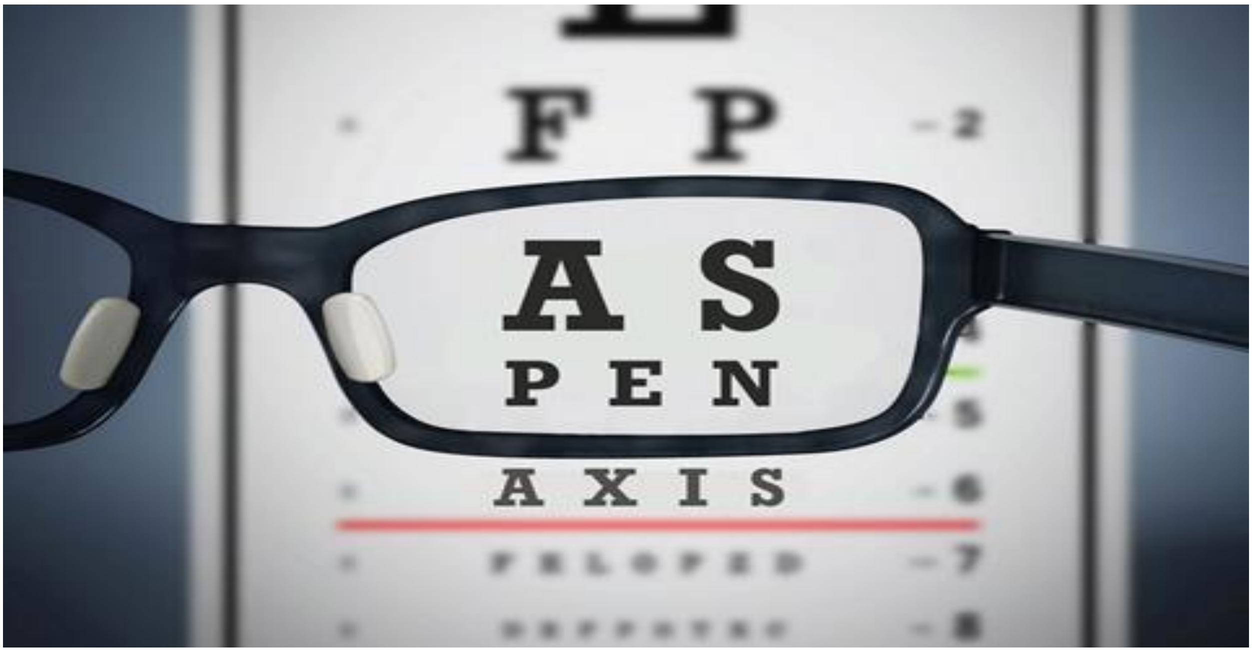
Looking at the wrong A?

With Aspen first round bids due at the end of this week, ***Re-Insurance.com*** looks at its larger Bermudian peer Axis which has a more credible track record, trades on a lower multiple and owns a better insurance franchise.



When ***re-Insurance.com*** revealed last month that Aspen's bankers were poised to begin a formal sale process, it sent shares in the Bermudian carrier up a further 5 percent.

Indeed, Aspen's shares are now up almost 30 percent since late February when the scale of its 2017 losses became apparent (see chart) and the carrier now trades on a price-to-earnings multiple of around 1.1x.

But garnering far less attention is the recent, strong share price movement of Aspen's Bermudian peer Axis, which - as the chart below demonstrates - has danced to a remarkably similar tune in the past year.

The clear implication is that the market has assumed Axis is also in play, albeit accompanied with far less noise.

Re-insurance.com compares the two and concludes that - at its current valuation - Axis is a more attractive proposition for buyers with deeper pockets. Here's why…

First, as it currently stands, Axis sits on a lower valuation with a price-to-book multiple hovering around 1.03x compared to Aspen's circa 1.1x.

If Aspen is sold at, say, 1.25x book (circa $50 per share) then it suggests that potential acquirers could offer a 25 percent premium to Axis' current share price of around $56.50 to gain a similar valuation.

Axis' underwriting returns are substantially better - even when looking at the devastation of last year - which inevitably hit specialty (re)insurers such as Aspen and Axis.

The trio of Atlantic hurricanes, duo of earthquakes in Mexico as well as the wildfires that scorched swathes of California, pushed Axis to a full year operating loss of $264.6mn with a combined ratio of 113.1 percent.

Aspen meanwhile, delivered a combined ratio that was significantly north of that at 125.7 percent, contributing to a $355.7mn loss.

That pattern is also repeated in more normal loss-years.

In 2016, for example, Axis delivered a 95.9 percent combined ratio, while Aspen's was almost a full three points higher at 98.5 percent. And while operating return on equity was negative for both firms in 2017, Axis still came off better - down just 5.4 percent against Aspen's 29.6 percent.

For 2016, Axis was in the black with a solid if unremarkable 7.9 percent return on equity while Aspen was still in the red reporting a negative return of 2.8 percent.

Both groups consist of substantial - and well-regarded - reinsurance businesses. In Aspen's case, its roots were the reinsurance arm of then-Lloyd's insurer Wellington that was carved out of Lime Street and into Bermuda as a private equity-backed management buyout after the 9/11 attacks. Axis' reinsurance franchise was also built after that defining moment - when it was launched by John Charman in late 2001.

But Axis' insurance business appears a more credible platform. For example, in 2017 Aspen's $1.81bn insurance business reported a 117.9 percent combined ratio, above the 111 percent reported by Axis' insurance segment which wrote $3.13bn in 2017.

In 2016, however, Axis' insurance combined ratio was 97.9 percent, while Aspen's was 99.6 percent.

One possible impediment is that, at $4.7bn, Axis' current market cap would require a buyer to reach into deeper pockets than Aspen's current $2.6bn. As Axis is not running a formal sale process, then there are the obvious "socials" that have hamstrung M&A in the past - ie who gets what job when two trade buyers contemplate tying the knot. In Aspen's case, this appears to be less of an issue after CEO Chris O'Kane had his "golden parachute" benefits increased by 50 percent.

XL's recent proxy statement also revealed that it had talks with six different trade buyers before agreeing to AXA's overtures. While no one knows for certain, received wisdom assumes that they are likely to include any six from the likes of: Liberty, Markel, Hartford, Fairfax, Allianz, Munich Re and Swiss Re - firms that are all known to be potential acquirers and which could stretch to writing an Axis-sized cheque if the "socials" worked.

But in a year that has already seen two premier Bermuda specialty (re)insurers agree to sell at remarkable premiums - with Axa's $15.3bn take-out of XL, equivalent to 1.96x tangible book value and AIG's $5.6bn acquisition of Validus, at 1.8x - perhaps it is not surprising that the market is assuming Axis could be in the cross-hairs. Aspen will likely go first but Axis - arguably - offers more…

ASPEN V AXIS…

	AXIS	ASPEN INSURANCE
Market cap	$4.69bn	$2.62bn
Combined ratio	113.10%	125.70%
Operating loss	$264.6mn	$355.7mn
Gross written premium	$5.6bn	$3.36bn
Insurance combined ratio	111%	117.90%
Reinsurance combined ratio	108.80%	125.10%
CEO	Albert Benchimol	Chris O'Kane
Founded	2001	2002

- Shortly after leaving ACE, John Charman launched Axis as a post-9/11 vehicle with $1.6bn of PE backing including cornerstone investors MMC Capital (now Stone Point). Charman builds Axis into premier global specialty reinsurer before an ugly 2012 ousting. Would he relish the opportunity to acquire the firm back through Sompo?

- Aspen was effectively the reinsurance business carved out of Lloyd's carrier Wellington (acquired by Catlin in 2006) in controversial circumstances after 9/11 attacks in a PE-backed MBO and then listed on NYSE. Successfully resisted a hostile bid from Charman's Endurance in 2014

All figures for full year 2017

SOURCE: COMPANY FILINGS, RE-INSURANCE.COM