Raymond James Institutional Investors Conference

Company Participants

- Jay S. Bullock, Chief Financial Officer & Executive Vice President

MANAGEMENT DISCUSSION SECTION

[Abrupt Start]

I cover insurance, insurance brokerage, and technology stocks for Raymond James. It's my pleasure to welcome back Argo Group to our conference this year. We currently have the stock rated as strong buy, and the performance over the last two years has been positive on a relative basis to its peer group.

From management, we have Jay Bullock who serves as the Chief Financial Officer, and I'm going to turn it over to Jay.

Jay S. Bullock {BIO 3644311 <GO>}

Greg, thanks, and I'd like to say it's been positive on a relative and absolute basis. So we'll have some numbers to talk about that. I need to show you the forward-looking statement disclaimer. Please take a chance to read that at your leisure. That's included in the presentation online, and it's included with the hard copies that we've got.

So what do I want to cover today? I want to cover today sort of three topics broadly. One is understanding what our strategy is. There may be some people in the audience or maybe some people listening who aren't as familiar with Argo. So what is that strategy and how is that strategy closely aligned to shareholder value. Number two, what's the strategy doing? Are we actually delivering results? And I think the story there is quite strong. It's quite strong over the last several years. And then finally, we'll talk a little bit about the year that we just finished. It wasn't - it was a good year. It was certainly a good year relative to a number of peers in the market. It wasn't a great year for the overall market because there was a lot of things going on, but we'll talk about that as well.

So let's jump right in. My first slide here is really a background slide. I want to make sure that, again, for those of you that may not be as familiar with the story, you get the chance to understand who Argo is. So Argo is a global underwriter of specialty insurance and reinsurance. And I always take the opportunity to explain because specialty sounds like a term that gets thrown around a lot. What is it? What is special? What does specialty mean? Specialty might mean unique underwriting expertise and we have a lot of talented underwriters on staff that have that expertise. It might be customizing a product for a unique distribution system, think the wholesale distribution system in the U.S. Or it might be a business that finds itself at one point or another in a capacity constrained way. And therefore we've got the underwriters to basically to provide the capacity in the market and make really good returns.

We're strategically located in major insurance centers, so those major insurance centers are well-known. We're headquartered in Bermuda. We've got operations across the United States obviously, London and then some smaller spots but they are important insurance centers Zurich, Dubai and Singapore. And we've got an established presence in some very desirable markets. The core of the Argo strategy of being a specialty insurer really goes back to the acquisition in 2000 of Colony Insurance which is our excess and surplus lines business. So there's a business that's been active in the in-house market for more than 20 years and I often ask myself why is it that the best performers have been around so long and why haven't we've seen so many come and go.

I think it really has a lot to do with the relationships that are built in that market. I'll talk about that some more in a moment. Away from our non-admitted market in the U.S., we have our admitted specialty franchise and that has a focus on some very narrow (00:03:33). We're one of the top Lloyd's syndicate by stamp capacity in 2018 and then our Bermuda operating platform enhanced via acquisition in 2017 of the Ariel platform is a strong performer in Bermuda market.

Diversified by geography, product and strategy, we don't feel like we're overcommitted in any market or to any strategy. We think that's helpful. And we have broad relationships with our producers. Our ratings are strong, A by A.M. Best and S&P put us on positive outlook last year after a couple of years of discussion about a number of things that we thought were working in our favor.

On the right-hand side of the page, you can see the business mix. That's what I was talking about in terms of diversified by product. We're based in Bermuda, so it's always helpful for me to say to folks we're an insurer, not a reinsurer because when you think about Bermuda, the first thing you think about often is reinsurance. We're actually 90% insurance and 10% reinsurance. And then finally, our biogeography, the preponderance of our business is still in the U.S., but a lot of the growth that we expect to see over the next few years will come outside of the United States.

Just to get a little bit more specific about our operations, so this is the strategy of how we set up our specialty operations in the U.S. I mentioned excess and surplus lines. I mentioned the 20-year operating history and those deep relationships with brokers and the underwriting expertise that comes along with that 20-year history.

I really feel like we've done a good job of institutionalizing that expertise because you do have - people change, but the institution has done a really good job over a long period of time. In our admitted market, let me give you a couple of examples of what we do there, Argo Pro is our professional liability business. So we're focused on both public and private companies offering D&O and management liability in that market.

Trident focuses on the public entity business. So think small public entities, whatever small town, wherever you might live, it might be a small town or the small towns near you, that's what we would be covering. It could be the liability cover for the town. In some cases, it's the property cover for those small municipalities. We don't tend to get into the larger cities. That's a very competitive market covered often by a different part of the marketplace.

Rockwood is a business focused on mining, workers' compensation for coal mines. If that doesn't sound specialized, I don't know what is. It's really an interesting operation. It's been in operation for over 40 years. We literally have guys with hardhats that go down into coal mines to understand how they're put together and understand which ones are the better engineered mines and therefore where's a better risk and where's a lesser risk.

On our Surety business, I'm quite proud of this one only because I had some involvement in the early days of helping to manage this indirectly. It's now grown into a top 20 surety provider in the U.S., largely commercial. We do have a growing contract business, but it's been a – there's obviously very strong margins in that business.

On the International side, the largest part of our operation is Syndicate 1200 and Syndicate 1910. Those are just the two operating syndicates, but let's talk a little bit about what those businesses are. They are the traditional Lloyd's multiline syndicate. That's what is written through Syndicate 1200. That's all insurance. Think property, think liability outside the United States. Think certain personal accident classes of business.

We've gotten out of a number of things there in the last couple of years. As I'm sure most of you know, Lloyd's has been a pretty challenging market and has taken a lot of action as an overall market to really pull back on some of the underwriting that just wasn't working. We made those decisions early. We exited aviation and aerospace a couple of years ago, and we've exited some other things.

The other thing that we do through Lloyd's is our reinsurance business. So most of our reinsurance talent is based in Bermuda, but they actually put the lines down on behalf of Syndicate 1910. And then finally, in Bermuda, we've got our excess casualty and excess professional lines and a property business. When we acquired Ariel in 2017, maybe it was an unintended consequence. I'd like to say it was an intended consequence. But we got a really strong property team and found that the ability to offer a full slate of products to the brokers in the Bermuda community was actually very helpful.

And then finally, we've got a small operation in Brazil that we started in 2012. It's been a great place for us to learn. We are making money there now. It took us a few years but we made a good return there last year. Of course, it helps with the investment yields in the Brazilian market. But nevertheless, we've been very focused on trying to replicate a business in Brazil that looks a lot like some of our businesses in the U.S., in other words, focused on small and middle market businesses.

And we overlay all of this with a digital strategy that you heard us talk a lot about on our recent calls. And I just want to spend a moment talking about that because I haven't included a slide that we often include in the core of this presentation. But we talked about a pie chart where we said, how much time are we spending focusing on the core business and how much time are we spending focusing outside of that business. Most of what we do, about 60% of the time is focused on making enhancements to the core business. And we used an example on the conference call. We said, look, the entire spend on digital is less than $10 million, the growth that we've had in core casualty, which has been brought about largely by digital initiatives, the margin on that growth is almost 2x of what we spent on digital itself.

That's just one example of where we've used digital applications in our business to enhance the existing business. Other areas would be things like using smart search technology to think about when large volumes of public data need to be - need to be gleaned for information, underwriting information. We have SmartSearch (00:10:03) technology that we've created. A lot of it's off the shelf product, but we've customized it for our business to help advance the business and make better underwriting decisions.

So the digital part of what we do is a very important element of where we think the organization is going in the coming years. I wanted just to pause here to talk about it because I don't have a slide on it again. And I think it's very important.

So when I take a step back and I understand, okay, we've established a specialty platform. So what? Why have you done that? Well, history would show that the underwriting margins in the specialty market are better than the underwriting margins in the traditional market. So when I look at this math equation and I say what is it that yield shareholder value creation. On the left hand side, we've got the underwriting margin which is the loss ratio and the expense ratio. You couple that with the strategy towards delivering additional value on the investment side. You multiply that by how you manage your capital and what comes out the other end is shareholder value creation which we measure in terms of growth in book value per share. But - which our shareholders, of which I am one, measure in terms of what's the return been.

How have we done on these? I mentioned the 440-basis point improvement in the loss ratio since 2012 and a 260-basis point improvement in the expense ratio 2017 to 2018. From a total return on investment standpoint, we've got data to show that we've been at the top of our peer group over the last three years. In capital management, we've been very active at returning capital to shareholders. All of which has led to a very long-term track record of growth in book value, 9% since 2002, investing class total shareholder returns.

So while we're at it, why don't we talk about the - how we're delivering on the results of that equation more specifically. Best-in-class shareholder returns, 43%, 63% and 141% over one, three and five years. I'll show the chart in just a second. I mentioned 9% growth in book value per share. We've also seen really good momentum in our top line, growing 10% over a very long period of time and 10% in the recent periods of time.

Loss ratios that have been better than peers, demonstrably better for a meaningful period of time, long enough so that you can say, hey, that's not just an accident. That's not just good luck. That is execution. And in expense ratio - and I will be the first to say that what I've been focused on in the last couple of years is how do we get more leverage out of our infrastructure. And we really started to see that in 2018, the efforts that we put in to hire the right talent, to have the right sort of processes, to drive that - to drive a lower expense ratio. And then finally, as I mentioned, returning capital.

So you just go down the list and you say, for shareholders best-in-class returns. As management is incented and motivated, much of my compensation is derived from our ability to grow book value per share, a good number over a long period of time. Operating growth momentum, core ratios that are either good or best-in-class, and we're improving, and then return to - return of capital to shareholders. We've talked a lot about what our targets are in this environment. Risk-free (00:13:42) rate, plus 700 basis points. I'm a big fan of round numbers. That means 10%. We think we're on our way to delivering a 10% return on capital and this is the path that we think will take us there.

Now we talked about shareholder returns, I had a number of conversations. Let's just look at the track record. Number one for one year, this is the same peer group that we've used throughout the presentation, and I want to address that in just a moment.

Number one in one year. Number four over three years. And number two over five years. That's pretty good. That's real good. And I was asked yesterday, okay, what about companies that have been taken out. What about a broader peer group. We looked at it last night, expand the peer group to 40 companies and it doesn't meaningfully change the number. Add the companies that have been taken out. It doesn't meaningfully change these numbers. We remain at the top of this class in terms of shareholder returns.

The book value per share growth track record, now this includes dividends because as a shareholder, the value that a shareholder receives is that growth in book value plus that dividend. We've had a couple of setbacks over time. Those setbacks happened as a result of large financial dislocation in the market and/or and often coupled with catastrophe losses in the market. So if you look at 2008, we all remember that year. There was a couple of large hurricanes that year. Book value backed up that year.

2011, very frustrating year for us, quarter after quarter after quarter we saw catastrophe activity that was just coming up to, but not going into our reinsurance programs. So it meant, we spent a lot of money on reinsurance that we didn't really get the value for out of that. We've done a lot to restructure our reinsurance program since then.

And in 2018, right. That was kind of a 60-day snapshot on the market and dislocation at December 31, most of which has been recovered already in the first two months of the year coupled with some pretty significant cat events last year. I'll talk about those cat - those numbers in just a moment because we said we were going to change the way we bought re-insurance in 2017 vis-à-vis the acquisition that we made of Ariel. We did that and it really made a difference going into 2018.

Operating growth momentum. So this is 17 years and you can see that along the way in 2009, we decided, look, we really need to back this thing up. We really need to take some of this business off the books. And that was intentional. That was after the acquisition of our platform in London. So the fact that it still works out to 10% growth over that long period of time, I think, is impressive and shows that the growth from 2010 to 2018 is at an even faster pace.

But most importantly, the growth over the last five years has been at around 10%. A lot of that's come from growth in what are our existing core businesses, and so that goes back to the thesis about digital – about using digital applications in our business, to take the existing business, make it that much better, make us that much more responsive and allow us to use what we already have coming in the door, i.e. the raw material to grow our business.

Now I think this is – this may be the most important page, right? So it's often said expense ratio of an insurance company can make you an underperformer, but it can't kill you. But what can kill you is having a loss ratio that doesn't stack up well, that doesn't perform well over a long period of time. We do this in reverse order, right? If you go down to the bottom of the page, 2014 to 2018 loss ratio, better than the average by a little over 200 basis points.

And I would say – I might say 200 basis points. I'm not sure that sounds like that big of an outperformance. But when you think about it over five years, that's really meaningful outperformance over five years against a really I think high class group of performers.

If we go back to 2018 and we look at the overall margin for the company. The overall margin as defined by what was our combined ratio in 2018. We were better than the average again by 130 basis points including loss and expense ratio. And then we look at loss ratio in 2018 and we continue that long-term trend of outperforming the market.

We think this is going to continue to improve. If you ask me where do you think – where do I think it's going to improve. I think it's likely that we'll see more improvement on the expense side than on the underwriting side. Having said that in every business that we have, I can tell you if we sat down and had plenty of time, we'd say let's talk about the strategy in this business. There's a strategy in place that we think will improve the loss ratio but that's a pretty loss ratio in total. And every time you have something that improves, you might have something that backs up just a little bit.

And then finally, I wanted to talk about the investment strategy. It's a total return investment strategy, so we're really focused on how do we deliver growth and book value per share through the investment portfolio. That portfolio has to be well-organized and well-structured. However to meet the needs of our policyholders first and to meet the needs of our shareholders second, so we're very mindful of that. We're very mindful of making sure that we've got the right sort of liquidity in the portfolio, that we have the right sort of duration relative to our assets. So all of that risk management is a fundamental part of what we do on the investment side.

That said, we also try to add value through what we call the capital appreciation part of the portfolio. That's a little over $1 billion today. And you can see the composition of that portfolio is equities, a small allocation to some hedge funds; non-investment grade debt;

other sort of, I call them riskier assets, but assets that are going to – that should have the – provide the opportunity to achieve some additional growth in the portfolio.

Now, I've got a question the other day about the duration of the portfolio, two-and-a-half years. That is shorter than our liabilities. You're obviously leaving some money potentially depending on the shape of the yield curve, leaving some money on the table by doing that. It's been a long-term decision of ours to keep the portfolio short because we felt that there was very little risk reward in going out on the curve. And when you look back on it over a long period of time, wrong decision. We'd still make it today every day because of the inverse risk and reward of going out on the curve and then the possibility that the curve shifts up meaningfully.

I mentioned in our yield of 2.8% is – that's going to be coming out of the core bond portfolio. But when we look at our total returns among peers over the last three years, I think for that same peer group, we were number three.

And finally, I mentioned the returning capital to shareholders. I'm going to repeat something that we've said often because I think it's really important and something that everybody needs to hear. The first thing we think about is do we have enough capital to support our balance sheet. If you go back to that first slide, the ratings, A.M. Best and S&P, critically important to us. Regulatory capital, critically important to us.

So the first thing that we think about is, do we have enough capital to support our balance sheet. The second thing we think about is, do we have enough capital to support growth. And we've seen some pretty strong growth in the last couple of years. So we've been – we're using the capital more effectively today than we were five years ago.

The next thing we think about is are there good opportunities to add to the platform vis-à-vis acquisition. And I'd like to say that my background before being the CFO which is now a long time ago was as a banker that we would have done more deals over the last 11 years, but we just haven't seen the returns and the opportunities that lead us to want to deploy capital in that way.

And so once, we've gone through those first three, then the fourth thing that we think about is okay, maybe we need to figure out how to give capital back to our shareholders, and so over that period of time since 2010, $646 million. Why 2010? That's the year when we instituted our regular dividend policy again. We didn't have a regular dividend before that. So, it's kind of a point in time where this is when you just start thinking about what have they done in terms of returning capital to shareholders. There were a few one-offs before that, but this is the real core period of time.

When I think about the decision between buying shares back and paying dividends, it was a lot more attractive in a perverse way because it wasn't very comfortable from a valuation standpoint. It was a lot more attractive to buy the stock back when it was trading at below book value. Now, we're trading at a meaningful premium to book value which is great, but that means we're more likely to lean towards a dividend policy change than we are towards repurchasing shares. And we increased our dividend recently which was part of that strategy, a matter of fact increasing it more than 3 times since 2012, once you adjust for some smaller stock dividends that we've done.

And finally, let me just pause here and talk about the fourth quarter and 2018. And I highlighted one line on this page because I think it matters and that's our operating ROE – sorry, our operating income, and you can see 2017 over 2018 a dramatic improvement.

So what's the big difference in those two numbers? The big difference was how the platform reacted to the catastrophe events that happened in 2017 and happened in 2018. So if you go back, you rewind the clock, and you think about the conversations we were having in 2017, we bought a business called Ariel in Bermuda. Their core business was reinsurance, property cat reinsurance.

We had our own property cat reinsurance business. We immediately combined the two businesses from an operations standpoint, literally put the people in the same office and put them together, and that worked out well right from the start. But when you buy a platform like that in the middle of a year, you've got two retentions, in effect.

And so we had a retention from the business we bought, we had a retention from the business that we owned, and acknowledged that, okay, not knowing at the start of that year what the set of events could be, there could be a set of events where we've got a bit more exposure on the bottom end than we would like, and in fact, that set of events happened. You had the three large hurricanes. You had the California wildfires. It was one of the larger cat years on record.

And what we said was, okay, we'll look at 2017. We've changed our program going into 2018. And if you look at that 2017 set of events, you probably would see something along the lines of a $40-million to $50-million reduction. It's not exact right (00:25:11) because you can't exactly apply the changed program to history. But we thought that that would be the reduction.

Fast-forward to 2018 and you had basically the same set of events, not quite as large in magnitude but pretty close. You had some – you had a very large hurricane. You had another series of large California wildfires. Catastrophe losses in 2017 net to the company were $145 million. Catastrophe losses net to the company in 2018 were $62 million. So I'm only trying to make the point that we said this is what we're going to do to execute on that. We think that by doing so, we'll significantly reduce our exposure and still be able to retain some of the upside in those businesses. And in fact, we did.

The other thing that's unusual about 2018 is the change in the accounting for equities. I'm going to knock on wood as I say this because the first quarter is far from over, but get ready for the first quarter because it's going to look pretty funny too. Positively, in the other direction because of all the gain that we've seen market-wide in our respective equity portfolios. Last year though, especially given the fact that, guess what, you publish your financials on December 31 right when the snapshot of when did the market – when was the market most dislocated.

And so, we, like a number of companies showed a large change in our realized loss on our equity portfolio. If you back that out, and I think you could only back that out when looking at 2019 versus 2018 because by the time you get to 2020, it's going to be a permanent - it's going to be in the year-over-year numbers. But to make 2018 relevant to 2017, that would put our adjusted return on equity last year at 8.2% versus the year before of 2.8%.

So I'm not suggesting that that's not real from where I sit as the CFO. It's geography. That would have been reflected in book value. The gain, will now go through our income statement. Again, knock on wood in the first quarter. And that would have gone through the balance sheet in the first quarter and restored some of that book value.

But as I said, given the level of catastrophe activity last year, the 260-basis point improvement on our expense ratio. We were pretty happy with the 97.9% combined ratio that we were able to produce.

So if I can conclude and how am I doing on time? I'm doing - okay, two minutes left.

Superior loss ratios over a long period of time, it's not easy to demonstrate that and keep it up unless it's real. And I think we have a long enough track record to prove that it's real. We're very focused on improving our expense ratio. We're very focused on improving our margins and that expense ratio showed demonstrable improvement last year.

The top line is growing. We've had great success doing that in the U.S. You may have seen some management changes. We took some of our leadership in the U.S. and gave them a broader remit. Therefore we expect the lessons learned in the U.S. business to be applied to the international business along with the ability to drive intelligent growth there. And finally, we've been very active returning capital to shareholders, and I think you should expect us to continue to think about that as we manage our capital going forward.

Great.

Jay S. Bullock {BIO 3644311 <GO>}

I'll pause there.

Yeah. Well, I think it's a good time. Why don't we just end here, go to the breakout session in Cordova 5...

Jay S. Bullock {BIO 3644311 <GO>}

Great.

...and we'll continue on our discussion there. Thank you very much.

Jay S. Bullock {BIO 3644311 <GO>}

Thank you very much for your time. Appreciate it.