

Q2 2018 Earnings Call

Company Participants

- Axel Schmidt, Group Chief Underwriting Officer
- Jay S. Bullock, Chief Financial Officer & Executive Vice President
- Mark E. Watson III, Chief Executive Officer & Director
- Mark H. Rose, Chief Investment Officer & Senior Vice President
- Susan Spivak Bernstein, Senior Vice President-Investor Relations

Other Participants

- Adam Klauber, Analyst
- Charles Gregory Peters, Analyst
- Christopher Campbell, Analyst
- Matthew J. Carletti, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Argo Group, 2018 Second Quarter Earnings 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 over to Susan Spivak Bernstein, Senior Vice President, Investor Relations. Please go ahead.

Susan Spivak Bernstein {BIO 1514699 <GO>}

Thank you and let me add my welcome to Argo Group's conference call for the second quarter of 2018. Last night, we issued a press release on earnings, which is available in the Investors section of our website at www.argolimited.com.

Presenting on the call today is Mark Watson, Chief Executive Officer; Axel Schmidt, Chief Underwriting Officer, Mark Rose, Chief Investment Officer, and Jay Bullock, Chief Financial Officer. As the operator mentioned this call is being recorded.

As a result of this conference call, Argo Group management may make comments that reflect their intention, beliefs, and expectations for the future. 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'll turn the call over now to Mark Watson, Chief Executive Officer of Argo Group. Mark?

Mark E. Watson III {BIO 1463509 <GO>}

Good morning. And I'd also like to welcome you to today's call on the second quarter and six month 2018 results. As reported, second quarter 2018 adjusted operating income was \$0.95 per diluted share. Adjusted operating earnings for the first six months of 2018 of \$2 per diluted share compares to \$1.76 per diluted share in the first six months of 2017. While the quarter result reflects a decline from \$1.14 per diluted share in the second quarter of 2017, last year's result included a one-time gain from the sale of an equity investment that benefited earnings in 2017 by approximately \$0.26 per diluted share.

Before we go through the financial details of the earnings report, I'd like to make a few comments on current industry trends and how Argo is positioned in the market. At Argo nearly two decades ago, we identified technology as a transformative and potentially disruptive force that would ultimately change the way business has transacted in the insurance market. Ours is an industry that historically has been slow to adapt to change and so it should have come as no surprise that it took longer than we anticipated for those trends to emerge.

Fortunately, at Argo, our size allows us to be nimble and responsive. As well, our commitment to developing our digital platform provides the opportunity to anticipate the changes in the business model while the industry adopts existing ideas. Recently we've been providing updates on our ongoing digital initiatives and will do so again later in my commentary. Another topic frequently debated is whether the pricing cycle still exists. Just to be clear we don't run our business based on the existence of a pricing cycle. And if you're a company with a strategy that relies upon the elusive hard market emerging to achieve rate adequacy, I think that this is a strategy that's probably not going to work any longer.

As seen after any of the recent loss events, capital is readily available and will flow in and out of the market as needed. In my opinion, the winners in the current environment are companies that focus on clients and make it easier for them to transact business, grow profitably while continuing to invest in their business going forward and have strong risk and capital management capabilities.

Now let me talk about our operations. In the U.S., gross written premiums rose 12.3% in the second quarter and 11.9% for the first six months of 2018. All business lines grew in the quarter with the strongest growth in professional lines. In the six month comparison all business lines were up except for property where we exited a program and had been very selective and in some instances have reduced exposure where we didn't think we had rate adequacy. Related to property, the ex-accident year loss ratio was 59% in the

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second quarter of 2018, which was up a bit from 57.4% in the second quarter of 2017 mainly due to a few discrete non-CAT attritional (00:05:36) losses in our property book and part of the reason that you see a decline in our premium this year.

Pre-tax underwriting income in the U.S. operations was \$26.4 million in the second quarter which was down from \$29.3 million in 2017. For the first six months of 2018, pre-tax underwriting income was \$42.4 million, compared to \$50.1 million in the comparable period of 2017. That said, prior year development contributed an additional \$14 million to the 2017 result, which explains a fair amount of the difference if not all between last year and this year.

Our international operations also continue to execute on our strategic initiatives as evidenced by improved underwriting results and targeted growth most notably in Europe. The reported gross written premium decline of 9.9% in the second quarter of 2018, compared to 2017 primarily reflects reduced participation on syndicating reinsurance business that is offsetting strong growth in Europe and Latin America. This reduced participation is consistent with our expanding strategy of incorporating third capital in our operations. Across broader business lines, the primary driver of growth was in Specialty lines.

From a profitability standpoint, the ex-CAT accident year loss ratio was 58.9% compared to 56.3% in 2017 from the second quarter and 56.3%, up modestly from 55.5% in the first six months. Pre-tax underwriting results in our international business improved to \$6.4 million from \$1 million profit in 2017 for the second quarter and \$22.2 million for the first six months, compared to \$4.6 million a year ago. Here both the three and six month results benefited slightly from positive prior-year development against, you may recall, some disappointing adverse development in the last three and six months from a year ago.

You may also recall us talking about changes that we wanted to make to our international portfolio particularly property underwritten in London, and a few other classes of business in London. And I'm happy to report, as you'll hear from Axel Schmidt, our Chief Underwriting Officer in a minute, that many of the things that are playing through today are initiatives that he and our colleagues began over a year ago.

Moving to capital management, our number one priority remains deploying our capital into the businesses where we see attractive returns. This can be achieved through organic growth or by acquisitions. Earlier this year we finalized the acquisition of Ariscom, a specialty Italian property/casualty carrier, while a relatively small transaction, it further demonstrates our ability to identify and capitalize on opportunities we see to expand product offerings, enter new geographic markets and strengthen distribution relationships.

As you have seen us do when we do not see opportunities to redeploy the capital in the business, we will return capital to our shareholders through share repurchases and dividends. To that point during the first half of 2018, we repurchased \$20.4 million of our stock and between stock buybacks and dividends paid we've repatriated approximately \$616 million (00:09:29) of capital since 2010. And to just put things in perspective during

that same periods of time, we've grown our GAAP book value from approximately \$1.4 billion to little over \$1.8 billion.

Moving on to digital, once again, we continue making significant steps forward toward our goal of using technology to reshape our business. Every part of our business from distribution partners, policyholders to employees are feeling the positive impact of our efforts in this area. Overall, we're pleased with the progress we're making in the digital space in terms of development of digital products, partnerships with ensure tech (00:10:12) focused companies and modest strategic investments in tech-enabled ventures. One example of how we're digitizing our operations to the benefit of our customers and partners is demonstrated in our casualty underwriting system. The system speeds and automates key parts of the submission handling process, allowing underwriters to quote more quickly. By the end of the second quarter, we were handling over 75% of our submissions in under one hour with the application representing an enormous improvement over the first quarter average, which back then and that was only a quarter ago was 33%.

This is a credit to our digital automation and operational streamlining efforts. This improvement also allows our distribution partners to be more responsive to their customers providing them rapid assurance of effective and competitive coverage and as we know the first to quote is often the one to bind. In prior quarters, I've talked about the quick quote application that's helping automate quoting for a key line of business in our casualty portfolio. This application continues to grow and our brokers - our broker partners who get a digital quote be a full service has increased from 18% to 23% of the brokers we work with, more coming. There's several initiatives underway to increase the rate still further all the while maintaining 80% fully automated rate for brokers submitted quotes that we mentioned last quarter.

An average 15% month-on-month growth rate between January and June means over 60% of this casualty line now flows through our digital system. Building on these successes, the application now becomes part of our digital centric launch of the Argo construction business unit in the third quarter which we announced a few weeks ago.

Last quarter I also talked about a new quick quote application from our management liability business where a key distribution partner can quote an issue policies entirely within the application. At the end of the second quarter, we launched the application three months ahead of schedule to a very positive response from our partners, a testament to our iterative customer centric modern approach to digital product development.

In addition, this complete self-service rate, quote, bind and issue platform for small-to-midsize specialty business will be used to quickly deploy more semi and fully self-service lines of business to partners later in the year and into 2019. Another exciting element of this platform is our ability to pursue new lines of business that now become commercially attracted due to our ability to automate most or all of the underwriting process and staff minimal operational head count against it. Look for more about this in the future quarters as we experiment with new opportunities along with our distribution partners.

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This quarter we announced our partnership with Corvus, a Bain Capital funded startup under smart cargo insurance product designed to help food and beverage companies reduce loss of perishable goods. We like this line of business from an underwriting perspective and believe Corvus' approach could help us improve the loss ratio in the business we underwrite here for ourselves.

So, in summary, we're seeing great progress in both our U.S. and international business. In the U.S. we're growing the top line in targeted markets, maintaining profitability while continuing to invest in the business.

We're attracting expert underwriting talent to the organization and developing new products to distribute on our digital platform. In our international operations, we're building a team of leading industry experts that have already demonstrated the ability to profitably build businesses in various geographic markets. I also have to say that I can't remember the last time that I was this optimistic about the future prospects of our growing platform or the talent within the organization.

I'd now like to turn the call over to Axel Schmidt to talk about some of our underwriting initiatives. Following Axel's comments, Mark Rose will update you on the investment portfolio. And then Jay Bullock will provide more details on the financials. Axel?

Axel Schmidt {BIO 19499069 <GO>}

Thank you, Mark, and good morning everyone. As Mark mentioned earlier those companies should wait for half market (00:14:40) to emerge in order to achieve adequate returns but no longer be successful. With that in mind we take a very proactive approach to identify this area of our business to try additional attention to maximize (00:14:55).

In group underwriting, it's a well-established process to identify underperforming products due to issues of scale or insufficient underwriting returns (00:15:05). There has been particular focus in our large Syndicate 1200 portfolio ramped (00:15:11) in mid-2017 we identified the number of products that are failing to meet the financial targets that we had set ourselves. At that point, we instigated a robust re-underwriting (00:15:23) initiative for each product with detailed action plans, timelines and associated financial metrics in order to achieve on target results (00:15:31). These initiatives with right (00:15:36) collaboration across a wide group of stakeholders including group underwriting, syndicate management (00:15:41) teams themselves in finance.

Echoing Mark's comments, this has resulted in a reduction in gross written premium as we have realigned portfolios away from areas that are causing drag on results. As I have talked about in previous quarters, our strong focus is an underwriting discipline and underwriting for profit, not for top line growth. We will continue to rebalance portfolios in order to meet on total underwriting standards, but actively pursuing profitable growth opportunities across each of our platforms. One of our products identified as underperforming at (00:16:24) portfolio.

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This was a traditional Lloyd's (00:16:27) with a large number of facility arrangements. This account had been impacted by 2017 hurricane losses and was not achieving adequate rate increases to return to sufficient profitability. Hence, we took the decision to cease underwriting this account effectively July 1, 2018.

Aside from the business written into the Syndicate and Lloyd's, we've added international platforms including our Miami (00:17:00) Italy and also lead up for (00:17:02) these platforms. We recognize the importance of establishing a consistent underwriting strategy and appetite across all lines of business, products and geographies. We've also established an underwriting risk framework across the business that clearly articulates (00:17:18) what business are the ones (00:17:21) at a group wide level ensures alignment and appetite across the group. And it helps to identify broad overlaps in appetite. The aim of the framework is to better understand our global positioning to sell more effectively and to ensure the profit opportunities are passed on to the appropriate teams within Argo.

It will also benefit from improved risk management and the ability to identify potential profit growth areas in line with our risk appetite.

Overall, I am very pleased with the progress that we are making, but it's still a challenging marketplace. I remain confident that the steps we are taking to position our portfolios and to enhance our underwriting capabilities have already improved the underwriting quality of our portfolios, this will allow us to take full advantage of opportunities as they arise.

With that, I'll handover to Mark Rose, our Chief Investment Officer. Mark?

Mark H. Rose {BIO 1557365 <GO>}

Thank you, Axel, and good morning, everyone. The second quarter - I'll go over the second quarter now in the investment portfolio. The second quarter total return was 0.5% up sequentially but down versus the second quarter of 2017 where the results were 1.6%. In the second quarter the financial markets were dominated by several cross-current trends.

In the bond markets, rates began the quarter were Q1 ended moving higher, but the U.S. 10-year topped out at 3.11% in mid-May and proceeded to grind tighter ending the quarter only up 12 basis points or 2.86%. The short end of the yield curve rose 25 basis points being more sensitive to the Fed's June hike. So the curve flattened, investment grade bonds struggled continuing the sell-off and spread widening that began in February of this year.

In the equity markets, tech, energy and small caps led the markets higher while safe haven such as consumer staples, stocks underperformed. Possibly the biggest disrupter in the quarter was the strengthening of the U.S. dollar versus developed and emerging market currencies. The U.S. dollar was up 5.5% versus the euro and the sterling, and up 14.7% versus, for example, the Brazilian real. The reality of the Fed interest rate hikes versus the discussion of reduction of QE by other central banks supported the dollar

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versus developed markets. In emerging markets, the negative sentiment kept building, whether it was from a major currency devaluation in Argentina, an election in Mexico, a trucker strike in Brazil or trade tariff negotiations.

For Argo, our core bond portfolio was basically flat in the quarter due to our short duration of 2.4 years which includes cash. We were actually up with this portfolio before the impact of our non-dollar assets, which was a minor headwind. The currency drag was offset by some FX hedging and liabilities on our balance sheet. Our risk portfolio, which was down 0.6% in the first quarter recovered with a return of 1.6% in the second quarter.

Our equity portfolio benefited from those market trends mentioned earlier and also driving returns were solid performances from our alternatives, the hedge fund investments as well as PE structured funds and our internal special situations portfolio.

Finally, it is worth noting that while our net investment income of \$69 million for the first six months of 2018 was down year-over-year by \$5 million, and this was mainly due to the gains in 2017 that Mark mentioned earlier, the one-off gains, our bond income for the year-to-date six months was actually up in the period. Our core bond income was up 12% year-over-year and our risk portfolio bond income was up 40% versus the first six months of 2017.

With that, I'll turn the call over to Jay.

Jay S. Bullock {BIO 3644311 <GO>}

Thanks, Mark, and good day, everyone. I'll focus my brief comments today on some key highlights and explanation to the financial results we reported last night and then open it up to Q&A. Commenting first on revenue as Mark discussed U.S. continues to perform quite well with growth in targeted markets in many cases enabled by the investments in digitization and technology.

In our international segment, the second quarter revenue numbers are somewhat distorted by the decision we made at the end of 2017 to increase the amount of third-party capital participation, primarily related to the reinsurance lines of business. Strategically bringing in partners to share on the results of that business allows us to have a larger presence in the market while exposing our individual result less volatility. Conversely, the growth in the first six months reflects the full six-month results of the acquired Ariel Re business which closed in February of 2017. The nature of business is such that a large portion of that business is underwritten at January 1.

Briefly on the loss ratio as Mark pointed out, current accident year results remain fairly stable with the exception of a modest increase in property losses. As to prior years both the three and six-month result benefited from an increased favorable contribution from prior years with the three-month result improving by \$1.3 million and the six-month result improving by \$10.1 million. Catastrophe losses while slightly different by quarter were virtually the same year-over-year. The expense ratio showed significant improvement down 1.3 points in the quarter to 37.5% and 1.5 points to 38.1% in the first six months of

2018. The improvement reflects the effective growth in our net-earned premiums, ongoing initiatives to increase operating efficiencies as mentioned above and the increased scale of the platform.

Another item which bears some additional mention and explanation is the investment result both the net investment income and realized gains. Mark Rose has already provided all the background on the trends, but trying to make the year-over-year results a bit more comparable, first on operating earnings. Last year's result includes the previously mentioned gain from the sale of a minority equity investment. This result was included in the operating result as we had previously reported the change of that value in the investment and - of that investment and net investment income. Adjusting for this one time item, last year's quarterly operating earnings per share would have been \$0.88 per share against a comparable second quarter 2018 result of \$0.95 per share.

Turning to net income, the adoption per share - the adoption of the change in reporting value movement in our equity portfolio led to us reporting a loss of \$26 million for the first six months which reduced EPS by approximately 61%. Again, isolating this one item, 2018 EPS would have been \$2.53 per share against the 2017 six month results of \$2.32 a share.

A few final items on the financials, the income tax expense of \$15.5 million through the first six months represents a 19% effective tax rate versus an assumed tax rate of 20% or roughly what we expect. There has been some variance quarter to quarter as we adjust certain elements of the structure in light of the changing tax rates and rules.

Finally, a couple of comments on the balance sheet. As Mark mentioned in May of this year we closed on the Ariscom acquisition, a specialty property casualty writer in Italy. The financial results of Ariscom are included in the quarter's results. And while the P&L was fairly nominal we did pick up approximately \$50 million of net reserves in the transaction.

Next with interest rates rising in the first half of the year. Embedded gain in the investment portfolio stood at \$96 million, the results of gains in our equity position offset by a modest unrealized loss on bond portfolio. And finally, book value per share in the quarter was essentially flat largely due to the decline in asset values, and the effect of some dilutive securities.

Operator, that concludes our prepared remarks, we're now ready to take questions.

Q&A

Operator

We will now begin the question-and-answer session. The first question comes from Greg Peters of Raymond James. Please go ahead.

Q - Charles Gregory Peters {BIO 4656608 <GO>}

Good morning. Thanks for the call. I've a couple of questions for you. First of all, from a big picture perspective, I know you've made a lot of changes for the 2018 calendar year. And I'm curious if you have a perspective of how the results, specifically the catastrophic events that rolled through 2017, how that might look differently in 2018, if it were to reoccur exactly as it happened before?

A - Jay S. Bullock {BIO 3644311 <GO>}

Sure. Greg, this is Jay. It's a good question and I think we alluded to it earlier this year. Last year, we were dealing with effectively two reinsurance programs, two referral programs, that's now one, that same set of events last year run through the portfolio, if the portfolio hasn't changed, I'm going to go to that in a second, would have reduced losses by about \$40 million with the (00:27:31) existing reinsurance structure. That said, that doesn't take into account other changes that we made such as the increased use of third-party capital in the reinsurance lines in our Syndicate 1910 work (00:27:44) which is where we write most of that business. So that number would be further reduced. In other words, the gross loss would be less and the net loss would be less.

Q - Charles Gregory Peters {BIO 4656608 <GO>}

Right. So on the alternative capital point, as I think about how the results have come through the first half of 2018 relative to at least (00:28:08) what I was modeling, the biggest variance I'm showing is in the international operations where the gross written premium on a year-to-date basis up 9%, net written premium - or 8%, and net premium, I think, is down about 9%. I know you don't like to provide specific guidance, but maybe you could help provide some color around how that might look for the full year as we think about obviously your increased emphasis around alternative capital solutions?

A - Jay S. Bullock {BIO 3644311 <GO>}

Yeah, Greg, I'm going to go back to some of the things that we talked about last year after the Ariel acquisition and talked about the size of that business, I think, we roughly - we notionally mentioned that it was on a gross basis 400-plus-million and we had a business that was, you could have seen in our historical financials \$125 million to \$150 million depending on the year. If we (00:29:09) put those together, they're not - it is not one plus one, because they are the reinsurance portfolios and so we optimized those meaning we don't just lay one set of risks on top of the other. As a result of increasing the third-party capital, I talked about that earlier this year, we've taken that up in the Syndicate 1910 which is the reinsurance business, we're retaining about 26% of that business. So you can do the math and figure out that the retained amount of business there is about \$125 million to \$150 million. A big chunk of it's written in January. So I think the ratios that you see in the second quarter should be fairly consistent for the rest of the year.

Q - Charles Gregory Peters {BIO 4656608 <GO>}

Great. More on the reinsurance side, on the balance sheet, I've sort of tracked reinsurance recoverables and that's tracking up. I assume part of that is reflection of the increase in just what's going on with the estimates from last year and maybe some current issues as well. But, can you provide us some color around your reinsurance recoverables and in light of the alternative capital, if we have a hurricane or a couple of

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hurricanes in 2018 would it - would we anticipate that recoverable number going up materially or provide us some color around how that might move?

A - Jay S. Bullock {BIO 3644311 <GO>}

There is really two pieces to it, Greg. One is, I'm going to try to answer this question as non-technically as I can. But certain of the legal entities that are providing - the corporate entities that provide third-party capital are owned by Argo. They're backed by other parties and 100% quarter share behind those entities. We end up consolidating those entities and so that brings on to the balance sheet recoverables and reserves that otherwise were spoken for by third parties, so that's part of it. And you'll see when you read in the 10-Q disclosure of about some of those things, that's number one. And number two, yeah, of course, when you have a set of events like that happened in the second half of the year, you're going to have an increase in reinsurance recoverables that number has already started to come down as we've gone through the first quarter.

And the last thing I'd say and then I know Mark wants to make a comment. The last thing that I'd say is that (00:31:43) reinsurers that we have hasn't changed much over the years and certainly the quality of those reinsurers hasn't changed at all and it is all very high quality.

A - Mark E. Watson III {BIO 1463509 <GO>}

Yeah. And some of that is backed by funds at Lloyd's as well. So if you look at the difference between loss reserves today versus the end of the year while some of it - while a part of it is a function of the acquisition that we made earlier a whole lot of it is the fact that we're still growing and as we grow, we had loss reserves, which is a positive thing.

As respect, CAT activity this year, just to repeat what Jay said a minute ago, if you take into consideration the consolidation of retro programs and our additional use of third-party capital this year beyond last year, if the same set of events happened again this year another way to think about it other than just absolute dollars is loss ratio points for the year and we're talking about 5 points or 6 points instead of 8 points or 10 points.

Q - Charles Gregory Peters {BIO 4656608 <GO>}

Thank you for the color, Mark and Jay. One final question, Mark, you'd be remiss if I didn't note the nice improvement in the expense ratio in your U.S. operations both in the quarter on a year-to-date basis. Should I look at the year-to-date expense ratio in the U.S. and sort of use that as a normalized run rate going forward or maybe you could comment on the success there and what we should be thinking about going forward? Thank you for your answers too.

A - Mark E. Watson III {BIO 1463509 <GO>}

Well, I think that it's always better to look at several periods of time to get a better sense for run rate. So, yes, I would focus more on the six-month number than the second quarter number. Having said that, I think a lot of the things that we talked about a year ago that we said would start hitting the bottom line this year, which Jay alluded to earlier in the

call are happening, and it's not just in the U.S. it's group wide. So we still have plenty of opportunity.

And I think that over the next several quarters, we will see continued improvement in the expense ratio. I don't expect it to be linear. I think it'll be lumpy because three months is too short a period of time, but I think that the trend is directionally correct over the next four, five quarters.

A - Jay S. Bullock {BIO 3644311 <GO>}

I guess the last thing I'd say to agreeing with what Mark said I think it is important to look at it on an overall basis, 37.5% is material improvement. I think, you'll see when we publish our 10-Q tonight, there is not - we would otherwise disclose and there is not any material one-off items that are affecting that ratio.

Q - Charles Gregory Peters {BIO 4656608 <GO>}

Great. Thank you for your answers.

Operator

The next question comes from Christopher Campbell of KBW. Please go ahead.

Q - Christopher Campbell {BIO 20262752 <GO>}

Yeah. Hi, good morning.

A - Mark E. Watson III {BIO 1463509 <GO>}

Good morning.

Q - Christopher Campbell {BIO 20262752 <GO>}

Again (00:35:09), my first question is, if I'm looking at the core loss ratio year-over-year, it's up about 200 bps and I know there are some non- CAT weather - and this is overall, I know there is some non- CAT weather and then some discrete Lloyd's things and you're also less property and more casualty that will drive it up.

So how should we be thinking about how much of - what was the real underlying movement in that if you strip out those kind of second quarter specific things?

A - Jay S. Bullock {BIO 3644311 <GO>}

So there is two things going on there, Chris. Let's talk about the U.S. first, right because you don't have to look at these on (00:35:43) pieces and the increase in the U.S. of that increase about 1.6 points was related to what we call that discrete one-off property losses which is kind of what they were. The international side is a little bit harder to quantify because there is two elements going on there. One, as I mentioned, we moved up our use of third-party capital in the reinsurance business. The reinsurance business is one of the lowest loss ratio businesses that we have. That said, when we see to weigh some of

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that business, we also see to weigh some of that volatility. So it's a little bit challenging to compare last year's loss ratio to this year's loss ratio, but you can appreciate that a portion of that is therefore simply, what I would call, related to business mix.

On top of that, and it was about another point in the syndicate that was related to we have a one-off cargo loss and actually it was one of the loss, it was one of the property loss.

Q - Christopher Campbell {BIO 20262752 <GO>}
(00:36:42).

A - Jay S. Bullock {BIO 3644311 <GO>}

So there was a couple of property losses that affected that by about one point.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay. Great. Well, that's very helpful. And then just kind of thinking about your catastrophe or experience this quarter, which was really good. How much of this is just kind of (00:36:59) versus like all of your efforts on like to use like increased sessions and U.S. and then more Aerial Re property risk. And then how should we think about the CAT load going forward overall?

A - Mark E. Watson III {BIO 1463509 <GO>}

So we don't really think about loss experience from CAT activity in the first half of the year is luck one way or the other. The way that our portfolio is positioned, we don't really expect that much CAT activity or emergent, particularly in our reinsurance portfolios except for some extreme events which we would not expect to happen every year or even every other year.

So I don't think there was much difference between our CAT activity this year or last year in the second quarter in absolute dollars perhaps on a percentage basis, but I mean the dollars are so small that I don't think it makes sense to focus on the percentages.

And as far as CAT load, well, that's a really good question but I'll just refer you back to the answer that I gave a minute ago to a similar question which is if a similar set of - the exact same events happened this year has happened last year then that probably equates to 5 points or 6 points on the combined ratio this year as compared to 8 points or 10 points a year ago.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay, great. And then just kind of switching gears, there were some articles this quarter about Argo being possibly interested in a sizable acquisition. So maybe you don't want to talk about that one specifically, but I mean how does Argo think about - I mean, given the priority is organic and possibly inorganic growth for capital management, how does Argo think about potentially transformational M&A, like what's strategic and operational metrics

would you prioritize and would large reinsurance exposure or a turnaround inhibit Argo in any way?

A - Mark E. Watson III {BIO 1463509 <GO>}

Our main goal is to grow our business and grow it organically, which I think we've done a very good job of over the last decade. You'll recall the previous decade included a significant amount of M&A including the acquisition of two independent public companies. I've been very, very transparent about us looking at things as opportunities present themselves. When I think that they will help us achieve our strategic goals and I think really good examples of that were the Ariel Re acquisition a year ago, which has proved to be a tremendous benefit to the company on many different levels that we've talked about in the past including the transformation from risk taker to originator and distributor of risk and improving data analytics and improving intellectual firepower among our management team. And most recently the acquisition that we made in Italy that's improved our market presence and grown our product portfolio in Italy. But every time we think about things we think about it in relation to what it allows us to do strategically and you will note that over the last decade we have repatriated a substantial amount of capital to our shareholders and continue to do so.

Q - Christopher Campbell {BIO 20262752 <GO>}

Got it. Great. And so would scale or broker relevance would that be something strategically you'd be looking for as well.

A - Mark E. Watson III {BIO 1463509 <GO>}

The brokers that we're most focused on were growing with double digits this year. We have more policy holders today than we did a year ago. Our expense ratio is coming down. So I think those are all examples of us being at scale or at least getting very close to scale depending upon which part of the group we're talking about.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay. Great. Well, that's very helpful. And then just one final one for, I think, Jay, looks like repurchases were a little bit weaker in the quarter anything driving this?

A - Jay S. Bullock {BIO 3644311 <GO>}

No, I think, we've been in a blackout period obviously, and we had a program in place, we had a price target in that program, we were occasionally above that price target that limited the activity in the quarter. We always pay attention to what's going on this time of the year, and where the stock is trading, and we'll make decisions about how we - how active we are as the year goes on.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay. Wonderful, well, thanks for all the answers. Best of luck in the next quarter.

Operator

The next question comes from Matthew Carletti of JMP Securities. Please go ahead.

Q - Matthew J. Carletti {BIO 5249827 <GO>}

Thanks. Good morning. Mark, thanks for all your comments and the opening about the digital efforts, I think, that was helpful for us to get our hands around kind of some of the things you're doing. My kind of follow-up question would be can you help us quantify either in dollars or expense ratio points, how you view that upfront investment, I understand that it never ends, but it does sound like there is more of a real push being taken currently? And so how should we think about that in terms of dollars or points in terms of a drag on the expense ratio currently? And for how long do you think that keeps up before it lets up and becomes more of a maintenance sort of thing as opposed to a build effort?

A - Mark E. Watson III {BIO 1463509 <GO>}

I don't know that it ever goes from maintenance, from build to maintenance at least in an absolute fashion it may in a relative fashion as we continue growing the top line and the bottom line. As you just pointed out very purposely dialed up the pace of innovation and development this time a year ago and said that we were going to really push hard in the near future to really build out our digital capabilities. And they're starting to pay off, you'll note that in the – in our February earnings call I talked about things generally and you'll note that this quarter I've been a lot more specific about the numbers. I get – I appreciate that I haven't talked about that financially yet, but I think that you'll see that coming very soon, perhaps not the next quarter, but the quarter after that. And as you know I like to talk about things that we've done not what we aspire to do. And I think we're getting very close to being able to talk about the financial outcome/benefit of the digital investments that we've been making over the last 12 months, in particular.

Q - Matthew J. Carletti {BIO 5249827 <GO>}

Okay. And then there's one other question, appreciate the comments you had helping us on the property side of some of the reinsurance changes. There's been a bit more focus broadly in the market, I think, on some percolating loss costs in certain casualty areas. So my question is, can you help us with in some of your casualty lines I think maybe excess casualty would be one area or how should we think about max net lines that Argo might put out in some casualty classes?

A - Mark E. Watson III {BIO 1463509 <GO>}

Well, I'm not sure that I followed the max net line we can put out relative to things percolating, so let me just answer the question in this way.

Over the last decade we've intentionally reduced the tail of our liability portfolio from what was five plus years down to less than four. So that gives us a lot more flexibility to adjust our pricing if we see loss cost inflation trends that might drive unexpected loss emergence at an industry level. As respects our use of insurance to put out – reinsurance to put out limits beyond what we want to take net, that just – that is very market specific even within a line of business casualty, it is very market specific and depending upon what

our customer's needs are we have the ability through our reinsurance partners to flex to their needs while keeping our net exposures relatively low in our risk tolerance.

Q - Matthew J. Carletti {BIO 5249827 <GO>}

Okay, great. Thank you for the color and congrats on a nice quarter.

A - Mark E. Watson III {BIO 1463509 <GO>}

Thank you.

A - Jay S. Bullock {BIO 3644311 <GO>}

Thank you.

Operator

The next question comes from Adam Klauber of William Blair. Please go ahead.

Q - Adam Klauber {BIO 1494359 <GO>}

Hi. Thanks. Good morning. Couple of questions, how are submissions in the E&S segment in the first half of this year compared to the first half of next year – the last year, sorry.

A - Mark E. Watson III {BIO 1463509 <GO>}

I don't have the exact number in front of me only to tell you that there are more this year than a year ago. Jay, you may have the number off the top of your head.

A - Jay S. Bullock {BIO 3644311 <GO>}

No, I don't. But I think submissions are certainly up, I think maybe...

A - Mark E. Watson III {BIO 1463509 <GO>}

And that was really the point I was talking (00:47:09) about all of our digital initiatives, what's driving a lot of that submission activity is a lot of our ability to be more dynamic with our customers and be more responsive to them, which is why I was talking about us being able to respond within an hour, and as I said the person who – the market that responds first typically gets the business.

Q - Adam Klauber {BIO 1494359 <GO>}

Right. Right. Great. And then also on the E&S, in general, I know it's different market by market and product by product, but are you seeing more interest in the standard markets coming into E&S like risks or are they continuing to, on a granular basis, move out of the E&S like risks?

A - Mark E. Watson III {BIO 1463509 <GO>}

No. I think that the standard markets have been increasing their risk appetite for quite a while, in part they've increased their risk appetite into risks that we might otherwise think of as E&S risks, but also a whole lot of what fits in the E&S market is Main Street business that's aggregated by wholesalers. And that's the business that we're seeing going back and staying with the admitted market and not finding its way into the E&S marketplace, but that trend has been going on for quite a while.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. Fine. Sorry.

A - Mark E. Watson III {BIO 1463509 <GO>}

What will be interesting to see is if cyber finds its way out of the admitted market back into the non-admitted marketplace where I think it ought to be where it's a lot easier to create product innovation and find more dynamic solutions for business owners. But we haven't seen that happen yet, but hopefully we will see that over the next few quarters.

Q - Adam Klauber {BIO 1494359 <GO>}

Yeah. That would add a nice growth component. And then as far as the - again standing the (00:49:14) U.S. liability casualty business, is the - would you say the legal environment is more challenging today than maybe two, three years ago. And if so, or I guess, what trends are you seeing in the legal environment these days?

A - Mark E. Watson III {BIO 1463509 <GO>}

I think the legal - if we limit our discussion to the U.S., I think the legal environment is always challenging. I think that that we should never underestimate the plan as far as ability to come up with the new novel theory of liability, but after all that's what keeps us in business. And so, it's our challenge to make sure we keep up with those. And having said that, I don't think there's anything that really stands out to me as extraordinary that makes us really rethink, how we're underwriting our portfolio at a broad level.

Okay. Thanks a lot.

Operator

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

A - Mark E. Watson III {BIO 1463509 <GO>}

Thank you. And I would like to thank everyone participating on our second quarter call today. I think when you compare to a year ago, there are a lot of really good positive improvements particularly in our operations where we are getting to scale and our ability to be more responsive to our customers. And we look forward to talking to you again at the end of the third quarter. And operator, that concludes my remarks.

Operator

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

FINAL

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