Acquisition of Ariel Re by Argo Group International Holdings Call

Company Participants

- Jay Stanley Bullock, Chief Financial Officer & Executive Vice President
- Mark E. Watson, Chief Executive Officer
- Susan Spivak Bernstein, Senior Vice President-Investor Relations

Other Participants

- Arash Soleimani, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Hello, and welcome to the Argo Group Acquisition of Ariel Re Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note, this event is being recorded.

I would now like to turn the conference call over to Susan Spivak, Senior Vice President of Investor Relations. Please go ahead.

Susan Spivak Bernstein {BIO 1514699 <GO>}

Good morning, and welcome to this conference call to discuss the pending acquisition of Ariel Re by Argo Group. Earlier this morning, we issued a press release announcing that Argo Group has entered into a definitive agreement to acquire Ariel Re, and filed a copy of a related investor presentation regarding the transaction.

All of those documents can be accessed on the Investors section of our website at www.argolimited.com or from the Form 8-K at the SEC website. As the operator mentioned, this call is being recorded. Information recorded on this call speaks only as of today, November 14, 2016, and therefore any time-sensitive information may no longer be accurate as of the day of the reply. Today's discussion is being webcast, and includes forward-looking statements.

We have based these forward-looking statements on our current assumptions, expectations, and projections about future events, such forward-looking statements are qualified by the inherent risks, and uncertainties surrounding future expectations generally and may materially differ from actual future results involving any one or more of such statements. Argo Group undertakes no obligation to publicly update forward-looking statements as a result of events or developments subsequent to this conference call. For a more detailed discussion of such risks and uncertainties, please see Argo Group's filings with the SEC.

With that, I'm pleased to turn the call over to Mark Watson, Chief Executive Officer of Argo Group. Mark will provide an overview of the transaction's strategic rationale, and other key highlights and assumptions. Following prepared remarks, both Mark Watson and Jay Bullock, Argo's Chief Financial Officer will take your questions. Mark?

Mark E. Watson {BIO 20610831 <GO>}

Thank you, Susan, and good morning to everyone. We appreciate you joining us particularly on such short notice.

As you may have seen in our press release, we announced the acquisition of Ariel Re by Argo Group earlier this morning. The transaction is another step in the building of a global specialty platform, which we started more than a decade ago. And this acquisition in particular enhances our scale at both our Lloyd's platform and Bermuda as well.

This transaction will allow Argo to better capitalize on distribution relationships, and more effectively compete across the market. Most important, it will enhance our ability to generate better returns for our shareholders. We expect the acquisition to be immediately accretive to earnings per share and return on equity with modest dilution to tangible book value, which we believe will be made up shortly.

But before I highlight some additional details on Ariel Re and its very profitable track record, I want to emphasize that Argo remains committed to the specialty insurance business. While this acquisition enhances our scale in the reinsurance market, it does not dramatically change our business mix. We have a well-diversified product and geographic portfolio that on a pro forma basis next year will be approximately 88% written on primary insurance risks and 12% on reinsurance risks.

Now, let's talk a bit about Ariel Re. First, I want to welcome the team to Argo. My colleagues and I have spent a lot of time getting to know them, and the way they think about, and approach the business, and the more time I spend with them, the more excited I am, and see the potential for this transaction to help us further achieve our international expansion plans. And as the numbers will show you, Ariel Re is one of the most profitable.

You all hear me talk a lot about digitization, and make it easier for our customers to do business with us. Ariel Re brings us even farther along on that track. They have been investing in their business quite a bit, and Ariel Re has a longstanding profitable position in the market, dating back to 2005. They underwrite a global portfolio of insurance and reinsurance business with teams in London, Bermuda, and the U.S. through Lloyd's Syndicate 1910. And not only does the business have one of the most profitable track records at Lloyd's, but it is also well-diversified by distribution, regional exposure, and peril.

The company has achieved superior returns by sourcing low-frequency/higher-severity, high-margin business. And similar to the strategy at Argo, Ariel has effectively used third-party capital that expands their market presence, enhances capital flexibility and provides a stable source of fee income.

When we put our two businesses together, we will be one of the top 12 underwriters at Lloyd's. Ariel also has new capabilities that can be leveraged throughout the entire organization, including Ariel Re's unique modeling and risk analysis tools, which will enhance Argo's already-robust underwriting analytics.

Ariel Re is a great fit with our existing Lloyd's operations. We have complementary portfolios in similar discipline and underwriting strategy, selection of clients and risk. Combining these businesses will be very straightforward and will enable us to increase our already-strong presence in this very important specialty markets. We expect the integration to be quick and effective with very little disruption during the transition period, which we expect to be over within the next 12 months.

As Susan mentioned, I've got, Jay Bullock here with me, our CFO to answer any of your questions. And operator with that, I'll turn the call over for questions.

Q&A

Operator

Our first question comes from Arash Soleimani of KBW. Please go ahead.

Q - Arash Soleimani {BIO 18869554 <GO>}

Thanks. So just to figure out, I guess, for the segment reporting, so will Ariel be its own segment, if I understand, like the fifth segment?

A - Mark E. Watson {BIO 20610831 <GO>}

No. You maybe referring to the presentation that we...

Q - Arash Soleimani {BIO 18869554 <GO>}

Yeah.

A - Mark E. Watson {BIO 20610831 <GO>}

...filed along with this. I think, the point of the presentation was that, Ariel uniquely enhances our Lloyd's business and our Bermuda-based business, which is International Specialty. To the extent we continue to write the business on the Lloyd's platform, our current intention, although this is still under consideration would be continue to report the business as part of our Lloyd's platform.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. So it will be long-term there (07:40), okay. And for modeling purposes, is it better to assume the 1Q 2017 close is more likely towards the end of the quarter; just wanted to know, (07:54) little bit more specificity around that?

A - Jay Stanley Bullock {BIO 3644311 <GO>}

Well, I don't think it matters, because we'll be closing as of December 31, 2016.

Q - Arash Soleimani {BIO 18869554 <GO>}

Oh, okay.

A - Jay Stanley Bullock {BIO 3644311 <GO>}

I mean, that will be the reference balance sheet for the close of the transaction, right.

A - Mark E. Watson {BIO 20610831 <GO>}

So the current shareholders will own the financial results of the company up till the end of the year, and then we'll own the results as of the beginning of 2017.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay, perfect. And then, I saw you provided the premium volumes and that – can you just discuss what the loss and expense ratios were the last maybe two or three years?

A - Jay Stanley Bullock {BIO 3644311 <GO>}

Well, I think that's disclosed on that schedule, the loss ratios in those businesses and some of those track records go back for almost nine years. I think that, Ariel like all businesses that trade at Lloyd's or...

A - Mark E. Watson {BIO 20610831 <GO>}

Sorry, you're referring, Jay, to page 9 of the Investor deck?

A - Jay Stanley Bullock {BIO 3644311 <GO>}

Sorry. No, thank you. I am Mark, on page 9 of the Investor deck, at the bottom of the page, you'll see the historical loss ratios. What I was going to say was that, as a standalone platform, Ariel like all of us that trade at Lloyd's and in Bermuda has had to support quite a bit of infrastructure around, whether it'd be Solvency II compliance in Bermuda or the same in London.

And so their expense ratios have worked very much like the market for other Lloyd's businesses, and not that dissimilar from ours. That said, we think part of this as we talked about quite often is, our interest in building more scale, this works for both of us, and so we do expect to be able to generate some savings from the transaction.

Q - Arash Soleimani {BIO 18869554 <GO>}

Thank you for that. And from a PPRD (09:49) five-year development perspective, how has that trended in the last few years?

A - Jay Stanley Bullock {BIO 3644311 <GO>}

Well, our track record as you know, goes back many, many years of positive prior-year development, likewise I would say that, the track record of the guys at Ariel and the team has been very prudent, and as a result, more often than not they've had modest prior-year development. Although, it's nothing that we – I would say, factored into our analysis in terms of an ongoing run rate.

A - Mark E. Watson {BIO 20610831 <GO>}

As I mentioned in my remarks, one of the things we like about them is the way they underwrite. They also manage their claims and loss reserves the same way.

Q - Arash Soleimani {BIO 18869554 <GO>}

Thanks. And the other question I just wanted to ask is, just around the strategic rationale of the acquisition given that you already had a Lloyd's Syndicate – why make an acquisition rather than increase your capacity of the existing Syndicate?

A - Mark E. Watson {BIO 20610831 <GO>}

Well, increasing capacity is pretty easy. Putting premium through it in this competitive marketplace right now is a whole different challenge, and I've said for several quarters now that, I thought that we needed to be a bit larger to really be at scale in terms of affording the cost of the – particularly the compliance cost of a platform at Lloyd's, and so this gets us there now, and it puts a nice portfolio on the books and the process.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. That makes sense. And does this change your tax rate on a go-forward basis in anyway?

A - Jay Stanley Bullock {BIO 3644311 <GO>}

Yeah, probably not that materially, because remember they write lot of business in London, and so it is – it would be factored into the tax rate very similar to our existing London business. So it's possible that there could be a very marginal improvement, but it's – again it wasn't a factor that necessarily went into our analysis and had any material influence on our analysis.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. Thank you. And my last question, can you – how big is the fee income stream they have from the third party capital management?

A - Jay Stanley Bullock {BIO 3644311 <GO>}

Well. The – so it's 50% of the book is in a quota share structure with a Special Purpose Syndicate, this tend to be on pretty consistent market terms, they have a fee component to them, and they have a profit commission component to them. The fee components tend to be in the 1%, 1.5% range and the profit commissions can range anywhere from 15% to 20%.

So if you can factor that into the 50% premium; that would give you a sense as to what the go-forward is. The reason I can't answer that with more specificity historically is because, the support has changed, meaning the structure in which the capital of support Syndicate 1910 has changed over time. So that would be – those would be different numbers, historically.

Q - Arash Soleimani {BIO 18869554 <GO>}

All right, great. Thank you very much for the answers.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to, Mark Watson, for any closing remarks.

A - Mark E. Watson {BIO 20610831 <GO>}

Thank you, operator. I'd like to again thank everyone for jumping on the call so quickly. Again, we've put all of the information on our website, if you'd like to look at it, and we've also filed the information as in 8-K with the SEC, and that concludes our call for today. Thank you again for joining us.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect. Have a great day.