Q4 2015 Earnings Call

Company Participants

- Jay Stanley Bullock
- Mark E. Watson
- Susan Spivak Bernstein

Other Participants

- Charles Gregory Peters
- Daniel D. Farrell
- Jeff Schmitt
- Meyer Shields

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Argo Group International Holdings' Fourth Quarter 2015 Earnings Conference Call. All participants will be in listen-only mode. 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 good morning. Welcome to Argo Group's conference call for the fourth quarter and calendar 2015 results. Last night, we issued a press release on earnings, which is available in the Investors section of our web site at www.argolimited.com.

Presenting on the call today is Mark Watson, Chief Executive Officer; and Jay Bullock, Chief Financial Officer. Also with them, is Axel Schmidt, Argo Group's Chief Underwriting Officer.

We are pleased to review the company's results for the quarter, as well as provide you with management's perspective on the business. As the operator mentioned, this conference call is being recorded. Following management's opening remarks, you will receive instructions on how to queue in to ask questions.

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 to Mark Watson, Chief Executive Officer of Argo Group. Mark?

Mark E. Watson {BIO 1463509 <GO>}

Thank you, Susan, and good morning everyone. I'd also like to welcome everyone to our fourth quarter and year-end 2015 earnings conference call.

After the market close yesterday, we reported 18.4% growth in operating earnings to $0.90 per share in the fourth quarter of 2015, compared to the fourth quarter of 2014, and 15% growth for the year to $3.70 per share for the calendar year 2015 versus the prior year.

We remain encouraged by our results, especially given the increasingly competitive landscape. Throughout the year, our focus has been on clearly identifying areas of business, with the most significant opportunities for profitable growth and focusing our time and attention on realizing that potential. At the same time, we focused on simplifying the business and investing in technology. These combined efforts are contributing to our stronger underwriting results.

During the year, underwriting income improved 28.5% to $66.2 million from $51.5 million in 2014, and a record level for our organization. In the fourth quarter of 2015, our underwriting profit increased 45% to $15.8 million from $10.9 million in the same period of 2015, despite the higher level of larger losses in certain businesses. Jay will provide some further details in his commentary on some of those things that happened in the fourth quarter.

As I mentioned last quarter, we are focused on simplifying how we run our business. The outcome of this should be increased efficiency, reduced expenses, and hopefully if we get it right, scalability. Part of that effort involves some tough decisions, which reduced head count in certain areas, and another area of focus has been our ongoing investment in technology.

As I mentioned on our last call, we improved the way we provide service to our clients, and in our E&S business for some classes of business that's resulted in growth of more than 20% year-over-year.

For the year 2015, we posted a combined ratio of 95.2%. Not only was this a one point improvement over the 2014 results, it was the achievement of our often-stated goal of delivering five points of underwriting margin in 2015.

Continuing with the improvement in margin, and consistent with my comments a moment ago, the expense ratio component of the underwriting result is showing favorable year-over-year comparisons. This improvement was achieved despite the impact that certain equity compensation has on the expense line, related to the very strong performance of our stock in 2015.

Another favorable trend for 2015 was the continued strength we see in our reserving process. For the 19th consecutive quarter, and the 11th consecutive year, we have seen positive reserve development, this quarter, in each of our ongoing operating segments.

Overall, from a growth standpoint, our top line was up 5% in the fourth quarter, and up 5.6% for the year. This result reflects the market we find ourselves in, but as in past periods, matched the progress we are making in certain of our better businesses, including our E&S platform, new lines added in recent years to the Syndicate, and parts of Commercial Specialty.

The top line result also reflects the challenging rate environment. In this environment, we continue to benefit from our specialization, deep market knowledge and account size selection.

Now let me briefly comment on each of our operating segments; in our Excess and Surplus Lines business, gross written premium was up 9.2% in the fourth quarter, and 11.9% for the year. We are achieving growth in our casualty units, our largest business by volume within E&S, and up nearly 20% as I mentioned a minute ago. And again, this reflects the benefit from our investment and technology, and overall process improvement as well.

We also benefited from growth initiatives in our professional lines business, an area we've been focusing on for the last few years. On average, rates were modestly down across the segment, other than property.

2015 was a year of improvement in most businesses within our Commercial Specialty segment. Overall, premium was up 5.7% in the quarter, and 5.8% in the calendar year 2015. Growth was driven by our program and public entity businesses.

While we continue to see an improvement in our underwriting results, it's getting more challenging to achieve rate increases due to competition. As we have across much of our business in the U.S., we will continue to focus on profitable relationships in these areas and driving results through deeper and more engaged relationships.

Turning to Syndicate 1200; pricing and competition remain robust across all the Lloyd's market. As a result, we only grew modestly, with our gross written premiums up 1.3% in the fourth quarter, and 3.8% for the year. Most of the growth is being driven by the North American binder business and new classes of risk that we've added in recent years, such as our international casualty and the launch of our platform in Asia. The growth in these areas is offset by competition in nearly all other lines. In addition, the top line for this segment is affected by our slight decrease in the participation on Syndicate 1200 during 2015 versus 2014.

Lastly, gross written premium in our International Specialty segment was relatively flat in the fourth quarter and declined 3.9% in the yearly comparison with 2014. The decline in the quarter reflects a decline in Brazil, not surprising, given the more challenging economic environment and weakness in the local currency.

In response to market conditions and any business that was a startup just a few years ago, we made selective changes to the business, and are beginning to see positive results. As such, we continue to believe this business is positioned for growth towards a scaled platform in 2016.

In our Bermuda insurance businesses, we still see new business flow and high renewal retention. However, rates are up modest single digits across the book. At Argo Re, our profitability remains strong, and we're happy with our renewal book on the 1st of January, 2016.

Turning to investments, while the fourth quarter started off with a strong U.S. equity markets up more than 8% in October, the positive sentiment was temporary. In both November and December, markets refocused and things went back the other way.

Moving a lot of that was geopolitical tensions and global events all weighed on risk sentiments. In December, coincident with the continued decline in oil prices, the equity markets sold off, and we had some impacts to our portfolio. In fact specifically, weakness in the bonds and energy stocks have weighed on our relative performance.

As you know, U.S. energy stocks within the S&P closed down 21% for the full year of 2015. Having said that, our exposure to high yield energy bonds remain small, and our exposure to energy equities is predominantly in large multinational companies. Our portfolio was down 0.6% or $24 million in 2015, including foreign exchange, given the strengthening of the U.S. dollar.

Our net investment income for the quarter was $21.7 million, bringing full year net investment income to $85.6 million, down roughly 1.2% versus the prior year. Remember, the prior year comparison was impacted by the sale of a private property in 2014 that generated significant rental income.

Opportunistically, we've added some income for higher yielding corporate bonds to augment our book yield. The good news is that our investment income from our fixed income portfolio continues to grow, and it is overtaking all other items in net investment income, supporting growth in 2016.

Moving on to capital management, our philosophy has not changed, and it is not likely to. Our first use of capital is to support the balance sheet. Second is to have capital available for opportunities as they arise, and third is to actively return excess capital to our shareholders in an effective manner.

In 2015, we repurchased 575,000 shares of stock for $29.7 million at an average price of $51.58 per share. In total, over the last six years, we've returned more than $427 million or 25% of the shares outstanding to shareholders with $331 million returned through share repurchases, and $96 million paid in cash dividends. We will continue to balance the return of capital to shareholders with our priority of building the Argo franchise and shareholder value in the long run.

In summary, our 2015 results demonstrate our focus on driving efficiency and improving performance through our platforms. The underwriting environment remains challenging, but with our focus of specialty niches, profitable lines and profitable relationships, we're producing improved and more consistent results that will generate more stable returns for our shareholders.

With that, I will turn the call over to our CFO, Jay Bullock. Jay?

Jay Stanley Bullock {BIO 3644311 <GO>}

Thanks Mark and good morning everyone. I'll quickly provide some detail on the financials and then we'll open it up for Q&A.

Echoing some of Mark's comments, 2015 represented a record top line result for the company, but more importantly, a record underwriting result as well. We achieved the key margin target we've discussed often, five points of underwriting margin, despite the challenges of the marketplace. In addition, we furthered the groundwork in 2015 for continued improvement.

As it relates to revenue, a couple of items to note: as Mark mentioned, we reduced our participation on Syndicate 1200, which has the effect, all other things being equal, of reducing the amount of premium we report in this segment. This was achieved through the expansion of the strategic relationships we have with our Syndicate trade capital providers, we believe these relationships are an important long-term element of our strategy in this segment.

Second, our business in Brazil was up year-over-year, but the growth in dollars is masked by the devaluation of the local currency during the year. Of note, related to loss trends, the fourth quarter and calendar year 2015 continued to demonstrate overall favorable reserve development from prior accident years. For the quarter, we experienced net favorable development of $17.1 million, compared to $11.3 million reported in the fourth quarter of 2014.

In the 2015 fourth quarter, we had favorable development in all of our ongoing business segments. The largest component of this quarter's positive development were from our Syndicate and E&S businesses. For calendar year 2015, favorable development in total was $32.4 million, compared to $37.7 million in 2014. As always, all the relevant figures on loss development are displayed in the table in the press release.

In addition to that continued trend and positive reserve development, and as significant, we saw an improvement in our current accident year non-cat loss ratio, from 56.4% to 57.3% in 2014. This result was achieved, despite the impact in the fourth quarter, of a few large losses impacting both our E&S and Syndicate 1200 segments. Such losses totaled $4 million and $9 million respectively by segment, and were the main contributors to the modest increase in the current accident year loss ratio for the quarter. The E&S loss was in our property business, and the losses in the Syndicate stem from energy-related losses.

Catastrophe losses that impacted our business for the quarter were $5.2 million, compared to $3.8 million in the fourth quarter of 2014. The quarter's cat losses were primarily due to U.S. storm activity.

For the year 2015, cat losses were $23.7 million versus $17.7 million in 2014. Losses for the 2015 year stem largely from U.S. storms, the Tianjin explosion and several smaller international events.

Of note related to expenses, for the year, the trend in our expense ratios continued to show improvement. As mentioned in the quarter, expenses were once again impacted by the effect of the increase in the stock price on certain equity related compensation. Such effect accounted for approximately $7 million of expense, above what would have been expected in the quarter. We've made certain changes to our equity compensation program that should have the effect of lessening the volatility related to movements in the stock price in the future.

Two other items of note, realized gains in the quarter were modest, reflective of the turbulent conditions in the investment markets. You will recall last year's quarterly results included a significant gain from the sale of the investment property in California. In addition, currency gains for the year are reflective of the significant increase in the value of the dollar, relative to the British pound, Euro and Canadian dollar. Generally speaking, there is an equal decline in the value, impacting our equity account, related to investments held in such currencies.

For the fourth quarter of 2015, the effective tax rate for the group was 6.8%, lower than our assumption of 20%. In the quarter, the lower tax rate reflects foreign exchange translation adjustments at the Syndicate that are not recognized locally and not taxed in the UK. For the year, the tax rate was 8.1%. In addition to the non-taxable foreign exchange items in the UK, the lower effective rate was impacted by certain foreign tax credits as state tax refund in the first quarter and to a larger portion of our earnings in 2015, attributable to the Bermuda platform.

Finally on the balance sheet, we ended the quarter with a pre-tax unrealized embedded gain of $84 million, down from $100 million at September 30, 2015. This decline was largely related to wider spreads in U.S. corporates and municipals, movements in foreign exchange, related to certain currency derivatives, and the realization of previously unrealized gains from the sales and equity position.

Operator, that concludes our prepared remarks, and we are now ready to take questions.

Q&A

Operator

. The first question comes from Greg Peters with Raymond James. Please go ahead.

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

Good morning. Congratulations on your year. Jay, in your comments, you spoke about the tax rate, and I think this is the second or third year, where the tax rate for the full year has come in below, sort of the bogey we've used in our model, which is 20%. And I am wondering if you are prepared to – as we look to 2016 and 2017, if you are prepared to lower that assumption from 20% to something less than that.

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

Greg, we look at this often, and do consider if the model is changing. But there have been some one-offs in the last two years, and I think we'll stick with our 20% assumption for now, and you kind of look at the math across the platform, it still seems to be a reasonable position to come out.

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

Yes.

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

Okay.

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

If I can just add to that, I think that a lot of it will also have to do from where growth comes prospectively. If you see our business growing more rapidly outside of the U.S., so in the Syndicate and/or International Specialty in particular, then that might impact the tax rate. But right now, I think growth is pretty balanced across the whole group. So I think 20% is probably still the right number.

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

Thanks for the clarity there. You mentioned some energy investments, I guess, minimal exposure in the high yield component for energy, and then some energy equities. I suppose, when you add those two components up, still your energy exposure is immaterial relative to the total portfolio.

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

Yes, I mean look, we invest in large cap companies, some of which are energy companies. We are slightly overweight energy and have been for several years, and so that's the only reason that we mentioned it. But when you add it all up, it is immaterial relative to the entire portfolio.

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

Mark, maybe can you spend a minute and just talk about the other side of the energy business, which would be bad on your insurance book? Where you might have some exposures or premium coming from energy related coverages, and how that might be affected as we think about 2016?

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

Well, I think the primary exposure is just an unwillingness on our part to ensure, this is where the rate continues to decline. We are comfortable with how the businesses that we insure are performing; it's just that the market has gotten very soft. So we haven't really added much energy exposure. Perhaps, there are a couple of accounts in London. But for the most part, our exposure has been flat to down because of market competition.

The only place that I can think of and Jay can comment more about this is, is surety. But we just got through going back through the entire portfolio again, and I think we are all pretty comfortable with the accounts that we insure there as well.

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

I think that's right, Mark. I mean, that's been a focus of our surety team for over the last 18 months. And I think that speaking – on behalf of the team, I think they recognize this pretty smart group of people when it comes to that business relative to sureties.

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

Yes. And in fact, if I had to pick the one place where I think we will grow our energy exposure this year, it probably is the surety business. And as Jay said, that's an large part, because we have such a good team.

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

And Mark, just to follow-up on that, when I think about that component of your business relative to the total premium, are we talking single digits, or is there something bigger than that in terms of percentage?

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

Sorry, Greg, are you referring to the entire organization?

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

Yes. I mean, we have four business segments. I assume you have some energy running through excess and surplus, the surety business, I believe we are on to specialty, yes-

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

Yes. When you add it all up, it's less than 10% of our premium.

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

Yes, that's what I imagined. So you now generated some very strong results improvement year-over-year for a couple of years now. So Mark, maybe you can spend a minute, outlining what kind of objectives we should use as a benchmark of your performance, whether it's in terms of combined ratio improvement or ROE improvement, as we think about 2016.

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

Yes. So we've improved our underwriting results and our operating results for the last four years in a row. At the beginning of 2015, our target was to get to a combined ratio of 95%, and both Jay and I were very particular about saying that, we weren't going to focus on just expense ratio improvement, but we wanted to see underwriting improvement as well. And if you look at our loss ratio for 2015, ex cats and prior year development, I believe it was 100 basis points better than the year before. So we actually did see improvement in both the expense ratio and the loss ratio on an accident year basis.

I think that as I said in my remarks earlier that a lot of the investments that we've been making over the last few years are now starting to pay off both in terms of product development, how we run our business, the technology supporting our business. And so, we believe that we've got a better product set today than we had a year ago or three years ago. We certainly have a better team today than we did three years ago. We have better systems to support the teams and the products. And given that a lot of what we do, particularly the investments that we've made recently have been focused on smaller accounts that are less price sensitive. We think that we are in a really good spot to keep moving ahead and improving our margin. So we'd like to think we can get another 100 basis improvement in combined ratio year-over-year between 2015 and 2016 in the market that we are in today.

And so, we think there is an opportunity to keep improving margin. We think we can grow the top line in places where we want in 2016, and I am actually – I am in a better frame of mind today than I have been in the last five or six years.

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

Thank you very much for the call and for the answers.

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

Thank you.

Operator

The next question comes from Dan Farrell with Piper Jaffray. Please go ahead.

Q - Daniel D. Farrell {BIO 4935961 <GO>}

Hi, and good morning. Jay, I missed it in your comments; I think you highlighted some large loss activity in the quarter. I couldn't hear if you had quantified what that impact might have been relative to a normalized (26:07) year ago. Is that something (26:09)

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

Well yes, I did say that the large losses in E&S were about $4 million and the large losses in Syndicate 1200 were about $9 million. The first was property related, the second was energy related. So that was part of what drove the change in the current quarter, but we had some improvement in some other areas.

So, relative to last year, it was a smaller component of large losses – sorry, a larger component of large losses this calendar year than last year, but not really that significant for the overall year. I think the more important thing to focus on is the improvement over 12 months, which as Mark pointed out was 100 basis points for the year. Large losses are going to happen when they happen, and for the year, obviously came in line with our expectations; otherwise, we wouldn't have seen that improvement in the current accident year.

Q - Daniel D. Farrell {BIO 4935961 <GO>}

Okay, great. And then also if you could expand a little bit more on some of the efficiency effort that you made, probably so you've been (27:19) spending stuff on talent and also people as well, actually. How should those benefits flow through the results? Do we start to see it as any further expense improvement; does it impact loss ratio through lower loss adjustment expense? How should that be flowing through the benefits of all those things that you've been doing?

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

So, it's a combination of things. We've made it easier for our clients to do business with us. So that's increasing the top line. We have a much better line of sight today on risk selection. So that's improving pricing, where we – to say differently, I think we are more accurately pricing our risk today than we were a few years ago. So I think that shows up in a better loss ratio, both in terms of price and risk selection, and also portfolio mix.

It doesn't take as much resource to run our business today as it did before. So that's a benefit to the expense ratio. And I think we have started to see some of these things play out in 2015, and I think we'll see a little more of that in 2016. So in summary, I think we'll have an improvement in top line percent businesses. I think we'll have an improvement in both the loss ratio and the expense ratio as we continue to do a better job of selecting risk and do it more efficiently.

Q - Daniel D. Farrell {BIO 4935961 <GO>}

Great. Thank you. And just one last sort of numbers question: fixed income (29:15) seems to have stabilized, improving slightly. I wonder if you could just talk about new money level, how you think about the trajectory of outline as we head forward.

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

Yes, well, you're right; it has stabilized, and I was thinking about this yesterday, if I hadn't pulled up the screen, and seen the 10 year at 1.75%, I would have said it's stabilized and starting to move up. It should start to move up incrementally, based on an increase in investment balances. But you tell me what yields are going to do; they seem to be retreating back to crazy low levels.

So I think you'll see it – I expect to see it maintain sort of a flat level for now, with very modest increases as we start to see investment balances. As Mark mentioned in his comments, there have been some efforts to put some higher yielding, and not necessarily that much lower and credit quality higher yielding investments into the portfolio, but in very modest amounts, relative to the overall size of the portfolio.

Q - Daniel D. Farrell {BIO 4935961 <GO>}

Okay, great. Thank you very much guys.

Operator

The next question comes from Meyer Shields with KBW. Please go ahead.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Good morning. Can I start in the Syndicate, where underwriting expenses sort of jumped up sequentially, despite the fact that there were the large general fee losses and for a higher loss ratio, so can you clarify that a little?

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

Well the energy losses and the expense ratio aren't related. The energy losses were just a frequency of large events, more than we would normally expect. And as you know, things can be lumpy from one quarter to the next at Lloyd's and in our Syndicate.

The expense ratio was higher, because we have a different mix of business this year than we did a year ago. We have – so we are paying more acquisition expense. We have a little less open market brokerage, and which comes at a lower acquisition expense. You are correct in assuming that we should expect to correspondingly lower loss ratio. But with the preponderance of large losses in the quarter, it went the other way.

Jay, do you want to add anything?

Q - Meyer Shields {BIO 4281064 <GO>}

Okay.

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

No. The other thing I'd add is that, expenses in the Syndicate can be a little lumpy, because-

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

Yes.

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

-the timing of certain Lloyd's cost is – I want to call it unpredictable, but it can come in different quarters, and there was a bit of that effect in the fourth quarter as well.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. But there was no incentive comp impact from the higher large losses? I guess that's what I was alluding to early on.

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

Well, the incentive comp relative to large losses – the incentive comp is related to share price, not large losses. And yes, there was more equity compensation expense this year than a year ago both for the quarter and for the year. That's a good point.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. And if you take a step back, obviously, you've had very, very strong underwriting equipment for a few years. How is that impacting required capital?

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

Well, my esteemed colleague is sitting beside me, and I always have a different point of view. If you look at our capital model, our internal capital models, I didn't mention the use of capital as an efficiency, but actually, we've been able to grow our portfolio, and not really need any more capital, which is why we've been giving back capital over the last few years.

I think we've done a very good job of efficiently using our capital for underwriting purposes. And I didn't mention this earlier, but in my opening remarks, I talked about how much capital we'd given back, but I didn't actually talk about return on capital.

In 2013, our return on capital was 9%. Last year, it was 11.5%, and this year, it was just shy of 10%. So, I think that we have a little excess capital, and so now we will figure out what to do with it.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. And then, a final question for Jay if I can; I know it's very complicated, but in the past, you provided rule of thumb relating change in the share price compensation expense. Is there an updated number based on the changes that you've made?

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

So my rule of thumb in the past have been every dollar yields $1.5 million to $2.5 million of additional expense in a quarter. And we sort of had always anticipated the stock going up by 2% to 2.5% a quarter from a planning standpoint.

The changes will be incremental over time, but what I would expect is that we'll land sort of at levels that looked kind of like less than the $9 million that we saw on the quarter, but more than what was planned kind of somewhere in the middle, relative to the changes that we've made.

So, that's the dampening of the affect. Obviously the expense doesn't go away. It's important to point out as well that there's no economic impact to the ultimate recipient of the securities. It's just, we have changed some of the structure that allows us to account for it differently, and that should give us more of a middle of the road kind of outcome.

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

Yes. I think at the end of the first quarter, we can give you more visibility on what that number is really going to look like. But let's say, it's half of what it was in 2015.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, fantastic. Thanks very much for everything.

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

Okay.

Operator

. The next question comes from Jeff Schmitt with William Blair. Please go ahead.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Hi. Good morning everyone.

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

Good morning.

Q - Jeff Schmitt {BIO 19747235 <GO>}

The E&S segment obviously showed a lot of good growth. Are you seeing any drop off in the first part of the year from lower economic activity or construction activity?

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

We're not seeing any drop off – sorry, let me answer that in two ways. Our E&S segment continues to grow. It continues to grow in the segments where we've been focused. And actually one of them is construction. But I think that has more to do with our team and how they approach the market rather than the economic conditions.

As I mentioned earlier, I think the energy business is the biggest place where we are not seeing growth. If I kind of move away from E&S and think about Brazil or the Syndicate, then the economy, and engineering and construction in particular, are declining portfolios for us by choice.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. And the Commercial Specialty segment obviously shown a lot of improvement over the last couple of years. The expense ratio down 350 basis points; is that - to 32% - is that a sustainable level was last year just high for some reason?

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

I would say that there was a one-time tax benefit that we had in Commercial Specialty during the year. I think that for 2016, our expense ratio for the year will be a bit better than it was in 2015. But I don't think we should expect it to be as good as the fourth quarter, because we had a one-time tax benefit that helped the expense ratio.

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

One other item that's been affecting Commercial Specialty, that is where our surety sits.

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

Yes.

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

Surety, as a rule of thumb, is going to run up expense ratio of somewhere between 55 and 60-

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

Correct.

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

-a loss ratio of 20 to 30. And so as that becomes a larger component that would creep up. All other things being equal, we're going to generate more underwriting income, which is what we're really focused on.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. Thank you.

Operator

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

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

Thank you. I would just in closing, like to thank all of my colleagues at Argo for 2015. They put in a lot of hard work and it's starting to pay off in certain parts of our company. And I'd like to encourage them to keep moving on, and if we can show the same progress in 2016 than we did in 2015, I think we will have built a terrific company. And I look forward to talking with you all at the end of the first quarter about our progress in 2016.

Operator that concludes my remarks.

Operator

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