Argo Group International Holdings Ltd at Raymond James Institutional Investors Conference

Company Participants

- Mark Watson, President, CEO

Other Participants

- Greg Peters, Analyst

Presentation

Greg Peters {BIO 3111497 <GO>}

Good afternoon. Continuing on with our afternoon schedule, I'm Greg Peters. I cover insurance, insurance brokerage. And technology companies for Raymond James.

It's an honor for me to introduce our next presenter, Argo Group. I've been following Argo Group for 15 years, I think, a long time. And over that period of time, this company has demonstrated a remarkable record of value creation, not only in book value growth but shareholder returns through stock ownership.

So I'm very pleased to have them present and participate again at our conference. From management today we have Susan Spivak, who serves in an Investor Relations role; Jay Bullock, the CFO; and Mark Watson, who's President and CEO. So let me turn it over to Mark.

Mark Watson {BIO 1463509 <GO>}

Thank you, Greg. Good afternoon, everyone. It's late in the day. But hopefully we can have a little bit of fun talking about how things are going at Argo.

What I'd like to do for the next 30 minutes or so is to tell you a little bit about who we are for those of you that don't know much about us. I'll try and drill into each one of our business segment a little bit. And then I'll leave time for questions. And hopefully I can come up with some good answers to those questions.

Just in case we talk about the future a little bit, if you all could just read this for a second or read it later. Everybody's got a hard copy of the deck. It's in there. Okay.

So who's Argo Group? Argo Group is a -- we're a holding company that own and operate insurance companies around the world. And we have one reinsurance company in

Bermuda. Our premium last year was about $2.2 billion. Our capital is sitting at about $2.2 billion. And our market cap is -- well, the other day it was about $2.1 billion. Now it's just slightly less than that. But we'll take it.

We're pretty happy with our share price. We actually traded at an all-time high last week. So everybody was pretty happy about that. And also, we recently just announced that we'd raised our quarterly dividend by 23%. If you've been a shareholder for the last seven years, we've increased our dividend I think about 3X over that period of time.

We're a specialty underwriter. We focus primarily on small commercial accounts. But we also write large commercial accounts. And we do it through four different business segments. The most popular and common that you've probably heard associated with our company is our excess and surplus lines business here in the US.

We also happen to have one of the 10 largest syndicates at Lloyd's. I'll talk more about that in a little bit. Sorry, we haven't updated this slide. We acquired one of our competitors recently. And that's kind of put us into the top 10 at Lloyd's. We also have one of the largest Bermuda insurance platforms as well. And I'll talk more about that.

But I think what you'll see when you look up there is a pretty broad spread of risk by product type. It's primarily property and casualty. But the fastest growing bits would be our specialty liability and our other specialty segment.

And as you can see, for 2016 93% of our premium was insurance. 7% was reinsurance. With the acquisition that I'll talk about more in a minute, you'll see that that number may move up to about 12% and then come back down to 10% of our total premium.

I mentioned a second ago that we're a specialist underwriter. And I think the easiest way to say that is we're not trying to be all things to all people. That sums it up, right? Now you know what a specialist underwriter is.

Okay. So let me actually be a little more serious. We try and focus on just participating in some markets or some industries. When you look at our company or our competitors, when we say we're specialist underwriters, we all focus on different things. And so, if you kind of peel back where we all focus, it's all slightly different.

And for us, it's being involved in businesses where we really understand our customers or we really understand the markets where we operate. And we think that we can really select through and make sure that we can not only select the right risk. But also provide the right service for our policyholders where they need it, whether it's helping them mitigate risk on the frontend through some of our safety and risk management services, or help them mitigate loss once a claim has happened through our claims organization.

While I mentioned that many of our policyholders, in fact most, are pretty small and therefore don't have a lot of claims, we also have a lot of very large Fortune 500 type policyholders. And for them, it's not a question of will they ever have a claim. It's how many claims are they going to have during the year and what can we really help them do to keep them from ever happening or mitigate the loss once they've occurred.

I think we've done a pretty good job, as you'll see in a minute, of growing the company both through acquisition and organically over more than one market cycle. And I think you'll see a fairly steady growth rate with one exception, when we hit the reset button in 2010 to really take stock of all of the risk that was on our balance sheet.

I think you'll also see that we've hired some very talented people over the last few years. In our industry, there has been a fair amount of consolidation over the last few years and a fair amount of restructuring. And we've had the benefit of picking up people that just didn't think that going forward they were the right fit at one of those companies.

And you'll also see later in my presentation that we've done a pretty good job, I think, of managing the capital structure of our company over that period of time. And when you add all of those things up, it's led to some pretty good value creation. And I'll show you a slide on that in just a minute.

But first, let me just -- let me kind of paint a picture or tell a story of how things have evolved at the company over the last dozen years or so. Greg mentioned that he'd been covering our company for about 15 years. I've been involved in the company either as an investor or a director or the CEO now since 2018 (sic).

So this is kind of our track record since I became CEO and we restructured the company at the end of 2002. It also began the transition and growth into a specialty company and away from more of a general insurance company. In fact, the original part of the company, which was called Argonaut Insurance Company, was primarily focused on large account workers' compensation business.

And if you look at the gray in the first four bars there, you'll see they stop at the end of 2005. That's because we actually sold the business that started the company in 2006 to another competitor.

Earlier I mentioned that the largest -- or the most common part of our business is our excess and surplus lines operation. And so, that's the dark blue bit. And you'll see that it grew quite nicely from the time that we picked it up in 2001. Sorry, we bought it in 2001. So you'll see 2002 is the first year.

So we grew quite nicely from 2002 to 2006. And then declined slightly in 2007. Well that was the top of the hard market. And since then, you've seen a decline. And it bottomed out in 2011. And then we kind of have been slowly moving ahead since then.

And that's been for two reasons. One, market pricing hasn't been as robust since it was in 2006 and 2007. It's a little better today than it was in 2011. But not much. And also, we've been changing out our portfolio.

So what you'll see in a minute is that, while the premium hasn't grown that much, it's been high single digits, underneath that the pieces that we really think are good have been growing at double digits. And we've been letting go some of the business that we didn't think we had the margin. And the result is today we've got 5 to 10 points of margin more than we did back then, depending upon the line of business that I'm talking about in particular.

The second part of our US business we refer to as commercial specialty. And it's kind of hard to see here. But really the last few years that's taken off. And also the last few years, we've really had a huge turnaround from the underwriting results of 2010, 2011. And 2012 that were not so spectacular. And I'll get more into the numbers in a little bit. But you'll see that the combination of those two make up a little more than half of the premium for the US -- I mean for the company as a whole.

Then the next bit you'll see is -- you'll start seeing a little bit of green in 2007 and then a fair amount since then. That's our international business outside of Lloyd's. And that is primarily our business underwritten in Bermuda, which is both reinsurance and insurance, as well as our operation in Brazil, which we started in 2011.

Then, of course the purple bit is Lloyd's. I mentioned a minute ago that we kind of took a reset button -- or hit the reset button in 2010. So if you look from 2002 to 2009, we grew a huge amount. About 65% of that growth was from acquisition. 35% of it was organic.

And so, we wanted to just take a step back and really look at what was on our balance sheet and make sure that we were really getting paid for the risk that we were putting on our balance sheet. And so, that led us to kind of right sizing some of the premium.

We were making money on a margin basis. But if you looked at how much capital it was consuming, it just didn't -- it didn't sense where market pricing was at the time. Since then, things have improved. And you've seen that we've added a bit more premium and, of course, margin has improved with it.

And I would say also since then 95% of our growth has been organic. And I say that to make the point that I think we're good at switching gears. It just depends on where market pricing is, where asset prices are. Sometimes we'd rather be a seller than a buyer. And sometimes we'd rather just move ahead and grow organically.

I mentioned at the beginning of my remarks that we acquired one of our competitors recently. The name of the company was Ariel. It's based in Bermuda. It's predominantly a reinsurance operation underwritten in Bermuda. It also has an insurance business in Bermuda as well as a specialty insurance operation in London and in the US.

And we thought this was a really nice fit with our company. It gives us a bit more size and weight in Bermuda. We're not changing what we do. Both our portfolio and their portfolio was primarily focused on property cat reinsurance. As there has been more consolidation in the marketplace of both underwriters and brokers, this kind of gives us a chance to level the playing field a bit with the brokers. So to speak.

Because the reinsurance market and the retrocessional market -- that's the reinsurance of reinsurance -- has got tons of capacity today and we think will for a while, we've been able to lay off all of the additional risk of this transaction to the markets. So on a net basis, our exposure isn't really going up materially from our property cat reinsurance portfolio.

And the other cool things about the acquisition are, second, it gives us enough scale in London, because all of this is underwritten through their syndicate at Lloyd's. So we now have two. Third, we've picked up some very talented people to complement the people that we have. In fact, of the top eight people at Ariel, six of them will be taking on significant and leadership positions at Argo.

And lastly, they've got some really good data -- or I should say I've got one more thing. So they've got some really good data that goes along with what we've got. And as much as we like our systems and our data, we think theirs are, on the margin, a bit better. So we're looking forward to rolling out stuff onto their platform. Sorry, when I say our stuff, I mean for our reinsurance business.

And also, their insurance business in Bermuda is very complementary with our insurance business. So we'll be combining that together. And so, literally we're had all the reinsurance people move from our building up to Ariel's building. And all the insurance people have moved from Ariel down to the Argo building in Bermuda.

So we're really happy with the market presence that this gives us. Because we're not bringing too much new into the company, it's an easier integration than other things that you've seen. No integration is easy. But on a relative basis it's an easier deal.

So we think this gives us a lot more presence and a lot more size and weight both in the Bermuda marketplace and in the London marketplace. And while it's shown up here as another bit, that doesn't mean we're now going to have five reporting segments.

In the Q&A, you can ask Jay where this is going to fit in our SEC statements going forward. I'll give you a hint. He's still trying to figure it out . Okay.

So this is a little bit more about us at kind of a broad level. The top left doughnut is just a carryover from the slide that we were looking at a minute ago. And then you can see by product. This is just a little bit more of a breakdown from the product slide you saw a minute ago.

And you can see a lot -- a pretty good spread of risk by product and around the world. If you look down below, you'll see that about 60% of our risk is originated in the US. That was up from 55% a year ago. That's just because the US grew quite a bit.

You'll see that change this year with the Ariel acquisition coming on in 2017. And again, you'll see the -- again, just to make the point in the bottom left, that we're still a reinsurance -- I mean an insurance company, not a reinsurance company.

Don't try and read everything on this slide. This is just to let you guys know that we've got a really broad distribution platform. We distribute our products through independent agents, small brokers, large brokers, small wholesalers, large wholesalers, London brokers, London wholesalers, independent brokers around the world where we operate on a local basis, particularly in Brazil, the Middle East. And Asia.

And if you look closely, also it's kind of broken down by product. And I'll talk more about that as I go through each one of the business segments in a minute.

The last thing I would point out at a -- for the moment at a group level is just kind of what this all means financially. Well for us, we think the best way to evaluate our company is our growth in book value per share and, equally important, the consistency in growth in book value per share.

And you'll note that since 2012 it's moved up pretty well sequentially, with the exception of 2008 and 2011. In 2008, you'll recall that we had a fairly large hurricane hit Galveston. And you'll also recall that we had the beginning of the financial crisis. But you can also see that by 2009 we more than made up for it.

Then again in 2011, in 2011 there were a number of natural catastrophes to hit around the world, both in the US and outside the US. In fact, it was so many that I don't remember them all, other than the earthquake in Japan and the flooding in Thailand. But again, you'll see that we moved up pretty nicely the year after that.

So the sum of all of that, since 2002, is growth in book value per share plus dividends that we pay to our shareholders of about 10% on a compounded basis.

Just a few more numbers to go through. Since 2002, our gross written premium has gone from a little over $600 million to almost $2.2 billion in 2016, or a growth of 3.5X. Earned premium grew by 3.7X.

Assets didn't grow quite as much. That's great. That means we're using our assets more efficiently. Invested assets grew by even more, 3.7X. Shareholders' equity grew by 5.5X. And book value per share grew 3.4X. That's because we did issue some stock when we bought the company in Bermuda in 2007.

If you want to just break things down by business segment for the minute, you can see that year-over-year our top line grew in all of our segments but international specialty. We did pull back a little bit in our reinsurance business because rates were not as robust as we would have liked. And also there was a decline in the real, which impacted, on the dollar basis, our premium in Brazil.

So let me talk about each one of our business segments in a little bit more detail. Again, first the most well known of our business segments is our excess and surplus lines business. Again, you'll see a pretty broad set of risk by product type.

For us, 90% of our policies are $1 million in premium or less. So to translate that into -- I'm sorry, $1 million and less in policy limits. And to translate that into premium, we're talking about thousands of dollars, not hundreds of thousands of dollars.

So it doesn't have a lot of volatility from year to the next. It's got some. And if you kind of look at our combined ratio you'll see that it's moved up and down over that period of time. But it's kind of hovered in the high 80%'s to low 90%'s depending upon the year. And the two variables to that have been how much cat activity there's been in the US and/or how much positive prior year development we've taken down from our loss reserves.

The thing that I like to point out is, when you go back to the year -- to 2007 on the far left where we made a fair amount of money, two-thirds of that came from our investment portfolio and only a third came from underwriting income, okay? That's primarily because interest rates, on average, were twice what they are today, or at least our dividend yield was twice -- excuse me, the interest income we were getting was twice what it is today.

And also, we've improved our -- and of course, today it's gone down. But we've also improved our underwriting margins. And so, that's kind of -- we're pretty excited about that. So today we're generating pre-tax operating income almost equal to the peak of the market back in 2006 and 2007. And again, you'll see the premium that we talked about a little bit earlier in the bottom right.

Some other things to -- some other characteristics of this portfolio, it is entirely underwritten through wholesale brokers in the US. Most of them are the smaller independent wholesale brokers by count.

We trade with all the big guys. And on a premium basis they do make up the majority. But in terms of just number of relationships that we have, most of that is driven by some of the smaller, more independent wholesalers that we've had relationships with now for decades.

All of the business is underwritten on a monoline basis, meaning we offer one line of coverage at a time, which is the opposite of our next segment, which I'll switch to, our commercial specialty segment.

For our commercial specialty segment, we're trying to offer packaged policy solutions a little more directly to business owners. I mentioned in my opening remarks that we try really hard to figure out how to provide risk management services to our policyholders to hopefully prevent losses from occurring and/or use our claims organization to mitigate risk.

And this is really true in this business segment with a couple of exceptions. And that's our professional liability business and our surety business. But otherwise, if we can't issue a number of lines of coverage where we can really help the policyholder, then we tend to kind of shy away. And as we move ahead, we're even joining up the surety and/or the professional liability in some cases here in the US and in other parts of the world.

Just some other things about our commercial specialty segment, you'll see, as I mentioned earlier, 2011 and 2012 were not really good years for commercial specialty. That had to do with one of our business segments that we restructured subsequent to that.

And you'll see today that the pre-tax operating income was equal to, or just about equal to, our excess and surplus lines business. And actually, we generated more underwriting income in commercial specialty in 2016 than we did in our excess and surplus lines business.

By the way, that's not a knock on E&S. That's just how good commercial specialty did in 2016. And again, you can kind of see better here than you could in the other bar chart just how quickly this business segment is growing.

So if I go outside the US and I focus on Lloyd's for a minute, Lloyd's is a pretty important part of who we are, particularly outside of the US. We really rely upon the Lloyd's infrastructure for our business, not just in London but also in the Middle East and in Asia. The only place where we're really operating directly is Brazil. And I'll come to that on the next slide.

Again, if you look on the top left-hand side, you'll see a very broad spread of risk. We have I think one of the -- well, I won't say one of, the more diversified. But if you look at kind of the top 10 or 15 syndicates at Lloyd's, you'll see a similar set up, with the exception that we have no property cat reinsurance business in our syndicate. We have it all in the Bermuda segment.

And if you go back to the previous chart about growth in book value per share, you'll recall that I mentioned that 2011 was a down year. Well here you go. So we took most of our lumps in the syndicate; to a lesser extent in the international segment.

But as you can see, the last few years it's done pretty well. And I'll show you another slide in a minute when we get to loss ratios. And you'll see that it's clipping along nicely. We didn't grow too much the last few years. Ironically, even though the market's more competitive, I think we might actually grow a bit more here.

So the last segment, international specialty, again, all the cat activity in 2011. You can see that we've sequentially moved up in net income, notwithstanding that the top line hasn't really grown. So again, we've been more focused on building margin and changing out low margin business for high margin business. And you can see this here. And again, a pretty good spread of risk.

So here are the numbers for the full year. We finished the year with a little less underwriting income than last year. That's because there was 2.5 times more cat activity this year for us than a year ago. Every company was a little bit different. But we still finished the year in a pretty good spot with a combined ratio of 96%.

If you strip out the cat activity and positive prior year development, we actually finished this year better than a year ago. I think I have another slide in here in a minute that gets to that.

So the investment portfolio, it's $4 billion in -- a little over $4 billion in AUM. A little over -- about $3 billion of that is investment grade fixed income. The other $1 billion is what we refer to as our capital appreciation portfolio, which is a combination of public equities, private equities, hedge fund strategies, mainly credit strategies. And a few other things, high yields being one.

So we had nice returns in our portfolio this last year. And we think it's actually pretty well balanced. I think it's going to be hard to repeat 2016 in 2017. But we're going to try.

Capital, that's the last thing I want to talk about. So since 2010, we've repatriated about $0.5 billion. If you rewind the tape, prior to that it's more than $0.5 billion. And what I also like to tell people is the amount of shares that we've bought back in the last few years have equaled the amount of shares that we issued to buy the Bermuda company and then fund all of our international business over that period of time. So I just use those as a few data points to think about how we manage capital.

Our share price performance has been pretty good over the last couple years -- or last three years. We've outperformed both the S&P 500 and our peer group. But as you can see, there's still a little bit of a gap between where we trade as a multiple of book and where our peers trade. We think that's the opportunity.

So why Argo? Well I think that all the big changes that we were trying to make we have now made. I think we've got a really good underwriting team. I think we've got a really good portfolio. Our loss ratio, absent cat, absent positive prior year development, for 2016 was a 54%. I'm not sure how many of our competitors have a 54% loss ratio. But I'll take that any day.

And we don't have that much financial leverage, notwithstanding the acquisition that we just made. It's just a little over 20% of total capital. And I think we started 2017 in perhaps the best place we've ever been.

And on that note, I'll stop and answer questions.

Questions And Answers

Q - Greg Peters {BIO 3111497 <GO>}

Okay, we have time for just one question. And I'm going to do that part. So just from an industry perspective, we've seen a couple companies take some high profile charges. What's your view on industry reserves and how Argo fits?

A - Mark Watson {BIO 1463509 <GO>}

Well we've had 13 years of positive prior year development. We haven't had any of those hiccups. But from one business to the next it moves a little bit.

But look, you're going to see that right now in the market because pricing is getting a little low, or has been. And so, I think you're going to continue to see that from one company to another. But if you see it once, you may see it again.

Q - Greg Peters {BIO 3111497 <GO>}

Yes. All right. Well thank you very much. We have a breakout in Cordova 6. Thank you, Mark.