Q2 2019 Earnings Call

Company Participants

- Axel Schmidt, Chief Underwriting Officer
- Brett Shirreffs, Interim Head of Investor Relations
- Jay S. Bullock, Executive Vice President and Chief Financial Officer
- Kevin J. Rehnberg, President - Americas and Chief Administrative Officer
- Mark E. Watson, Chief Executive Officer
- Mark H. Rose, Senior Vice President and Chief Investment Officer

Other Participants

- Bob Farnam, Analyst
- Christopher Campbell, Analyst
- Greg Peters, Analyst
- Jeff Schmitt, Analyst

Presentation

Operator

Good day, and welcome to the Argo Group 2019 Second Quarter Earnings call. Today, all participants will be in listen-only mode. (Operator Instructions) After today's presentation, there will be an opportunity to ask questions. (Operator Instructions) Please note, that today's event is being recorded.

At this time, I would like to turn the conference over to Brett Shirreffs, Interim Head of Investor Relations. You may begin.

Brett Shirreffs {BIO 15817618 <GO>}

Thank you, and good morning. Welcome to Argo Group's conference call for the second quarter of 2019. After the market closed last night, we issued a press release on our earnings, which is available on the Investor section of our website at www.argolimited.com.

Presenting on the call today is Mark Watson, Chief Executive Officer; Mark Rose, Chief Investment Officer; and Jay Bullock, Chief Financial Officer. Kevin Rehnberg, Chief Administrative Officer and President of Americas, will also be available during the question-and-answer session. As the operator mentioned, this call is being recorded.

As a result of this conference call, Argo management may make comments that reflect their intentions, 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 call. For a more detailed discussion of such risks and uncertainties, please see Argo Group's filings with the SEC.

I will now turn the call over to Mark Watson, Chief Executive Officer of Argo group.

Mark E. Watson {BIO 20610831 <GO>}

Thank you, Brett, and hello, everyone. I would also like to add that Axel Schmidt, our Head of Underwriting will be with us for the Q&A as well.

Welcome to Argo Group's conference call for the second quarter of 2019. After the market closed last night, we issued a press release on our earnings, which is available in the Investor section of our website. As we measure shareholder value creation, we've made some real progress in our half year mark. For the first six months, Argo's growth and book value per share, plus dividends paid was 10.6%, and our annualized return on shareholders equity was 13.1%. While our underwriting results in the second quarter were disappointing, we are continuing to make progress on the strategic objectives we're focused on delivering.

I don't want to lose focus on an outstanding result in our US operations, which had record performance for the first six months. Let me share some details on our results, then I'll talk more about our strategy.

Our gross written premium in the quarter was $773 million, up 10% over our 2018 second quarter results. Similarly, at $1.53 billion, our year-to-date gross written premium is up approximately 9% of the -- over the prior year. The positive effect of that momentum was moderated by the effects of a number of loss items, which we announced a couple of weeks ago. The net effect of these was an increase to prior year loss reserves of approximately $22 million, or 5.2 points on our consolidated loss ratio, and an increase in our current year losses of approximately $10 million or 2.3 points on our consolidated loss ratio for the second quarter.

The prior year was concentrated -- the prior year development was concentrated in our Bermuda casually business unit, and to a lesser extent our European and London businesses within our international operations. Current accident year losses were energy and property related. All of this was partially offset by another modest reserve decrease in our US operations, and Jay will provide more detail on the nature of the losses and the specific actions we took in a moment.

While these loss items did adversely affect our second quarter results, this is a reminder that specialty insurance businesses is subject to occasional volatility, and we don't consider this to be any indication of a longer term trend. To the contrary, our Bermuda casualty business has a strong track record of performance and profitability over the long term. Over the past 10 years, this business has generated almost $600 million in gross written premium, with an underwriting profit of nearly $60 million. Despite the volatility this quarter, this business has generated strong double digit returns on capital during that period of time.

It's also well worth noting that the results in Europe and London are primarily related to businesses that we've previously exited, or we've taken aggressive remedial underwriting actions. It is also worth keeping things in focus. Even with this quarter's volatility, our year-to-date loss ratio is still at 61.3%, which I think in the environment we're in right now is a pretty good result. Our strategy of focusing on profitable underwriting and relationships, portfolio investment, and disciplined capital allocation, continues delivering value to our shareholders.

Our intent continues to be the evolution of a unique company with a meaningful breadth of products and differentiated businesses, across key markets, where our clients need us, and it makes sense. We are becoming a digitally focused specialty company, and where there are other opportunities, we take advantage of them. And we're doing just that as we continue to build competitive scale in each of our key operations. While our immediate interest is appropriately on well executed profitable performance quarter-by-quarter, we keep our eyes on the horizon. We're engineering a business that can prosper in a variety of market cycles, one that prepares for continued success a decade or more down the road.

Over the years, we've demonstrated through our loss ratios that we're good at selecting risk. We're now acutely focused on improving our efficiency, while maintaining our advantage in risk selection. We've discussed this as the natural necessary step in our long term strategy, which is the continued investment and technology to reduce cost, improve risk selection, and enhance customer experience.

Our net income this quarter was $28.8 million compared to $41.8 million in the second quarter of 2018. The quarterly loss ratio moved from 58.8% in the second quarter of last year to 66% in the second quarter of 2019. If we focus on the current accident year excluding catastrophes versus a year ago, the combined -- the loss ratio was 58.9% for the second quarter this year versus 59.3% in the current quarter. Turning our attention to the investment portfolio. The portfolio continues to perform well in the second quarter with the total return of just above 2% up approximately $100 million. Our total return for the first half of the year was 5.2%, up nearly $250, or $250 million, or to put it in perspective, on a percentage basis, we were up almost as much for the first half of this year, as we were for all of 2017.

Our chief investment officer, Mark Rose, will provide more detail on these results in his remarks in just a minute. But let me just say that the investment result was again a key contributor to the strong growth in book value per share, and the core investment portfolio. Investment income in the quarter was up to $33.3 million for this quarter versus $28 million a year ago. And this is driven by another stronger quarter from our alternatives within the investment portfolio. And again, Mark will get into that more in just a minute.

If I break down the business operations for a minute, let's talk a little bit more about the US first. As we continue to leverage technology in our US businesses, creating significant efficiencies, driving down costs, and enhancing customer service. Each consecutive quarter as we look at the targeted growth and the improvement in margins, the benefits of our digital investments becomes increasingly more evident.

With $454 million of gross written premium, the last quarter has been the highest second quarter in the history of our US operations. And with the year-to-date total of $864 million in gross written premium. It's our highest half year result as well. And I should also add, this was achieved by actually reducing headcount, and thus keeping our expenses relatively flat over that period of time.

As a part of our continuing strategy to focus resources on our best performing units, we moved our construction business out of its former home and casualty this year, creating the Argo construction brand, which we've now launched .

Two of our other units we identified four additional investment have again turned in strong results. Argo Pro grew by over 40% this quarter and Argo Surety was up 20%. Growth in Argo Pro was supported by strong rate increases of over 10%, and we're continuing to see that in the recent months as well. We also saw pricing improvement in many of our lines of business during the quarter, which gives me a lot of encouragement about our prospects going forward.

Talking about turnarounds in our US operations, I'd like to give a special thanks to, Ray Hall, our head of contract PNC and his team, who've excelled at turning around a business that only last year we had a lot of questions about. Ray and his team are a perfect example of how Argo can take focus and resources, and turn a business around in a short timeframe. And we saw this same transformation at Argo Insurance a year ago.

Our international results, as mentioned, were adversely affected by lost development in Bermuda Casualty, Syndicate 1200, and the European business .To address the loss development, we're working on remediation plan focused on two things. To improve our loss ratio, we're implementing rate and underwriting actions in Syndicate 1200 which we've been talking about for the last few quarters. And at the same time, we're closing unprofitable cover older relationships in our European operation .

To reduce expenses, we're also focusing on specific actions to lower acquisition costs in the Syndicate business. Over the past two years, we've taken deliberate actions to increase rates and improve our loss ratio. For example, in Syndicate 1200 we achieved a cumulative risk adjusted rate change of 9.3%. The DNF property business has seen the strongest increases, but we've achieved positive rate change across all lines of business in 1200, not just the DNF property book.

Through underwriting actions including business mix changes, appetite and cover-holder relationships for the management of those, Syndicate 1200 is better positioned going forward we believe. Similar actions were taken on our European business where the number of cover holders was significantly reduced during 2018 and 2019. And I'm happy to say the loss ratio from the ongoing cover-holder relationships is 17 loss ratio points better than the relationships that we terminated.

Finally, Syndicate 1200 has been executing a plan to reduce the acquisition costs through the mix in business and negotiations with our broker partners to reduce commission expense. Despite our losses on the international side, I want to point out that our international gross written premiums increased $27 million from $293 million in the second quarter of 2018, to $319 million this year, a gain of 9%. And again, much of this driven by the improving rate environment as compared to exposure.

I'd like to take a minute to talk specifically about technology. As you know, the velocity of digital transformation in our industry is increasing rapidly. Over three years ago, we established Argo Digital as a proof of concept along with our R&D team. Since then we've deployed a number of solutions that have increased our efficiency, underwriting accuracy, and risk management, all leading to accelerated sales velocity and profitable growth. Our digital teams have broad experience, both in the insurance industry itself, and in the kind of strategic digital conversion, that will allow us to take advantage of the rapidly advancing technologies available to us.

We're now ready to pick up the pace of our own digital transferring information, and we're looking in every corner of the company to make improvement. With the combined expertise of our digital teams, and our shared services partners, we're now working toward rapid and sustainable transformation that produces five results.

First, a company wide digital vision with clear financial impact across the group. Second, quality data, both internal and external, enhanced by data analytics at all levels, to strengthen underwriting accuracy, reduce our loss ratios, and improve profitability. Third, a strong lean underlying system and workflow capability. Fourth digitally driven processes, both internal and customer facing, and that increase profitability and support incremental growth. And fifth, significant reduction in outsourced costs.

I emphasize that in our digital evolution, we have no interest in merely layering digital products, or interfaces on the top of legacy analog processes. Our goal is to be digital from top to bottom in the future. We've started and we'll continue to reengineer all aspects of our business. We've started to implement machine learning and artificial intelligence more broadly, which I've talked about on previous calls, and we're now applying many of these tools to the solid digital solutions we have in place already.

Overall, our intense focus on transformation is showing immediate results across our business. One example that I want to focus on this quarter, is what we refer to as Argo Compass. It's the innovative online broker agent portal we developed to compete with the major casualty players in our industry. Our Argo Compass is one of the first products developed internally by Argo Digital giving our partner real time claims information, billing details and quick delivery of policy, and endorsed endorsement documents.

Although, such a service may now seem to be basic, even routine offering, our broker agent partners, and our larger risk manage insurers have reported that Argo Compass is, "one of the best online systems they've seen" from any carrier.

Now that we've pioneered, tested and refined our Argo Compass software, we're ready to extend this benefit to all of our partners not just the select few that were part of our pilot project. In the third quarter last year, we launched a similar portal for Argo Construction workers. And as we previously have talked about, we've improved calling time from days to hours, and now I'm happy to say that for some of all products, we've been able to take that from hours to minutes. These innovations significantly reduce the costs associated with older manual processes that took out much of our underwriters time and energy. Just as important, our proven technology should help us grow and retain the business that comes to us through our distribution partners.

And just to put things in terms numerically, cumulatively, since we really got Argo digital going, we've now written over $500 million of premium through Argo Digital. So to summarize, Argo's performance across the second quarter and the half year of 2019, our business has shown significant strength and agility in the competitive market and remain strongly positioned.

We believe the combined result led by our US Specialty operations continues to prove the value of our diversity in business lines, platforms, and geography. As a result of growing in target areas where we see the most profit potential, our business continues growing and our expense ratio continues to improve as we remain focused on scaling our business and managing costs.

While we always expect investment performance to contribute to our continued growth in book value, our goal is to achieve consistent results driven by underwriting income and to generate a 10% return on shareholders equity. And I'm confident that we have the right team in place with the right skill sets and experience to do that. We look forward to talking and updating you on our continued progress going forward.

And I'll now turn the call over to, Mark Rose, to talk about our investment portfolio in more detail. Mark?

Mark H. Rose {BIO 1557365 <GO>}

Thanks, Mark, and good morning. Turning to investments, the second quarter total return was up 2% or approximately $100 million. It was a strong continuation of the first quarter rally, bringing our first half 2019 total return to 5.2%, up nearly $250 million. This compares favorably to second quarter 2018, where we were up a 0.5% and flat year-to-date in 2018.

A year ago in the second quarter, we were speculating on how much more the Fed could raise rates. The US 10-year hovered around 3% percent, the treasury curve was flattening and corporate spreads were widening. Fast-forward 12 months to second quarter 2019, the speculation was on when the Fed would cut, how much the Fed would cut. The US 10-year was at 2% at the end of the quarter, and corporate spreads were well off their highs getting closer to their tights historically. In the second quarter of this year, the financial markets generally higher, with the S&P of 4.3%. The corporate investment grade bond market on a longer duration was up over 5%. And the US 10-year Treasury made up most of that return up 4.4% and in ending the quarter right at 2%. Small cap stocks in high yield were up, but to a lesser extent.

Generally, the only read on my Bloomberg screen for the quarter was an oil related stocks in the British pound sterling. For Argo Group, our core bond portfolio was up 1.8% in the second quarter and 3.8% for the first six months of 2019. Our risk portfolio, which is a mix of equities, high yield debt, and alternatives, was up 3.3% for the second quarter, and 12 % year-to-date.

Supporting this strong performance was our equity portfolio up over 19% year today and our high yield credit portfolio up over 8% year today. Also driving returns were solid performances from our EM debt and our alternatives, which include hedge funds and PE structured funds. Alternatives, contributed $7.6 million to the increase in our net investment income quarter-over-quarter and $4.4 million to the increase in net investment income year-over-year.

Interest and dividend income contributed $1.1 million quarter-over-quarter and $5.5 million year-over-year to the increase in net investment income. As you probably know, the US 10-year bond is much lower today and corporate bond spreads are closer to their tights. So reinvesting our bond portfolio as maturities roll will be more challenging to grow interest income over the next few quarters.

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

Jay S. Bullock {BIO 3644311 <GO>}

Thanks, Mark, and good morning, everyone. I'll focus my comments today on some key highlights and explanations to the financials we reported last night, and we'll take your questions. Commenting first on the top line, Gross premium growth was strong in both the US and international operations, contributing to 10% overall growth. I would point out that on a net written and earn basis that, our growth was more measured at around 3%.

As we've talked about on recent call, some of the risk management actions taken in our reinsurance purchasing, and increasing our use of third party capital resources has resulted in lower net written premiums. We expect our net to gross premium retention will come in a few points less than 60% for the full year. The loss ratio for 2019 second quarter was 66% up from 58.8% in the prior year quarter. The loss results the 2019 second quarter were impacted by a few items that I would like to spend some more time going through. First, we reported $22.3 million of prior year reserve strengthening during the quarter. The adverse movements were related to various business units in our international operations. The largest impact was in our Bermuda casualty unit.

This business provides large account casualty coverage to Fortune 1000 companies, and other major public and private enterprises. During the quarter, additional information became available on several individual claims, including reports of counsel and other specific information. And based on this, it became evident that certain losses would reach our attachment point, and we adjusted our reserves accordingly.

As we discussed in the past, we took actions last year to modify and in some cases remove certain geographies and classes from the Bermuda casualty business, because we didn't like the risks. Utilities was one of these classes and contributed to the reserve strengthening in the quarter. The balance of the prior year strengthening related alliance in London and Europe, where we have previously taken remedial action or exited certain lines of business and relationships altogether.

The reserve development in international was primarily related to action year 2017 and 2018. In our US operations we continue to experience modest favorable reserve development primarily related to our casualty business from accident years 2014 and prior.

Additionally, we reported higher current accident year losses in our international operations, primarily related to a large loss that impacted the energy market broadly, as well as several other large property losses. Catastrophe losses were higher in the second quarter at 1.5 points on the loss ratio compared to 0.4 points in the prior year quarter, and were mainly driven by US weather including losses related to flooding.

In terms of expenses, I would note that we recorded $7.5 million of cost related to the proxy solicitation process, and related activities during the second quarter. We do not believe these expenses are representative of our ongoing business, and have excluded them from the calculation of our expense ratio and adjusted operating earnings.

Overall, our expense ratio of 37.4% was down 10 basis points year-over-year. And while our focus is on continued growth in underwriting income, we continue to pursue initiatives which we will book, which we believe will drive further improvement to our expense ratio. Touching on the US operations for a moment, gross written premium rose by 10.6% or $454 million during the second quarter.

Growth was achieved across our property, professional, specialty, and liability lines, and reflects the continued execution of growth initiatives and a positive rate environment. The margin picture in the US was also positive. In the quarter loss ratio, as well as the current accident year ex-cat loss ratios, both improved over the prior year quarter. All in US reported a loss ratio of 57.4%. The expense ratio in the US was 32.3%, up modestly from 31.8% in the prior year quarter. The increase primarily reflects the business, mix as well as a one time beneficial adjustment in the prior year quarter.

The bottom line in the US was $29.4 million of underwriting income for the quarter, or an increase of approximately 11% in the second quarter of 2018. In our international operations gross written premium rose by 9.1% to $319 million compared to the 2018 second quarter. Growth was most pronounced in property lines, and was partially offset by decreased writing in specialty lines. Again positively impacted by the momentum in the rate environment.

I already spoke about the losses that impacted international during the quarter. Overall, the loss ratio was 81.9%, up from 58.9% in the prior year quarter. And as Mark already touched on, we've already taken remedial action on our London and European business units, and expect better loss results going forward. The expense ratio in international was $38.7 up from $36.8 in the prior year quarter.

The increase primarily related to an increase in acquisition cost which are being addressed and to a lesser extent, investments in technology to support our growth. International reported an underwriting loss of $21 million compared to underwriting income of $13.2 in the second quarter of 2018. Obviously not a result we're happy with. And we expect better performance going forward.

Following on Mark Rose's comments on investments, our core portfolio continues to perform quite well, with net investment income growing nearly 29% in the second quarter. Alternatives, which are generally reported on a lag, contributed $9.5 million, representing a growth of over 80% year-over-year. The tax expense for the quarter was $800,000, which represents a 2.7% effective tax rate. The lower effective tax rate primarily reflects the jurisdiction where income was earned during the quarter. This compares to the 15% that we used to calculate our adjusted operating earnings.

Finally, a couple of milestones to note on the balance sheet. Total assets past the $10 billion mark for the first time, driven by the strong performance in the investment portfolio, and our shareholders equity close at above $1.9 billion, up over $180 million in the first six months of 2019.

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

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) Today's first question comes from Greg Peters of Raymond James. Please proceed.

Q - Greg Peters {BIO 3111497 <GO>}

Good morning. I was going to focus on two questions: one, around the expense ratio, and then longer term target of your 10% return on equity. On your expense ratio, it looked like it moved a little bit against you in US and I think you called out in the international operations acquisition cost to support growth yet, the earned or the written premium was down year-over-year. So maybe you could provide some additional color about -- around that? And then give us some ideas of the levers you have to pull going forward to get it lower?

A - Mark E. Watson {BIO 20610831 <GO>}

Sure, Greg. Well, let me answer that. I'll start with the answer to that question, and I'll let Kevin jump in on the US. But one of the things that we know that there was a one-time benefit in the last year's quarter in the expense ratio in the US. Those numbers are really pretty comparable year-over-year. I don't know. Kevin, if you want to add anything else on the US side.

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

No, slight mix shift and --

A - Mark E. Watson {BIO 20610831 <GO>}

That's right, yeah.

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

The thing you mentioned earlier about last year, we had benefit from a seeding [ph] commission that went through.

A - Mark E. Watson {BIO 20610831 <GO>}

Yeah. Remember Greg, that the surety business is predominantly in the US and that expense ratio runs significantly higher. That's one of the business units, where we've seen the most growth.

In the International business, I would just -- I would note that business that has been -- much of which was canceled last year continues to earn through this year. And so the acquisition costs related to that are still being felt in the expense ratio. The growth that you saw in the international business was largely driven by property and professional, where both benefiting from a very strong rate environment. So I understand that drawing the connection between the two, but I would say that the growth and expense ratio are kind of working with different drivers at the moment and should come into the line -- come in the line as the rest of this year and next year plays out.

Q - Greg Peters {BIO 3111497 <GO>}

So the timing of -- this is more of a 2020 impact, versus 2019 because of the run off, correct?

A - Mark E. Watson {BIO 20610831 <GO>}

Yeah. (inaudible) yes.

A - Mark H. Rose {BIO 1557365 <GO>}

Well, and also just as we're getting more -- this is Mark, as we're getting more rate across the board now, it's just -- it's going to take a few more months for that to translate into earned premium or revenue, which then impacts the financial statement.

Q - Greg Peters {BIO 3111497 <GO>}

Okay. I have -- I can't help myself on the reserve adjustment in the international. You called out the Bermuda casualty business, where it hit your attachment points. Did you then book that to a full case reserve on that, or can you walk us through the mechanics?

A - Mark H. Rose {BIO 1557365 <GO>}

This is Mark. There were a couple of claims that in the original -- in the initial reports that we received, we didn't think they would hit our layer, and information came up during the quarter that led us to conclude otherwise. And what's happened is -- this -- we had the -- I mean look, this happens quite a bit, but it's unusual to have so many things happen in one time. And the last time that we saw a fair amount of activity in a short period of time, I think was back in 2010 or '11.

So it's been quite a while, which is why I was trying to make the point in my remarks earlier that when you look at this portfolio, over the course of time, the margins on average -- the margins cumulatively have run about 10% from an underwriting perspective, which has generated pretty significant double digit returns even with the loss -- the changes we made to our loss reserves in the second quarter of this year.

Q - Greg Peters {BIO 3111497 <GO>}

Right. I just sort of pair that up with the rhetoric or the pitch from the activists about the underperforming international operations. And I think your investors are just looking for an improved -- looking for the next step up and improvement in your outlook. And that, I guess, dovetails into the ROE observation. The operating ROE is down, obviously, because of what happened in the international operations. And should we -- you have the 10% for operating. Is that -- is this a 2020 target, or can you give us some sort of timeframe on where we'll see this step up and improvement?

A - Mark E. Watson {BIO 20610831 <GO>}

Okay. Well, let's -- so I'll start and then I'll let Jay jump in. But the other thing that I look back to Bermuda insurance for a minute. I also made the point in our remarks earlier that this line of business is volatile as well as our property cat business. And so there are times when we're going to have an event or series of events in a short enough period of time then it's going to impact the quarter, which is why I keep trying to get us to focus on a longer period of time, where even inclusive of the actions taken in the second quarter, it still generate a significant return on invested capital.

As for when do I think we get to a 10% ROE? Well, I mean, on an annualized basis (inaudible) for the first half of this year. But in terms of thinking about it from an operating perspective, which is not necessarily how I think about it, because I'm focused on total value creation, which includes the contribution from the investment portfolio. I -- Jay, you jump in. But I think we've got a pretty clear line of sight for 2020, based upon what we see today.

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

Yeah. Greg, I just would go back to some of the things that we put out and published earlier this year. We talked about how did we get to 10% risk free rate plus 700 basis points. I would note that as of yesterday, the risk free rate was 1.75. But we often try to communicate in longer term -- longer timeframes. And so three is -- two or three is probably a more reasonable number, but let's call it 10%.

And in order to get there, we needed a certain level of leverage on the platform. We have identified around $1.8 billion in the premium, that feels like an achievable number for us. And the combined ratio of 93% was depending upon getting the expenses down to around 36%. So the expense ratio. So I would agree with Mark that we've got a pretty clear line of sight to be hitting that on a quarterly basis in 2020.

A - Mark H. Rose {BIO 1557365 <GO>}

Absent volatility.

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

Absent volatility.

Q - Greg Peters {BIO 3111497 <GO>}

Okay. Thank you for those answers. I just a final cleanup question. Given the volatility in the marketplace, in the stock markets specifically and interest rates, I'm wondering if we'll see some sort of step back in investment income in the third quarter if this holds out for the balance of the quarter?

A - Mark E. Watson {BIO 20610831 <GO>}

Mark?

A - Mark H. Rose {BIO 1557365 <GO>}

Yeah, Greg, you're trying to predict the day trading password right there, I mean. a week -- in the last 10 days, we saw a significant drop in treasury rates globally and now we're starting -- in the last three days, we're seeing the spreads on corporate bonds, widen out materially so that could be a positive as we roll into new single A and triple B rated paper to pick up some yield because spreads have moved enough. But it's so unpredictable right now. So I would take a conservative view that it's going to be more challenging than the last four quarters today. But it's something to watch.

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

Yeah. And the other thing that I would add, Greg this Jay again, is there is a difference in the environment today. And that is at the very short-end of the curve. It's not zero. And it was a couple of years ago. And so that very short-end of the curve, whether it's three, nine or a 1.5 or two years, has an impact on us as well. So it depends on what happens to that, is really what drives the outlook -- immediate outlook, and outlook for the next eight quarters.

Q - Greg Peters {BIO 3111497 <GO>}

Great. Thank you for your answers.

Operator

Our next question comes from Christopher Campbell of KBW. Please proceed.

Q - Christopher Campbell {BIO 20262752 <GO>}

Hi, all. Good morning, and congrats on the quarter.

A - Mark E. Watson {BIO 20610831 <GO>}

Thank you.

Q - Christopher Campbell {BIO 20262752 <GO>}

I guess the first question is, I think you mentioned Mark in your in the opening script about loss rates being up 9.3%. What do you see in the US?

A - Mark E. Watson {BIO 20610831 <GO>}

Well, actually, I'll let Kevin handle that. And I also like, actually, to talk a little bit more about what that is at Lloyd's. But Kevin, go first.

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

Yeah. Hi, Christopher. Across the US, we're seeing mid single digit rate increases. But specifically in a few areas, we're seeing solid double digits, and those would be in the access casualty, property, and professional liability areas, with some of our transportation related businesses being closer to double digits as well. So across the board, we're seeing upward trend and it's improved in the second quarter markedly over the first quarter.

A - Axel Schmidt {BIO 19499069 <GO>}

It's Axel Schmidt here. With regards to Lloyd's or Syndicate 1200 you're seeing the most rate increases of property being off book. Yesterday, it's about 23%, 24%, on top of what we had achieved going back to post Harvey or Maria in 2017. And on top what we achieved about 20% in 2018. So we are really getting very, very close to the great adequacy we need to have. However, we also value being property business on Lloyd's, like the other of Bermuda and there we see even more -- even steeper rate increases, particularly driven by the best of substantial capacity, from some important carriers. With regards to our management liability, it follows what Kevin described would be seen as the best. It's not that much yet, but we are also achieving double digit rate increases and less of liability in all our Syndicate 1200 book.

Q - Christopher Campbell {BIO 20262752 <GO>}

Great.Thanks for that color. I appreciate it. And that's just a question on -- dovetailing on one of Greg's questions about one of the activists proposals was to like exit the international segment. I guess, just how should we think about that as investors? If we think of like -- if we think of Argo's US peers, they tend to trade at higher multiples than the Lloyd's and the Bermudian peers. So there would be a benefit there. I guess, just how should we think about what could the ROEs look like if there was an international sale? And what would be the benefits and costs in terms of like thinking about that?

A - Mark H. Rose {BIO 1557365 <GO>}

I think that when we look at our organization today, it looks very similar to most of our US peers who also have significant operations in London for sure, and to a lesser extent, perhaps Bermuda or other parts of the world. When I look at our business today, by line of business, which is how we run it, we're agnostic to geography and more focused on where can we get the right rate of return.

Having said that, there are parts of our business that we're always looking at for improvement, whether that's in the US or outside the US. If you think back to our earnings calls over the last couple of years, we've spent as much time talking about remediating or shutting down lines of business in the US as we have in international. So that's how we think about it. actually. Axel,do you want to add anything?

A - Axel Schmidt {BIO 19499069 <GO>}

Just -- yeah. On top of what Mark mentioned. On the last 12 months, we have exited 10 products respective lines of business, largely international for the reasons Mark and Jay alluded to earlier. But we've also re-added products that we believe are no good for, not just because of market changes, but also because of upselling ourselves physically and to give our underwriting disparities. And that's going to be profitable, including our business in the international. So therefore, the projected returns, I think, are in line with expectations.

A - Mark H. Rose {BIO 1557365 <GO>}

The other thing that I would add, Chris, is where we operate has different cost structures. And in parts of the world where we see the transaction costs going up, either because of the platform on or commission expense? We're taking a hard look at how much exposure we really want to that platform.

Q - Christopher Campbell {BIO 20262752 <GO>}

Got it. And then what are the ROEs by each of the segments currently and then where do you think they can be?

A - Mark H. Rose {BIO 1557365 <GO>}

So I'm just going to say that our goal is a double digit ROE for all the businesses that we're in. The majority of them are performing at that now, and that's what we're focused on.

Q - Christopher Campbell {BIO 20262752 <GO>}

Got it. And then Rochie [ph] also had some other ideas to improve ROEs, like they said, like a run-off sale, corporate restructuring, investment expenses. I guess, what are your thoughts on potentially adopting some of those ideas as well?

A - Mark H. Rose {BIO 1557365 <GO>}

Well, I think we mentioned a couple of quarters ago that we've entertained looking at had at a sale of the runoff book for, oh, gosh. Well, we've been looking at it off and on for 20 years. And that we had entered into to a review of that at the end of last year. And I'll just say that those discussions are ongoing.

Q - Christopher Campbell {BIO 20262752 <GO>}

Got it. And then just one last one on the shares to fall back a little bit since, they hit their highs. So how are you guys thinking about repurchases?

A - Mark E. Watson {BIO 20610831 <GO>}

Well, look, if you look at how we think about shareholder repatriation, or the repatriation of capital in general, over the last eight years, our gap equity has gone from, I think, a $1.5 billion to $1.9 billion and we've given back through either dividends or share repurchases over $650 million. And I would point out that we significantly increased our dividend again at the end of the fourth quarter.

So I -- look, I think we're always focused on how we can maximize capital or the utilization of capital. That's an important lever. I frequently talk about the levers of how to grow the book value per share. The first is underwriting income, the second is total return on the investment portfolio, and the third is how effectively we manage capital to the extent that we believe that we have excess capital, that we don't need for our core underwriting business with our share price down. I think we have to keep thinking about that.

Q - Christopher Campbell {BIO 20262752 <GO>}

Yeah. I just want to make sure of it. Yeah. There was no change in the philosophy, just because you guys haven't bought back in the last two quarters.

A - Mark H. Rose {BIO 1557365 <GO>}

No. But I know, well, there's no change in the philosophy of how we think about capital. But I would say that given that our share price is trading above book, that we have we have suggested, I think previously, that perhaps increasing or use of dividends as a way to repatriate capital might be more effective to our shareholders than a share buyback. So I don't mean to exclude that, Chris, but rather to say there is a range of things that we can do when we're still open to looking at all of them.

Q - Christopher Campbell {BIO 20262752 <GO>}

Okay. Great. Well, thanks for all the answers. Best of luck in the third quarter.

A - Mark H. Rose {BIO 1557365 <GO>}

Thank you.

Operator

(Operator Instructions) The next question comes from Jeff Schmitt of William Blair. Please proceed.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Hi, good morning. Looking at the professional liability book, it looks like it drove a lot of the growth in the US, maybe not quite half, growth was 35%. I know you had mentioned rate increases. There were in the double digits. How far into the double digits are we talking there? And can you maybe discuss what you're seeing in that in that market? And why there is --

A - Mark E. Watson {BIO 20610831 <GO>}

Yes.

Q - Jeff Schmitt {BIO 19747235 <GO>}

That opportunity?

A - Mark E. Watson {BIO 20610831 <GO>}

Yes. Let me start, and then I'll let Kevin jump in. It's not just about rate increase. It's about how we face the market, and how we structure our products today, and what our expectations are in the future. Kevin?

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

Yeah, it's really been driven by the management professional liability book and there's some market conditions that are different where, a year ago people were offering $50 million limits. They're down to $10 million now, which is opening up a lot of opportunities that didn't exist before to participate on programs. A lot of digital work we've done is allowing us to respond quicker and the -- in management professional liability, the price increases have been strong -- very strong double digits, especially in this quarter.

A - Mark H. Rose {BIO 1557365 <GO>}

Yeah. And to just go back to Argo Digital for a minute. We -- I think we said -- I think we talked about this on our -- on the last quarter, that we now have built a predictive analytic tool that's really helping us figure out; one, which risk to write or not write at all; second, what layer we want to participate on a program, and what we believe the right price is for that. So I think we have much more underwriting precision today than we did a year ago. And that giving us a lot more comfort as these market opportunities that Kevin just mentioned come up.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Got it. Okay. That makes sense. I mean, are the rate increases, are you seeing competitors facing loss pressures there, you're not really seeing that. I mean, you're able to sort of through technology, have better risk selection there, but you're not seeing any issues on the lost front?

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

No. Across the board, the industry is seeing losses increase. And that's part of the reason that there's a pullback on limit sizes being put out by all carriers, the increases in rates, the increases in retentions which are happening across the board and management professional liability.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. And could you discuss growth in the E&S books, specifically what you're seeing there just given pullbacks by AIG, by Lloyd's, what's growth levels there in the profitability of that book?

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

Sure. It's Kevin, again answering. What we've seen is pretty much continuation of what we have seen in the past. It's still over 10% in terms of the increase in submission activity, but our appetites are very clearly defined. So if it fits the boxes we've had, we're happy to see it. There's a lot of stuff that moves in and out of the E&S market and we may not be competing on all of that, but we've seen a continual growth in the flow of submission activity and a slight improvement of the quality that's allowed us to continue to grow and grow in that area.

Q - Jeff Schmitt {BIO 19747235 <GO>}

Okay. Thank you.

Operator

The next question comes from Bob Farnam of Boenning & Scattergood. Please proceed.

Q - Bob Farnam {BIO 15005467 <GO>}

Hi, thanks. Good morning. I had a quick question on the current year, large losses. I know Jay you mentioned about the energy piece, but I want to know if there's any commonality in the large property losses, kind of what was behind those?

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

Well, what has happened particularly this regards to our Lloyd's business was issues that the international loss pick those actual. We have taken immediate actions, but that was the only common denominator.

A - Mark E. Watson {BIO 20610831 <GO>}

Yeah, there were some large losses, this great large property losses that happened at the European business. There wasn't -- there didn't seem to be a commonality there other than, we were on the wrong risks. The largest loss accounting for more than half of the $10 million we reported, was a big energy loss that affected a lot of markets in the US. So it was felt across the market. So not that much in common to anything either.

Q - Bob Farnam {BIO 15005467 <GO>}

Is this something -- I mean, large losses like that, is that's something that happens every quarter, just having to be -- had maybe more than couple that was notable enough that they had to kind of disclose that or just like?

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

Yeah.

Q - Bob Farnam {BIO 15005467 <GO>}

Okay.

A - Kevin J. Rehnberg {BIO 3832713 <GO>}

It was a spike in frequency Bob, and I've had this conversation internally a lot because you think about you have these large losses and how many are you going to have in a year? And the answer is 1.2. Well, you never have one point, you have zero, or you have three. So this was a time when we had four. And so when it happen -- when it hits in a quarter like that, there's no IBNR from a prior quarter, you're not going to go borrow IBNR from a future quarter. It's just bad stuff happened in that particular quarter.

Q - Bob Farnam {BIO 15005467 <GO>}

Right. Okay, thanks.

Operator

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

A - Mark E. Watson {BIO 20610831 <GO>}

I'd like to thank everyone for joining us on the call today. There's been a lot of activity during the quarter, and I think we're off to a good start for the third quarter. We'll see what happens with the capital markets. And I look forward to speaking to everyone in November at the end of the third quarter. Thank you very much for your time again. And operator, this concludes our call.

Operator

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