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Q3 2015 Earnings Call

Company Participants

- Jay Stanley Bullock, Chief Financial Officer & Executive Vice President
- Mark E. Watson, President, Chief Executive Officer & Director
- Susan Spivak Bernstein, Senior Vice President-Investor Relations

Other Participants

- Adam Klauber, Analyst
- Arash Soleimani, Analyst
- Charles Gregory Peters, Analyst
- Christopher Martin, Analyst
- Ken G. Billingsley, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Argo Group's Third Quarter 2015 Earnings Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note that the event is being recorded.

I would now like to turn the conference over to Susan Spivak Bernstein, Senior Vice President of 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 third quarter and nine months 2015 results. Last night, we issued a press release on earnings, which is available on the Investors section of our website at www.argolimited.com.

Presenting on the call today is Mark Watson, Chief Executive Officer; and Jay Bullock, Chief Financial Officer. We're 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 call is being recorded. Following management's opening remarks, you'll receive instructions on how to queue.

As a result of this call, Argo Group 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 the actual future results involving any one or more of such statement.

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 20610831 <GO>}

Thank you, Susan. Good morning, everyone, and welcome to Argo Group's third quarter earnings call. I'd like to share my thoughts about the quarter, after which Jay Bullock will add some commentary to the financial results. Also, joining us on this quarter's call is Axel Schmidt, our Chief Underwriting Officer. And we look forward to responding to any questions you may have during the Q&A portion of the call, following our remarks.

After the market closed yesterday, Argo reported growth in operating earnings to $0.86 per share in the third quarter of 2015. And for the first nine months of 2015, operating earnings per share were $2.80, up 13.3% from the prior year. These are encouraging results and we remain focused on the ongoing day-to-day challenge of innovating and adding differentiated value to our customers, especially given the competitive landscape.

Our results reflect continuing work across all divisions to stay focused on growth of profitable business and identify new opportunities for future profitable growth. Some quick examples include strong results in the casualty area for our E&S segment and Argo Pro. Our smaller entity Professional Liability business and the positive turnaround of the results tried in our public entity and surety.

Overall, for the first nine months of 2015, we posted a combined ratio of 95%, reflecting continued improvement in all of our operating segments. During the same nine-month period, we also generated a 24% improvement in underwriting income to $50.4 million from $40.6 million in 2014. We're making ongoing progress in achieving efficiencies across the organization.

Our underlying expense ratio is showing favorable year-over-year comparisons in both the three- and nine-month periods, particularly for non-acquisition expenses. Our loss reserves remained strong as we benefited from favorable loss reserve development now for the last 18 consecutive quarters, and a point worth noting, each of the last 10 years has shown positive development as well.

From a growth standpoint, we continue to find opportunities in our niches to grow intelligently and profitably, despite challenging market conditions. Our top line was up 6.9% in the third quarter and up 5.8% in the nine-month period. Like in previous quarters, we remained focused on constant improvement in the mix of business. Part of this is

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actively managing the book across the pricing cycle and maintaining a high level of diversification.

In addition, we're employing new and analytical and business process tools, in some cases increasing demand by making it easier for our clients to do business with us. That said, across the entire business, rates have flattened out with some lines of business like property experiencing reductions.

Offsetting that pressure somewhat, we're achieving strong retention rates in both our well-performing books of business, those we're actively working on improving risk selection. Our results reflect some of the impact of these initiatives, but we expect to see further improvements going forward.

Now let me briefly comment on each of our operating segments. In our Excess and Surplus Lines business, gross written premium was up 10.9% in the third quarter and 12.7% for the first nine months of 2015 compared to 2014. We're achieving growth in our casualty units, our largest business by volume within E&S, by nearly 20%, reflecting the benefit from our investments in technology and overall process improvement.

Our E&S premium growth also reflects the contribution from new teams and product lines. Over the last year, we've significantly reduced our exposure to transportation lines and have now returned that much smaller business to profitability. On average, rates were modestly down across this segment other than property, which was down a fair bit due to continued competition.

This quarter reflects the significant work that's gone into improving the results in certain businesses in our Commercial Specialty segment. Overall, premium was up 6.6% in the quarter and 5.8% in the first nine months. Growth was driven by our program, public entity and surety businesses. In several of our businesses in this segment, we continue to achieve rate increases that are in line with the targets we've set. Despite this, we're seeing a continued increase in competition, especially in areas such as the public entity and mining businesses.

Argo Insurance, our retail insurance business, is now under the new leadership of Rooney Gleason, who's experience in distribution and risk management technology applications will strengthen our ability to provide market-leading solutions for our clients and look for us to talk more about this in a couple of quarters.

Turning to Syndicate 1200, while our results remain solid and consistent, pricing and competition remained intense across all the Lloyd's market. We grew our gross written premiums by 7.5% in the third quarter and 4.4% in the first nine months of 2015. Growth, while modest, is being driven by the North American binder business and new risks we've added in recent years.

The growth in these areas is being offset by price competition and U.S. direct and facultative property, energy and also our aviation portfolio, particularly airlines. In addition, the increasing practice of moving open-market business in the facilities has begun to put pressure on acquisition costs to insurers, particularly ourselves. In fact, you'll note a slight increase in our expense ratio year-over-year for the third quarter, which was driven almost entirely by increased commission expense.

Overall, gross written premiums in our International Specialty segment declined 1.3% in the third quarter and 4.5% in the first nine months compared to 2014. The decline in top line in the quarter reflects a decline in foreign exchange related to our business in Brazil as well as a reduction in our top line for Argo Re.

In our Bermuda excess casualty and professional liability business, we continue to see strong new business flow with higher renewal retention. However, rates are slightly down across the book. Just going back to Argo Re for a minute, I should also add that that reduction in top line is mainly driven by competition in the marketplace, but no differently than what we expected for the quarter.

Turning to investments, our investment portfolio declined just over 1% for the quarter. As many of you know, the third quarter provide to be quite a challenge as markets continue to grapple with concerns about slowing growth in China, oil price volatility and uncertainty surrounding the timing of defense first interest rate hike.

And U.S. equity markets were a bit challenged, as was our portfolio. Just to give you an example, a lot of our - we have a fair amount of exposure to energy stocks and they fell over 17% during the quarter. Some of that's rebounded since then. In fact, as of today, we've made back more in the portfolio than the declines of the third quarter.

Our net investment income for the quarter was $21.3 million, down slightly from the prior quarter, but up from the prior year. The prior quarter comparison is impacted by the timing of dividends from a private investment. However, our book yield has reached an inflection point versus both prior quarter and prior year, meaning we would expect a higher investment income in the quarters that follow, especially if and when risk-free rates move to more normalized levels.

Moving on to capital management, our philosophy has not changed. As you heard me say in the past, our first use of capital is to support the balance sheet and the ongoing business that we have, then to save capital for available opportunities as they might arise, and to then actively return excess capital to our shareholders in an effective manner.

During the quarter, we repurchased about $4.8 million worth of stock at an average price of $55.27. In the first nine months of 2015, we've repurchased almost 600,000 shares for just under $30 million at an average price of $51.58. In total, over the last six years, we've returned more than $421 million of capital to shareholders with $330 million returned through share repurchases and $90 million paid in cash dividend.

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. As we look to the fourth quarter of 2015 and more importantly 2016, our focus will remain on an excellent

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customer service, generating growth in book value and providing stable returns to shareholders.

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

Jay Stanley Bullock {BIO 3644311 <GO>}

Thanks, Mark, and good morning, everyone. I'll provide some detail on the financials and then we'll open it up to Q&A. As highlighted, growth while modest was achieved in all of our business segments in the first nine months of the year, but perhaps of greater significance was the improvement in the ex-cat and ex-prior-year development loss ratio in three out of our four operating segments.

This trend has continued over the last three years and is the primary contributor to the growth in underwriting income Mark mentioned. That higher underwriting income enables us to report an annualized net income return on equity of 10%, despite a lower level of gains reported from the investment portfolio.

Of note related to loss trends, the third quarter and first nine months of 2015 were characterized by continued overall favorable reserve development from prior accident years and a moderate level of catastrophe losses.

For the quarter, we experience net favorable development of $6.6 million, which is a few million greater than reported in the third quarter of 2014. In this year's third quarter, we had favorable development in all of our ongoing business segments. The largest component of this quarter's release was from our E&S business at $10.1 million concentrated in causality lines.

This development was partially offset by a charge to our run-off segment, as this is the quarter where we typically take a close look at the provision for A&E and risk management. The year-to-date favorable development is $15.3 million, which continues the long-term trends referenced earlier. All the relevant figures on loss development are displayed in a table of the press release.

In the third quarter of 2015, we posted a current accident year non-cat loss ratio of 55.8%, essentially flat with the 56% posted in 2014 third quarter. Catastrophe losses that impacted our business for the quarter were $13.1 million, compared to $5.5 million in the third quarter of 2013, and stemmed largely from the Tianjin explosion approximately $8 million and various other smaller U.S. storms and international events.

As Mark mentioned, we continue to see a positive trend in our expense ratio, reporting a ratio of 38.4% in the quarter, down from 39.6% a year ago. And while our central focus remains the expansion of underwriting income, be it from loss or expense ratio improvement, there's a significant amount of work underway in the organization to continue to address our relative efficiency. We're examining each of our functional support areas as well as each business, often asking the question what can be supported across a broader area of the group. We'll continue to report on these efforts in coming quarters.

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For the third quarter of 2015, the effective tax rate for the group was 2.5% and through nine months 8.5%, both lower than our expected 20%. The tax rate for the year has been affected by a number of one-time items, including certain foreign currency adjustments and credits in our UK operation, receipt of a state tax refund in the U.S. as well as by an increased level of earnings in 2015 attributable to our operation in Bermuda.

Finally, to the balance sheet, we ended the quarter with a pre-tax unrealized embedded gain of $100 million, down from $167 million at June 30 and $197 million at March 31. This decline was related to wider spreads in U.S. corporates and municipals, movement in foreign currency related to certain currency derivatives and the realization of unrealized gains from the sale of some equity positions. As Mark pointed out, most of the decline in the quarter has been – more than the decline in the quarter has been regained in the month of October.

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

Q&A

Operator

Thank you. We will now begin the question-and-answer session. And our first question comes from Greg Peters from Raymond James. Please go ahead.

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

Good afternoon and congratulations on the quarter.

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

Thanks.

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

Thank you.

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

I had a couple of questions. If I look at the gross written premium on a consolidated basis year-to-date, up 6%, almost 6%, which is a pretty solid result in a competitive market. When I think about the opportunities for growth next year and the puts and takes with pricing in the competitive marketplace, what kind of result do you think is – do you think you can achieve a similar type of result next year or do you expect it to step down a little bit?

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

Actually I think that in terms of top line next year, even with the market where it is, I think we have an opportunity to grow at a similar rate and I'll tell you why. I think that as long as we continue seeing strong growth in our casualty segment within E&S, maybe it won't be

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20% next year because that's awfully robust, but even if it's double-digits I think that moves the needle quite a bit.

Within Commercial Specialty, while I was happy to see us grow a little bit this year, we've still been in retooling mode. Having said that, I think that whatever new premium rate will be offset by the elimination of some small counts in our Argo Insurance segment.

We have a number of initiatives going on in the Syndicate that I think will lead to modest growth, and I'll define that as somewhere between 5% and 7%. It's a little early to tell right now though, given how competitive things are here in London.

And then, in our International segment, I think that if the real settles out, I think we will see some growth in Brazil. I would expect our business in Bermuda to remain relatively flat both for insurance and reinsurance. So, plus or minus 5%, but I think relatively flat.

But I think when you add it all up, I think that we still have an opportunity to see a similar amount of growth next year on the top line.

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

That's great color. Thank you. A couple of questions on the expense side. And I recognize, Mark and Jay, you both touched on the issue in your prepared comments. But Syndicate and International Specialty didn't show year-over-year improvement. Your other businesses did and you did on a consolidated basis.

Should we be thinking in the context of eventually you're going to start to show some improvement in those two businesses that are lagging right now? Or because of the competitive environments, should we hold out sort of a steady as we go sort of outlook?

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

Well, I think – so I'm going to give you multiple answers. I think that, in general, we will continue to see improvement in the expense ratio across the board. I think that some of that is going to come from additional earned premium. Some of that's going to come from us beginning to streamline and simplify our operations, and I think some cost will actually come out of that. We began working on that a few months ago and I'll have more to say about that next quarter.

I think offsetting some of that will be the reality that in this market we're all having to pay more acquisition costs or higher commissions than we were a year ago. That was the pressure that you saw in the Syndicate that I mentioned earlier and actually that was a pressure in International Specialty as well. So, that's a little harder to control because the market is the market.

Having said that, I think if we can continue to grow our earned premium modestly that we'll continue to see improvement in the expense ratio. And I'm sure Jay will jump in in a minute and remind everyone that we're more focused on the combined ratio as a whole.

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But I was very pleasantly pleased to see the expense ratio improvement and the U.S. businesses finally start to play out in the financial results.

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

Jay, on the expense side, in the last conference call, you talked about the impact on higher stock price in terms of incremental expense. And I'm just trying to gauge how I should be thinking about that since the end of the quarter the stock has performed quite well and actually has performed well on a year-to-date basis too.

But if I look at the price of the stock at the end of the quarter, it was $56 and some change, and yet there was a high in the quarter of $59 and some change. And the difference between the two based on where the stock is today can add up to a couple of million dollars or more in terms of incremental expense. So how should we calculate the formula?

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

Well, I'll kind of go through the comment that I made last quarter and the one thing I'll say is caution everybody that if it were, it's somewhat of a spreadsheet exercise but it's never perfect. We're dealing with the option math and other things and forfeiture rates and so forth.

But we expect to see in any given quarter the stock to go up call it 2% or 3%. If we expect growth and book value to be between 8% and 10% a year and it does that divided by four, that's kind of what we expect to see in the stock price. We've had the good fortune of seeing it move up to a more reasonable valuation level recently.

But embedded in that increase of 2% to 3% is probably $2 million to $3 million of LTI expense. Beyond that, kind of every dollar increase is somewhere between $1.5 million and $2 million of additional expense. So the extrapolation to movement in the fourth quarter or movement in October is appropriate, if and when the stock closes out at the end of the year at that same level. Inter-period is not as impactful as the start and end of a given quarter.

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

And that is...

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

So the...

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

Yeah. And Mark...

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

Yeah. So the...

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

Sorry. Go ahead, Greg.

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

No, no, what where you saying, I'm sorry.

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

Well, Mark was pointing out, it is a non-cash charge in the period that we recognized.

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

Right. Right. So, okay. So, use at the end of the quarter is sort of a bogie or a baseline. The final question is capital management. I think your run rate the last couple of years has been between $40 million or $50 million of stock repurchases. Year-to-date seems to be like you're running a little bit below that run rate. And I'm wondering if now that the stock is above book value, if it's changing your calculus or if there's a change in your perspective towards share repurchase?

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

Well, remember, the third quarter is usually pretty light because we're in the cat season. So we don't tend to buyback as much in the third quarter.

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

Yeah. So otherwise there's no change in your approach and I think you highlighted in your opening comments. Is that a fair assumption to make?

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

Yeah. If you go back and look historically at how we repatriated capital, I think I talked about the last six years. But if you go back – you can go back longer than that. And depending upon what we thought was appropriate at the time, looking to bought back stock, we've paid dividends, we've paid stock dividends and we've also done one-time dividends as well on top of our regular dividend. So I think we have a number of tools available to us to repatriate capital depending upon what we think is best for shareholders and best for the company.

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

Fair enough. Congratulations on the quarter.

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

Thank you.

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

Thanks, Greg.

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Operator

Our next question comes from Christopher Martin from Macquarie. Please go ahead.

Q - Christopher Martin {BIO 18924633 <GO>}

Hey, guys. Congrats on the quarter.

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

Thanks, Chris.

Q - Christopher Martin {BIO 18924633 <GO>}

So one thing I want to touch on is I know you mentioned last quarter is that you'd seen sort of regarding M&A more resumes coming in in the first six months of the year than you had over the past six years. Has that sort of continued or is it sort of cooled down like the rest of the market has?

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

No, we've got even more now than we did the last time I mentioned it.

Q - Christopher Martin {BIO 18924633 <GO>}

Are these mostly smaller like statutory players or sort of globally – can you sort of talk about what kind of resumes you're getting in?

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

Well, without turning this into a recruiting call, I mean we're getting interest from mainly our global specialty competitors and not just underwriters, but people in all skilled positions across the organization.

Q - Christopher Martin {BIO 18924633 <GO>}

All right. Got it. And then sort of looking at the reserves in the run-off book, you'd mentioned that that was sort of running off at $10 million to $15 million a quarter. Is that sort of after your last review what you anticipate moving forward? And sort of did your review this time go more or less as expected?

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

Yes. I think what you're – Chris, what you may be referring to is the payout of those reserves over time.

Q - Christopher Martin {BIO 18924633 <GO>}

Yes.

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

Right. And I'm going to use some round numbers. $200 million is the old risk management book, $50 million is A&E. The risk management book has a declining payout pattern because you end up with some permanent and total disable lives that go on for a long period of time. So, that slowed somewhat. Although we still continue to see decline in the total level of reserves outstanding, it's much less than 10% of the portfolio today.

In terms of what we saw in the quarter, total was about $7 million. It was a little bit from risk management, but it was mostly from the asbestos and environmental. That's a lighter number than what we've seen in prior years. And I don't read too much into that other than it was nice to see that number declining a bit.

Q - Christopher Martin {BIO 18924633 <GO>}

All right. Great. Thanks. And then just sort of sticking on the reserves. So the commercial book year-to-date still has closely adverse whether a solid (28:07) quarter . Was there sort of any line that came in more favorable or unfavorable compared to what your expectations were?

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

Well, in any one of these quarters, there's an up and a down, right. And so, that is just as if we spent the time and disclosed how much got into the E&S work, you'd see mostly up and maybe one or two lines with small adjustments. The good news in Commercial Specialty this quarter is we had a couple of businesses that were favorable and the ones that had any adverse development had relatively very small amounts of adverse development.

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

Yeah. It's million of dollars up and down, it's not big numbers.

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

Yeah. There's no one big positive number carrying a large negative number.

Q - Christopher Martin {BIO 18924633 <GO>}

All right. Great. Thanks, guys. That's all I had.

Operator

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

Q - Adam Klauber {BIO 1494359 <GO>}

Thanks. Good morning, everyone.

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

Good morning.

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Q - Adam Klauber {BIO 1494359 <GO>}

E&S growth is very good to see. Could you give us maybe some color, how much is coming from business flow, just more business coming through the pipe? How much is coming from the economy, more construction, more lives, and how much is you just growing in different areas?

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

Well, for E&S, I think it's all 100% what's in the pipeline. Sorry, the growth is coming from what's already in the pipeline and I think I talked about on the last quarter's call or perhaps two quarters ago, we're doing a better job of taking advantage of what's coming through our pipeline today.

So we haven't been trying to expand the pipeline or expand product offering too much, but rather do a better job of servicing our clients' needs from submissions that are already coming in the door. And we've changed the way we get work done, which has helped a lot, and of course the technology investments that we've made have helped as well.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. So there's really not much change in the mix of the business or the type of the business products, would you say more property, more casualty, is it just more of the same?

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

Yeah. I would say that we've been more focused on writing the casualty opportunities that have come in the door than the property, because property is so competitive at the moment. There's probably a bit more property we could write if we wanted to, but we're not so inclined to chase the market down.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay.

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

Yeah. I mean, Adam, the reality is we've still got more business coming in the door than we can handle. So our challenge isn't to go find new customers. It's to make sure that we can service the ones we've got.

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. And then on Commercial Specialty, over the last couple of years you've done a great job of really managing the margin, including the profitability there. Over the long-term, does that have a potential to be a sub-90% combined somewhere to the E&S business?

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

Well, I guess the answer is it depends on the market. If you go back and look at our financial results in 2006 and 2007 and perhaps even 2005, Commercial Specialty ran in the 80%s and actually generated a better return on capital than E&S did. Was that a fleeting moment in time or was that a reflection of what it can do? Ask me in a couple of years. But I think right now we've got all the businesses, but one running the way we'd like and I think we've got a clear line of sight on getting Argo Insurance back to profitability by the end of next year...

Q - Adam Klauber {BIO 1494359 <GO>}

Okay. Okay. Thanks.

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

...on a standalone basis.

Q - Adam Klauber {BIO 1494359 <GO>}

And then also you mentioned that some pressure on the commission line in that. The ebbs and flows of the business when the market gets tough, that tends to happen. Is that also a function of particularly in the international markets voids that (32:21) the distribution is a bit more concentrated these days?

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

For sure. I think that the larger brokers here in London have a lot more leverage today than they did before. Having said that, the majority of our premium comes from kind of that next year down in (32:45) broker, but even they are exercising a bit of leverage right now on all of us in the marketplace.

Q - Adam Klauber {BIO 1494359 <GO>}

Sure. And again, when the market softens...

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

Yeah. A point of commission doesn't sound like a lot, but actually a point of commission is just another point of expense ratio.

Q - Adam Klauber {BIO 1494359 <GO>}

Yep. Yep. Okay. Well, thank you very much.

Operator

Our next question comes from Arash Soleimani from KBW. Please go ahead.

Q - Arash Soleimani {BIO 18869554 <GO>}

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Hi. Thanks. My congrats on the quarter. Just have a couple of questions. I guess could you talk a little bit about your expectations for the core loss ratio? Obviously, it looks good this quarter. I was wondering to get your thoughts on the loss ratio going forward excluding cat and favorable development, if you think that momentum can continue?

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

Yeah. Well, this wasn't like the first time that's happened. Our loss ratio ex-cat, ex-reserve developments been running in the mid-50%s for a while now. Jay, you can jump in and refresh our memories of how long that's been going on, but it's been quite a while. So I do see that continuing. It may move around a point or two, but I don't think we're going to see it move up and down 10 points.

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

And just the only other thing that I'd add to that, I might find the chart here in a minute. The only other thing that I'd add to it is there's nothing in the quarter that I find either up or down. To the extent we had a line of business where we thought we might have to increase that loss pick a bit and that's a $0.5 million or $1 million there, or maybe a large loss that might've been more than a large loss load. But nothing – I think it's been pretty consistent for a while. So I don't see anything that says that that – there's nothing fluke-ish about that number, I guess, is my point.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. Thanks. That's helpful. And I guess my other question on the ROE side, obviously the results look good on the combined ratio this quarter. Investment income look good. When can we start to see the ROE start to fill the gap between Argo's ROE and sort of the specialty peer group's ROE? When we can expect to see that narrow a bit?

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

Well, I think it narrows every quarter. So I would keep looking for next quarter and I think you'll see it narrow a bit more.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay.

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

Remember, what part of the message and I don't want to lose side of this, but part of the message at beginning of the year was we have changed part of the – and changed over a four-, five-year period, but added an element to the investment strategy that takes what used to be some income and runs it and now comes to recurring gains.

We think on an average year, that's probably going to contribute meaning average markets, average year $15 million, $20 million or so. So I would encourage you not to overlook that when you're thinking about the total return, the ROE.

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Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. That's fair. And I guess, finally, you guys talked a lot about the technology investments that you've made. And I know it's hard to quantify, but to what extent do you think that that's really fueling some of the growth that you've been seeing? Is that a major contributor?

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

Yeah. For the businesses where we've made that investment, I think it's allowed us to stay in the game and be very competitive. Had we not made those investments, I think our top line would look a lot different in the U.S.

Q - Arash Soleimani {BIO 18869554 <GO>}

Okay. Thank you and congrats on the quarter.

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

Thank you.

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

Thank you.

Operator

Our next question comes from Ken Billingsley from Compass Point. Please go ahead.

Q - Ken G. Billingsley {BIO 6971717 <GO>}

Good morning. I'd like to just kind of add on to the technology question. You talked a little bit about some potential expense savings and technology investments, and you'll give us some more color in the next quarter. Can you talk about maybe the cost and maybe where that's flowing through in the income statement and maybe how much that might be moving the needle little bit and how long you expect the cost to be in the model?

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

Well, the comment – I'll let Jay answer the second part. The point I was trying to make a minute ago is I think that we've done a good job of leveraging – well, building something we can now leverage and we're just beginning to.

We've changed our workflow. And as we – it's like a lot of things, right? The minute you change one thing, then you realize other things that you can change. And one of the things that we've realized over the last couple of months is, at the rate of change that we've got going right now with our ability to leverage technology not only what exists today, but what's coming next, and the way we do work, we think we can continue changing the way we do work and streamlining the way we do work.

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And we think that will – for the last couple of years, Ken, you've heard me talk about how we're building a platform that we think we can leverage and the expense savings or, I should say, the positive change in the expense ratio is likely to come from revenue growth as opposed to cutting expense.

And I think we've now discovered that actually there's some expense to be taken out. And I don't want to speculate on that right now so you can ask me that question again in three months. But I think there are some opportunity to pull some expense out over the next year that will move the needle as well that's complementary to some of the things we've already started.

Q - Ken G. Billingsley {BIO 6971717 <GO>}

And could you talk to me, has there been – I mean, can you talk about what you've spent that maybe outside of the normal recurring expense over the next two years or three years that may be able to come out that maybe is in these numbers? Is it 0.5 point, 1 point that you've spent on these initiatives, or is there some more that you need to spend that we just need to be aware of over the next 12 months, 24 months?

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

Yeah. So, like with all big capital projects, they're amortized over a period of time. And the expense load that's in the U.S. business for that in any one year is several million dollars. We haven't said exactly and I don't think I want to be any more specific than that.

Q - Ken G. Billingsley {BIO 6971717 <GO>}

Okay. And I would imagine just in the current market environment, you talked about there might be some players to actually pull some expense out. But it was – a lot of was supposed to come from growth. I guess it's kind of a struggle in this current market not for you but for everyone, given the competition, to really let the model work out properly with the leverage.

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

Sure. Yeah. And that's why I was trying to make the point a minute ago that I think that before I said, look, don't count on the expense ratio to come down until revenue goes up. And what I'm seeing now is that I think there's an opportunity to not only grow revenue but cut expense. So I think we'll have an expense ratio benefit or non-acquisition expense ratio benefit from both.

Q - Ken G. Billingsley {BIO 6971717 <GO>}

Okay. The other question I just had was on the comments that you made earlier. Sorry to bring you back to the beginning. But you talked about transportation and you reduced your exposure. There's been some commentary this quarter already about that certain lines of transportation, I know it's pretty broad, are looking like the fundamentals are starting to improve and maybe some rational pricing. Do you see that in your own book as a place to move back in because pricing is better, or do you see that you still need to reduce your exposure right now with the current mix of business you have?

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

Yeah. So we've seen the same thing. I don't – so there's nothing else for us to reduce. Will we expand our transportation book a little more? We might. I mean, we didn't cancel everything. We just canceled the things that we thought for sure don't make money over a market cycle. So the easiest one to talk about, of course, is long-haul trucking in the U.S. Even if rates go up there, I don't think you'll see us come back into that.

I think we'll spend the next six months to nine months just watching what's really going on in the transportation market. If there's a class of business that we really like that we think we can do more, then we absolutely will. We're not afraid of transportation. We just know there's certain parts that empirically don't make money.

Q - Ken G. Billingsley {BIO 6971717 <GO>}

Great. Well, thank you for taking my questions.

Operator

This will conclude our question-and-answer session. I would like to turn the conference back over to Mr. Watson for any closing remarks.

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

I'd like to thank everyone for joining the call today and also like to thank everyone for their patience. I think that we're now finally starting to see in the financial results a lot of the work that we've been doing for the last couple of years. We still have a lot more work to do and we look forward to talking to you at the end of the fourth quarter on how we're doing. And again, thank you for your time today.

Operator

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

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