New York Society of Security Analysts Conference

Company Participants

- Jay Bullock, Chief Financial Officer
- Mark Watson, President and Chief Executive Officer

Other Participants

- Unidentified Participant

Presentation

Unidentified Participant

Okay. Let's continue on with our schedule. I'm honored to welcome back Argo Group presenting before the conference for yet another year. Argo has been a loyal participant in this conference for almost as long as I've been involved. I think your first presentation before the conference may have been in 2001 or 2002.

We have some of the executives from the company with us today, they include Mike Fusco who serves as a Chief Actuary. He is sitting all the way over there in the corner. Certainly Susan Spivak, who serves as our Investor Relations person, Jay Bullock, the Chief Financial Officer and Mark Watson who is President and CEO. So as you go through the list of all the companies that are presenting that have presented and will present over the next day and a half and you'll find that Argo's stock has been one of the best performing issues for the companies that have presented in the prior year. Stocks of 50 some percent from March to March. So congratulations.

So at this point, we look forward to hearing you tell us why it's going to continue to march upwards. Finally I'd like to say that we're going to change the format from this presentation a little bit. I've suggested to Mark that maybe he spend 10 or 15 minutes just giving us a brief overview of the company. But since they've been here for so many years, I thought it might be useful for the members of the NYSSA to just engage in a Q&A with the management team of Argo Group.

So, with that, let me turn it over to Mark.

Mark Watson {BIO 20610831 <GO>}

Thanks Greg and good morning to everyone. I was happy to not have to wear my snow shoes today and I think this is the first time I've been in New York in the last two months where it wasn't -- well I guess we did get delayed again last night anyway. It's good to see you all this morning. I recognize most of the faces in the room. And what I thought I would do is just kind of run through a few of the slides in our deck and just kind of update everybody on who we are and what we're up to.

Guide for a few minutes and as Greg said I'll turn it over to Q&A. And given that I'm sure that we may talk about the future a little bit. So if you all can just read the forward-looking statements slide for usually those of you who are listening on the Internet. So where are we today. Our share price is not quite 54.29. We did a 10% stock dividend about a month ago and so right now we're trading at about $50 a share but that takes into consideration the stock dividend.

Our market cap is about 1.4 billion, our total capital is about $2 billion. And as you can see we're pretty widely followed for a company of our size. What are we? Well, we're an underwriter first and kind of everything else, second, we're an insurance company, not a reinsurance company. We do have a property cat reinsurance portfolio in Bermuda but that in some of our other reinsurance underwritings make up about 10% of the total premium of the company.

What I really want to talk about today is kind of the other parts of the company that have been the real strength of the company for over a decade now in many cases. We are one of the largest excess and surplus lines underwriters in the US. We trade under the name of accounting [ph]. I was going to say, we have one of the larger Bermuda Insurance operations in the US, but there are fewer and fewer of those as the consolidation on the island continues and I'm sure you all will want to talk more about that later.

We have one of the larger syndicates at Lloyd's. We have a stamp capacity of GBP350 million and that's an important part of our international strategy that I'll talk about a little bit more. And we also have a couple of operations in the US that are retail focused which are market leaders in their own areas of expertise.

But let me tell little bit more about what our definition of being a specialty underwriter is. It starts with saying we're not trying to be all things to all people. We try and focus on markets that we know, markets where we can make a difference, markets where we can use our underwriting expertise, if not our knowledge (Technical Difficulty) return for our shareholders. And in the case where we have intimacy, not just with our distribution partners with our policyholders, really focusing on providing customer service whether it's safety and lost control services on the front-end to keep hopefully losses from happening or events from happening that lead to losses.

We're mitigating those to our claims organization when something is happened. We try and focus on products and industries over the long haul recognizing that not only is our industry cyclical service there's but, we try not to get in and out of things but, stay committed to businesses where we're pretty sure that over the long haul, we can make money and help them run their business.

And as you'll see, I'll get to a slide later on. I think, not only do we have a pretty strong team, but we've done a very good job of managing our capital base over the last 15 years or so.

This next slide, and I'm going to spend most of my time on this one. It really talks about the evolution of our company since we recapitalized the company and I started running it back at the end of 2002. And what you'll see is a very different company today than back then. And you'll also see that over the last six years or seven years, the company has been pretty similar, pretty well balanced, internationally diversified specialty underwriter. I talked earlier about our E&S operation, that's the blue on the bottom. And you'll note that the premium volume kind of hedge inflows, it peaked in 2006 and it's now been heading back up for the last three years and if you kind of look at market pricing for the E&S marketplace you will see a similar trend line. And what you should take away from that is when the market is hard, we tend to write a lot of business and when it's not we tend to pull our horns back in a little better and save our capital for another day.

The light blue, what we refer to is our commercial specialty business in the US, it's all retail based, it's all package policy driven and it's focused on ensuring particular businesses in an industry I should say particular industries. We are one of the largest insurers of mining operators in the US, I think we are now the number two behind AIG and have been for a couple of years.

We're also one of the larger insurers, small to medium sized public entities in the US and we're one of the larger insurers of independent food merchants in the US.

And again, this is all kind of geared towards helping these businesses really managing their risk and creating that intimacy with the policyholder not just our distribution partners. In 2007, we made a really big decision and again in 2008, in 2007 we acquired our Bermuda operation and started both a reinsurance and insurance operation in Bermuda. And a year later, in 2008 we acquired our syndicate and that's the purple piece.

You will notice that the premium went up and the new premium came down, well part of that is we bought it halfway through 2008, we're actually more than halfway so you didn't have a full year in there. But then you'll see between 2009 and '10 a pretty dramatic decline, but now was again a recognition that the market was pretty competitive back then and actually we didn't think we were getting paid for the risk we were putting on the balance sheet, particularly when you think about tail risk for cat exposed business.

We had a lot more of it then than we do now. So we cut the premium back in half, we moved some of the cat risk to the Bermuda company that's the green piece. And you can see that since 2011, we started to grow, we're actually started since 2010, we started to grow again in the Lloyd's platform. Our Lloyd's syndicate is a pretty diversified portfolio. In addition to property cat-insurance exposure, we also have marine, energy, aviation, construction, engineering and professional liability risks. So a pretty broad composite of what comes into Lloyd's. And I think a pretty good representation of the Lloyd's syndicate. The other pieces that are in the green box, what we refer to as international specialty. So we have then here the Bermuda business. You also have our operation in Brazil that we started a couple of years ago. And to a lesser extent, some of our professional liability business that underwritten directly in Continental Europe and in Dubai where Argo Re the Bermuda company has a branch office.

And as I said a minute ago, if you kind of look where we are today, for the last few years, I think we've had a pretty balanced portfolio for the company. It's about 55% US, 45% outside the US. If you look at the bottom right hand corner. And if you kind of go up and just look at the product diversity that we have, I think, what you'll see is a pretty balanced company.

We're still more dependent upon liability and professional liability risks as compared to property, it's about a 60-40 split property and then everything else being 60%. And again just to make the point that we're mainly in the insurance business, not the reinsurance business.

Just a couple more data points for you. We have a pretty broad distribution platform depending upon which business we're talking about. And that really goes from one end of the value chain to another. We have partnerships with independent agents, small brokers, regional brokers, regional wholesale brokers, national brokers, national wholesale brokers, international brokers, international wholesale brokers, it just depends on which part of the business that we're focused on.

And I won't try and go down this list. But so, just think about it kind of generally. Our Specialty Commercial business is underwritten either through independent agents or small brokers, the Excess and Surplus Lines business is primarily underwritten through wholesale brokers or some of the large retail brokers in the US. Lloyd's is entirely wholesale driven, the Bermuda business is large retail as is Brazil.

So, it kind of moves all over the place depending upon which part of the world and which product we are offering. If you look at our track record since 2002 in terms of growth and book value per share, we've been able to grow book value including dividends at over 10% a year on a compounded basis over the last 12 years. Tangible actually grew at a slightly faster rate, and you'll see that there have been times when we have been rewarded with a pretty high price to book multiple of 1.6 and 1.7 back in 2005 and 2006 when the market is really hard and 2012 was not one of my favorite years when our peak that year was 60% of book, we are now trading at about 90% of book. But I think we still have a little ways to go. Just to show you couple more data points over this time period, we've grown gross written premium more than 3x, we've grown earned premium so revenue 3.5x while only growing total assets 2.5x. And we've grown shareholders' equity 5x during that period of time.

You can see that in 2014, year-over-year that our E&S business continued to grow modestly at 5%. I just wanted to make a couple of points here. Last year we pushed out some of our property risk and some of our transportation risk because the market was getting competitive. So if you look at our continuing business, it actually grew a bit faster. And we were reselling some of our portfolios within commercial specialty. So you saw a modest decline there.

And with the competition at Lloyd's right now, we were kind of happy to just stay flat year-over-year, although I think we've got some better opportunities to grow this year even though the market remains competitive. And most of the growth in international specialty is coming from Brazil. Rather than go through all the slides in a lot of detail I just want to kind of slip to the end here. And just go through our investment strategy for a minute, you'll notice that -- bit about 69% of our invested assets are in fixed maturities and the remainder is either in cash or what we refer to as our capital appreciation portfolio where our cap portfolio.

So, that's mainly large cap equities as well as a number of hedge fund mandates that are mainly hedged credit strategies but it's really performed very well for us over the last few years and helped us generate nice returns for our shareholders. If you -- I mentioned a minute ago, I thought we did a pretty good job of repatriating capital to our shareholders.

Over the last five years we have repatriated $373 million to our shareholders most of that through share repurchases. In fact, we bought back 27% of the outstanding shares of the company over the last few years. And we continue buying back our stock this year as well. Our share price performance has improved over the last few years as we talked about a minute ago. And this just shows you the difference between our growth in share price versus our peers in the S&P 500. But also if you look at where we're trading relative to that group is a multiple of book while we've certainly improved some of that in terms of their share price and their share price multiple. And so while we narrowed the gap before, we're still narrowing that gap. And so I think that provides the opportunity that we should spend a little bit of time talking about. And so maybe I'll just kind of leave it on this slide and stop and open it up to questions and we can talk about Argo or we can talk about the industry in general, if you all would like.

Questions And Answers

Q - Unidentified Participant

Okay. I'm going to kick it off with the first broad question for you. Two things, first of all, there's been a substantial decline over the last year in energy prices and I'm curious how that might affect some of your businesses and then at that same time we've seen some currency fluctuations. So maybe you could talk about those two macro factors and how they've affected your business?

A - Mark Watson {BIO 20610831 <GO>}

Yeah, so let's talk about energy first, for every energy company that we insure there's probably 10 consumer companies that we insure that benefits from them. Energy is a broad category and if you kind of break it down into sub-component parts, you've got upstream so I think oil and gas production, we'll come back to that in a minute. Midstream pipelines, downstream petrochemical facilities, petroleum, gasoline manufacturing, plastics and you've also got power stations and other utilities.

And of course, we've got a big coal mining operation that I referred to earlier. Ever since the Obama administration came in, that's been under attack but we've actually still grown there so that's good. I don't see that changing by the way, even though it may be modest as we've seen in the last couple of years.

I think the real focus is what happens with not so much the diversified energy companies which we insure most of them through our company in Bermuda but the more regional E&P companies and whether they're still going to punch holes in the ground and how much CapEx they are going to really spend this year, and therefore if the risk is coming down their balance sheet, they're going to -- are they going to buy less insurance, that's a pretty small part.

Q - Unidentified Participant

Is that dovetail with your surety operations at all?

A - Mark Watson {BIO 20610831 <GO>}

Good question. It does, I think that our bigger challenge in our surety business, which by the way is growing is not so much that there is less risk to insure but rather there are more and more market entrants because it's been a pretty good place to be in the last few years. We've also grown our risk appetite a little bit and so I think that's offset some of the -- that will offset some of the decline in oil prices. But I think that's a pretty small part of our energy portfolio in general in the Group as a whole.

Q - Unidentified Participant

And then FX, yes.

A - Mark Watson {BIO 20610831 <GO>}

Yeah. So remember for most, I won't say this is true of every company. But I think most insurance companies like ours that have fairly diversified operations. We pay claims in a number of different currencies around the world probably about a dozen. And so the purest form of hedge that we've got is to invest to the extent that we can and those currencies where we intend to pay claims and Jay can jump in here if you'd like Jay.

But we mainly pay claims in dollars, euros and British pounds, so guess what most of our invested assets are in dollars, euros and British pounds. And so the first thing that we try and focus on is making sure that we've got enough money to pay claims. And so the best way to do that is to stay invested.

Now, I mean in those currencies. With all the currency fluctuation going on right now and given the fact that we report in dollars, are there things that we can do to reduce some of that FX volatility and the answer is yes. And so if we're pretty sure that we think we're going to see one currency move one way or the other then we may buy futures or other derivatives to hedge that. Or we may move on the margin, how we invest. So as an example, now if we all still think it's just hypothetical, okay.

But if we all still think that the dollar is going to strengthen then we may decide that for some of our European companies that perhaps some of their investment has more of their investment has, more of the investment portfolio should be in dollar denominated assets. So we could do that instead of trying to put on hedges. I'm not saying, we've done that but we could do that.

So I think there is a fair amount of flexibility in how insurance companies can manage FX. Do you want to add anything Jay?

A - Jay Bullock {BIO 3644311 <GO>}

No, I got that. That's troublesome for surely.

Q - Unidentified Participant

Mark, just picking up on Greg's question, I was wondering if you could elaborate if I can pronounce it a little bit more on where you're headed strategically in the surety business and then the partnership with SureTec. And also tactically is that not likely to be continue to be a good place to be as the underwriting cycle maybe that's helpful little and the economic cycle improves.

A - Mark Watson {BIO 20610831 <GO>}

Yeah. So we think the surety business is a wonderful place to be. We have exposure to surety in two forms, large commercial risks, we run through our own account. And as you just pointed out, we have a partnership and own part of a company called SureTec which is privately held and they tend to focus more on contract and performance bonds which is not something that we do and so we're happy to be a shareholder and a partner with them. More and more of the expertise that we've built here in the US we're trying to export and follow our clients to other parts of the world. Believe it or not, our US clients are still doing business in Brazil.

So we're trying to do more down there with them. And of course they do a fair amount in the EU as well. So and that's kind of the scene throughout our company. It's being able to export the expertise we have in one part of the group to another of the group.

And I think you'll -- as you see as evolve over this year and to a lesser extent next year, I think you'll see us hiring a number of people that have more expertise so that we can transport our domain expertise in particular products from one part of the world to another. Energy being one example or surety and energy being one example, professional liability being another, perhaps even bigger example. And there are plenty people that as you can imagine with all the merger mania going on right now, my phone has been ringing off the hook. So, people sending resumes, sorry to be clear. I saw, Tony (inaudible) get kind of excited there from it. Okay.

Q - Unidentified Participant

You mentioned that hedge funds was at least somewhat important part of your investment strategy and I just want to go into that. Do use hedge funds as a means of hedging your currency exposure, as a means of perhaps reinsuring or selling insurance related derivatives or buying insurance related derivatives or when you invest in hedge funds it's in areas totally outside of insurance.

A - Mark Watson {BIO 20610831 <GO>}

Most of the investments we have in hedge funds or if they are in insurance it's coincidental. They've got particular credit strategies that they're putting in place that we think are not correlated but everything else in our investment portfolio or in our underwriting portfolio from that matter. And I didn't mean to suggest they were an unimportant part actually I think that makes up now almost 5% of our investment portfolio. But it's not related to the hedging that we do in FX.

Q - Unidentified Participant

Yeah. That as it relates to capital location, you repurchased 4% of shares in 2014. Just you're trading below book value, and it seems like you kind of expect that to improve, kind of just curious and why you didn't repurchase more shares as it seems like it would might be a good opportunity, as you think so.

A - Mark Watson {BIO 20610831 <GO>}

Yes. So, the smart alike answer would be float. But, that's also the real answer. We bought back pretty much what we could last year with the average daily trading volume that we were faced with year ago. We haven't announced how much we've bought, since we reported earnings. I can tell you we have same approach this year as a year ago.

And I think right now, you are right with our share price still trading below book, it's very attractive. And at the last Board Meeting, we were debating how much capital we have to set aside to -- so first of all it's how much do we want to repatriate. okay.

And so, first we kind of run through the math, okay, do we have enough capital for the risk on the balance sheet, asset side and the liability side. Then the second, okay, we know we've got some pretty easy growth opportunities, we have enough capital to support those, yes, okay. We decide M&A for a moment and say okay, well, that's in the path with, do we have excess capital, maybe to repatriate.

And so, are we going to do it through dividends or we going to do it through share repurchases. And I mentioned in the beginning of my remarks this morning that -- I said one thing and I should have said two, we not only did a stock dividend, we also increased the dividend again this year. And so we're always balancing both of those, I think, don't hold me to this. But, I believe that in last seven years with all the dividend increases, we've now pretty much doubled the dividend over that period of time.

It's somewhere around there.

So, that's a national comment everybody. So, I think we try to do both. And I think we'll continue to do that. We're still growing the company but because we're able to use other forms of capital mainly the ILS marketplace. We don't need as much equity capital today as we did six years or seven years ago, just as an example.

If you think of reinsurance as another form of capital which it is, the majority of the reinsurance that we buy today, we buy from the ILS marketplace, whether it's the side card that we have that supports our property cat portfolio or the cat bonds that we issued, it support the property cat portfolio or just the one-off transactions that we do with some of the ILS underwriters. That's the -- that in the aggregate is what supports the property cat exposure to our company.

Not that much of it comes from the traditional reinsurance marketplace, and it allows us to free up some of our own capital as well by using that instead of our own equity capital.

Q - Unidentified Participant

Could you provide some additional color on the pricing environment in the beginning of 2015, as it relates to -- I believe you guys are still targeting a 95% combined ratio. And also, where you're seeing the most attractive opportunities to deploy capital besides, I believe you already mentioned surety.

A - Mark Watson {BIO 20610831 <GO>}

So, the pricing environment so far in 2015 is about where we thought it would be. We've grown places where we think we have pretty good margin and let business go where we don't think we have good margin. I mentioned earlier, just as a couple of examples of things going away was some of the property insurance in the US and some of the transportation risks.

So, when you replace that with our ongoing business that we think is priced periodically, it allows us to kind of keep our same return expectations, because we're doing a portfolio change. So, we may not grow it at quite the same rate as we might otherwise. But, I'd rather keep generating mid 50s loss ratios than keep growing the top line. And that's really our main focus. So, I think there is plenty of opportunity this year because of some of the investments we made a year ago to keep moving ahead in the market this year, even though it's getting a bit more competitive.

As for other opportunities, besides surety, that I talked about earlier, more and more we continue to reinvest and reinvest in the small account business. The barrier to entry keeps getting higher because you've got to have more and more investment in technology and be able to process the business more and more efficiently than even a couple of years ago.

And if you look at the loss ratio, it's great. You just have to build the access. And so that's really where we're putting a lot of our energy or we're putting it into hiring more and more talent and some of our more global specialty businesses underwritten in Bermuda and London.

Q - Unidentified Participant

Let's follow up with -- you mentioned M&A, certainly Bermuda as you know has been under assault from competitive pricing issues and then certainly there's been a recent pickup in M&A there. Can you talk about your perspectives on the property market, property reinsurance and what's going on in Bermuda. And what or how you see Argo's long-term positioning in that market to be.

A - Mark Watson {BIO 20610831 <GO>}

Yeah. So, you have now seen, so I'm speaking in the past tense, a secular change in the property cap marketplace. With new sources of capital coming in, so, pension funds and or endowment funds or what we now refer to is the ILS marketplace. I mean, that really is a substantial portion of reinsurance capacity. And I will argue that, I don't care how big the event is, it really is permanent at this point. The returns that these guys have made relative to other returns in other parts of their investment portfolio have been pretty good. I don't see that changing. So, what that's meant is that if you are a traditional reinsurance company, you've got less customers or you've got maybe the same number of customers buying less reinsurance from you because, they're buying it from your competitor.

And so that's led to some of the activity going on in the marketplace. As respects, our portfolio in particular, it's kind of stayed about the same size. The margin has compressed a little bit, but we still think that the margin is better than it is writing property cat insurance, particularly, well pick anywhere in the world and then having to buy reinsurance to support it.

If rates drop and again I'm going to speak notionally not precisely but imagine rates drop another 10% to 20%, that's a big range, right. Then, I'm not sure, what we will be doing as a seller of reinsurance but my guess is we'll be a much bigger buyer of property cat reinsurance around the world.

Q - Unidentified Participant

And what about the consolidation aspect of what's going on in Bermuda and how do you fit in that?

A - Mark Watson {BIO 20610831 <GO>}

Well, I like buying from people bigger than us. So that's good. Most of the consolidation has been focused on reinsurance and if you look at what's going to happen and I think, I've said this every time I've stood on this podium. There is always a reason for these transactions other than investment bankers trying to cook up a deal. You've got to have a motivated party and the party may be motivated because one plus one equals more than two. A shareholder wants their money back, Board loses its confidence in the management team or there is a secular change in the industry and you've got to readjust.

And, if you look at what's happened in our industry over the last 18 months, I think you can tick every box that I just mentioned with one deal or another. I think, that will continue. But we've always had M&A in our industry, just kind of comes and waves. And so, for us, it's a real net benefit because we've got really good people looking for places and we're hiring. As I said a second ago, we like having a reinsurers bigger than we are. And so, I'm kind of happy.

Q - Unidentified Participant

And then we're running out of time so close out with just a question. If we look at your operating performance, underwriting performance particularly. The loss ratio seems to be performing very much in-line with the industry, if not better than the industry. And then, but the expense ratio has been a challenge there. And I know, you've been talking about this for some time now. Could you provide us an update on your thinking, on that side.

A - Mark Watson {BIO 20610831 <GO>}

Yeah. So, three years when pricing was better and we thought pricing was going to improve. We would have thought, we would have had several 100 million dollars more premium on the books today than we do.

But, we've decided that pricing isn't quite right to keep adding too much more risk and so we haven't really fully utilized the platform that we've been investing in over the last few years. And we're going to get there. It's just going to take a little bit longer but look our combined ratio has come down steadily over the last three, four years now. And so, I think our return on equity last year was 12%, 11% or 12%.

A - Jay Bullock {BIO 3644311 <GO>}

11.4%.

A - Mark Watson {BIO 20610831 <GO>}

A 11.4% and it was something 9, something the year before. So, I think we're moving in the right direction.

Q - Unidentified Participant

Okay. Great, we are out of time. But, thank you very much for participating again this year.

A - Mark Watson {BIO 20610831 <GO>}

Thank you .