NYSSA & Raymond James Insurance Industry Conference

Company Participants

- Jay Bullock, EVP & CFO
- Mark Watson, President & CEO

Other Participants

- Greg Peters, Analyst
- Unidentified Participant, Unknown

Presentation

Greg Peters {BIO 3111497 <GO>}

Okay, let's continue on with our schedule. Honor to welcome back Argo Group, presenting before the conference for yet another year.

Argo has been a loyal participant in this conference for almost as long as I have been involved. I think your first presentation before the conference may have been in 2001 or 2002.

We have some of the executives from the Company with us today. They include Mike Fusco, who serves as the Chief Actuary. He is sitting all the way over there in the corner. Certainly Susan Spivak, who serves as our Investor Relations person; Jay Bullock, the Chief Financial Officer; and Mark Watson, who is President and CEO.

As you go through the list of all the companies that are presenting -- that have presented and will present over the next day and a half and you will find that Argo's stock has been one of the best-performing issues for the companies that have presented in the prior year. The stock is up 50-some-% from March to March. So congratulations. At this point, we look forward to hearing you tell us why it's going to continue its march upwards.

Finally, I would like to say that we're going to change the format for this presentation a little bit. I've suggested to Mark that maybe he spend 10 or 15 minutes just giving us a brief overview of the Company. But since they've been here for so many years, I thought it might be useful for the members of the NYSSA to just engage in a Q&A with the management team of Argo Group. So with that, let me turn it over to Mark.

Mark Watson {BIO 1463509 <GO>}

Thanks, Greg. Good morning to everyone. I was happy to not have to wear my snowshoes today. I think this is the first time I've been in New York in the last two months where it wasn't -- well, I guess we did get delayed again last night. Any way.

It's good to see you all this morning. I recognize most of the faces in the room and what I thought I would do is just kind of run through a few of the slides in our deck and just kind of update everybody on who we are and what we're up to for a few minutes. Then, as Greg said, I will turn it over to Q&A.

Given that I'm sure that we may talk about the future a little bit. So if you all can just read the forward-looking statement slide, particularly those of you are listening on the Internet.

So where are we today? Our share price is not quite $54.29. We did a 10% stock dividend about a month ago and so right now we are trading at about $50 a share. But that takes into consideration the stock dividend.

Our market cap is about $1.4 billion. Our total capital is about $2 billion and, as you can see, we are pretty widely followed for a company of our size.

What are we? Well we're an underwriter first and kind of everything else second. We're an insurance company, not a reinsurance company. We do have a property cat reinsurance portfolio in Bermuda. But that and some of our other reinsurance underwritings make up about 10% of the total premium of the Company.

What I really want to talk about today is the other parts of the Company that have been the real strength of the Company for over a decade now in many cases. We have one of the largest excess and surplus lines underwriters in the US. We trade under the name of Colony.

I was going to say we have one of the larger Bermuda insurance operations in the US. But there are fewer and fewer of those as the consolidation on the island continues. And I'm sure you all will want to talk more about that later.

We are one of the larger syndicates at Lloyd's. We have a stand capacity of GBP350 million and that's an important part of our international strategy that I will talk about a little bit more. And we also have a couple of operations in the US that are retail focused, which are market leaders in their own areas of expertise.

But let me tell you a little bit more about what our definition of being a specialty underwriter is. It starts with saying we are not trying to be all things to all people. We try and focus on markets that we know; markets where we can make a difference. Markets where we can use our underwriting expertise, if not our knowledge of the marketplace, to generate a superior return for our shareholders.

And in the case where we have intimacy not just with our distribution partners, with our policyholders, really focusing on providing customer service, whether it's safety and loss control services on the front end to keep, hopefully, losses from happening or events from happening that lead to losses, or mitigating those through our claims organization once something has happened.

We try and focus on products and industries over the long haul, recognizing that not only is our industry cyclical. So is theirs. But we try not to get in and out of things. But stay committed to businesses we are pretty sure that over the long haul we can make money and help them run our business. And as you will see -- I'll get to a slide later on -- I think that not only do we have a pretty strong team but we have done a very good job of managing our capital base over the last 15 years or so.

This next slide -- and I'm going to spend most of my time on this one -- really talks about the evolution of our company since we recapitalized the Company and I started running it back at the end of 2002. What you'll see is a very different company today than back then. You will also see that over the last six or seven years the Company has been pretty similar, pretty well-balanced, internationally-diversified, specialty underwriter.

I talked earlier about our E&S operation. That's the blue piece on the bottom and you will note that the premium volume kind of ebbs and flows. It peaked in 2006 and it has now been heading back up for the last three years.

If you kind of look at market pricing for the E&S marketplace, you will see a similar trend line. What you should take away from that is: when the market is hard, we tend to write a lot of business. And when it's not, we tend to pull our horns back in a little bit and save our capital for another day.

The light blue, what we refer to as our commercial specialty business in the US, is all retail-based. It's all package policy-driven and it's focused on ensuring particular businesses in an industry, or I should say particular industries.

We have one of the largest insurers of mining operators in the US. I think we are now number two behind AIG and have been for a couple of years. We are also one of the larger insurers of small to medium-sized public entities in the US and we are one of the larger insurers of independent food merchants in the US.

Again, this is all kind of geared towards helping these businesses really manage -- managing their risk and create that intimacy with the policyholder, not just our distribution partners.

In 2007, we made a really big decision and again in 2008. In 2007, we acquired our Bermuda operation and started both a reinsurance and insurance operation in Bermuda. And a year later in 2008 we acquired our syndicate and that's the purple piece.

You'll notice that the premium went up and the premium came down. Well part of that is bought it halfway through 2008, or actually more than halfway. So you didn't have a full year in there. But then you'll see between 2009 and 2010 a pretty dramatic decline and that was again a recognition that the market was pretty competitive back then.

Actually, we didn't think we were getting paid for the risk we were putting on the balance sheet, particularly when you think about tail risk for cat-exposed business. And we had a lot more of it then than we do now.

So we cut the premium back in half. We moved some of the cap risk to the Bermuda company; that's the green piece. And you can see that since 2011 we started to grow. Actually started -- since 2010 we started to grow again in the Lloyd's platform.

Our Lloyd's syndicate is a pretty diversified portfolio. In addition to property cat insurance exposure, we also have marine, energy, aviation, construction, engineering. And professional liability risks. So a pretty broad composite of what comes into Lloyd's and I think a pretty good representation of the Lloyd's syndicate.

The other pieces that are in the green box, what we refer to as international specialty. So you have in here the Bermuda business. You also have our operation in Brazil that we started a couple of years ago and, to a lesser extent, some of our professional liability business that is underwritten directly in Continental Europe and in Dubai, where Argo Re, the Bermuda company, has a branch office.

As I said minute ago, if you kind of look where we are today, for the last few years I think we've had a pretty balanced portfolio for the Company. It's about 55% US, 45% outside the US, if you look at the bottom right-hand corner. And if you kind of go up and just look at the product diversity that we have, I think what you will see is a pretty balanced company.

We are still more dependent upon liability and professional liability risks as compared to property. It's about a 60%/40% split, property and then everything else being 60%. And again, just to make the point that we are mainly in the insurance business, not the reinsurance business.

Just a couple more data points for you. We have a pretty broad distribution platform, depending upon which business we are talking about. And it really goes from one end of the value chain to another. We have partnerships with independent agents, small brokers, regional brokers, regional wholesale brokers, national brokers, national wholesale brokers, international brokers, international wholesale brokers. It just depends on which part of the business that we are focused on.

I won't try and go down this list. So just think about it kind of generally. Our specialty commercial business is underwritten either through independent agents or small brokers. The excess and surplus lines business is primarily underwritten through wholesale brokers or some of the large retail brokers in the US.

Lloyd's is entirely wholesale-driven. The Bermuda business is large retail, as is Brazil. So it kind of moves all over the place depending upon which part of the world and which product we are offering.

If you look at our track record since 2002 in terms of growth in book value per share, we have been able to grow book value, including dividends, at over 10% a year on a compounded basis over the last 12 years. Tangible actually grew at a slightly faster rate and you will see that there have been times when we have been rewarded with a pretty high price-to-book multiple of 1.6 and 1.7 back in 2005 and 2006 when the market was really hard.

And 2012 was not one of my favorite years, when our peak that here was 60% of book. We are now trading at about 90% of book. But I think we still have a little ways to go.

Just to show you a couple more data points over this time period, we've grown gross written premium more than 3x. We've grown earned premium. So revenue, 3.5x, while only growing total assets 2.5x. And we've grown shareholders' equity 5x during that period of time.

You can see that in 2014 year over year that our E&S business continued to grow modestly at 5%. I just wanted to make a couple of points here.

Last year we pushed off some of our property risk and some of our transportation risk because the market was getting competitive. So if you look at our continuing business, it actually grew a bit faster and we were resetting some of our portfolios within commercial specialty. So you saw a modest decline there.

And with the competition at Lloyd's right now, we were kind of happy to just stay flat year over year, although I think we've got some better opportunities to grow this year even though the market remains competitive. And most of the growth in international specialty is coming from Brazil.

Rather than go through all these slides in a lot of detail I just want to kind of slip to the end here and just go through our investment strategy for a minute.

You will notice that about 69% of our invested assets are in fixed maturities and the remainder is either in cash or what we refer to as our capital appreciation portfolio or our cap portfolio. So that's mainly large-cap equities, as well as a number of hedge fund mandates that are mainly hedged credit strategies. But it has really performed very well for us over the last few years and helped us generate nice returns for our shareholders.

If you -- I mentioned a minute ago I thought we did a pretty good job of repatriating capital to our shareholders. Over the last five years we have repatriated $373 million to our shareholders, most of that through share repurchases. In fact, we bought back 27% of the outstanding shares of the Company over the last few years and we continue buying back our stock this year as well.

Our share price performance has improved over the last few years, as we talked about a minute ago. And this just shows you the difference between our growth in share price versus our peers in the S&P 500. But also, if you look at where we are trading relative to that group as a multiple of book, while we've certainly improved. So have they in terms of their share price and their share price multiple. And so while we narrowed the gap before, we are still narrowing that gap and so I think that provides the opportunity that we should spend a little bit of time talking about.

And so maybe I will just kind of leave it on this slide and stop and open it up to questions. We can talk about Argo or we can talk about the industry in general, if you all would like.

Questions And Answers

Q - Greg Peters {BIO 3111497 <GO>}

Okay, I'm going to kick it off with the first broad question for you.

Two things, first of all there has been a substantial decline over the last year in energy prices and I'm curious how that might affect some of your businesses. Then at the same time we've seen some currency fluctuations. So maybe you could talk about those two macro factors and how they've affected your business.

A - Mark Watson {BIO 1463509 <GO>}

Let's talk about energy first. For every energy company that we insure, there's probably 10 consumer companies that we insure that benefit from that.

If you -- energy is a broad category and if you kind of break it down into its subcomponent parts, you've got upstream so think oil and gas production -- we will come back to that in a minute -- midstream, pipelines, downstream, petrochemical facilities, petroleum -- excuse me, gasoline manufacturing, plastics. You've also got power stations and other utilities and, of course, we've got a big coal mining operation that I referred to earlier.

Ever since the Obama administration came in, that's been under attack. But we've actually still grown there so that's good. I don't see that changing, by the way, even though it may be modest as we've seen the last couple of years.

I think the real focus is what happens with not so much the diversified energy companies, of which we insure most of them through our company in Bermuda. But the more regional E&P companies. Whether they are still going to punch holes in the ground and how much CapEx they are going to really spend this year and, therefore, if the risk is coming down their balance sheet, are they going to buy less insurance? But that's a pretty small part.

Q - Greg Peters {BIO 3111497 <GO>}

Does that dovetail with your surety operations at all?

A - Mark Watson {BIO 1463509 <GO>}

Good question. It does. I think that our bigger challenge in our surety business, which by the way is growing, is not so much that there's less risk to insure. But rather there are more and more market entrants because it's been a pretty good place to be the last few years.

We've also grown our risk appetite a little bit and so I think that has offset some of the -- that will offset some of the decline in oil prices. But I see that as a pretty small part of our energy portfolio in general and the group as a whole.

Q - Greg Peters {BIO 3111497 <GO>}

Then FX?

A - Mark Watson {BIO 1463509 <GO>}

Remember for most -- I won't say this is true of every company. But I think most insurance companies like ours that have fairly diversified operations -- we pay claims in a number of different currencies around the world, probably about a dozen. And so the purest form of hedge that we've got is to invest, to the extent that we can, in those currencies where we intend to pay claims. And Jay can jump in here if you would like, Jay.

But we mainly pay claims in dollars, euros. And British pounds. So guess what? Most of our invested assets are in dollars, euros. And British pounds.

And so the first thing that we try and focus on is making sure that we've got enough money to pay claims and so the best way to do that is to stay invested in those currencies. With all the currency fluctuation going on right now and given the fact that we report in dollars, are there things that we can do to reduce some of that FX volatility? The answer is yes.

And so if we're pretty sure that we think we're going to see one currency move one way or the other, then we may buy futures or other derivatives to hedge that or we may move on the margin how we invest.

As an example, now if we all still think -- it's just hypothetical. But if we all still think that the dollar is going to strengthen then we may decide that for some of our European companies that perhaps some more of their investment assets -- more of their investment portfolio should be in dollar-denominated assets. So we could do that instead of trying to put on hedges. I'm not saying we have done that. But we could do that.

So I think there's a fair amount of flexibility in how insurance companies can manage FX. Do you want to anything, Jay?

A - Jay Bullock {BIO 3644311 <GO>}

No. That covers it pretty thoroughly.

Q - Unidentified Participant

Mark, just picking up on Greg's question, I was wondering if you could elaborate a little bit more on where you are headed strategically in the surety business in the partnership with SureTec. And also tactically is that not likely to continue to be a good place to be as the underwriting cycle maybe backs off a little and the economic cycle improves?

A - Mark Watson {BIO 1463509 <GO>}

Yes. So we think the surety business is a wonderful place to be. We have exposure to surety in two forms: large commercial risks we run through our own account and, as you just pointed out, we have a partnership and own part of a company called SureTec, which is privately held. And they tend to focus more on contract and performance bonds, which is not something that we do so we're happy to be a shareholder and a partner with them.

More and more of the expertise that we build here in the US we're trying to export and follow our clients to other parts of the world. Believe it or not, our US clients are still doing business in Brazil so we are trying to do more down there with them. And of course, they do a fair amount in the EU as well so --. And that's kind of a theme throughout our company is being able to export the expertise we have in one part of the group to another part of the group.

I think as you see us evolve over this year and, to a lesser extent, next year, I think you'll see us hiring a number of people that have more expertise so that we can transport our domain expertise and particular products from one part of the world to another. Energy being one example -- surety and energy being one example. Professional liability being another, perhaps even bigger, example.

And there are plenty of people that -- as you can imagine with all the merger mania going on right now, my phone has been ringing off the hook. People sending resumes. Sorry, to be clear. I saw Tony DeFrancesco get kind of excited there for a minute.

Q - Unidentified Participant

You mentioned that hedge funds was at least a somewhat important part of your investment strategy and I just want to go into that. Do you use hedge funds as a means of hedging your currency exposure, as a means of perhaps reinsuring or selling insurance-related derivatives or buying insurance-related derivatives? Or when you invest in hedge funds is it in areas totally outside of insurance?

A - Mark Watson {BIO 1463509 <GO>}

Most of the investments we have in hedge funds are -- if they are in insurance, it is coincidental. They have got particular credit strategies that they are putting in place that we think are not correlated with everything else in our investment portfolio, or in our underwriting portfolio for that matter.

And I didn't mean to suggest they were an important part. Actually I think that makes up now almost 5% of our investment portfolio. But it's not related to the hedging that we do in FX.

Q - Unidentified Participant

As it relates to capital allocation, you repurchased 4% of shares in 2014. Just you are trading below book value and it seemed like you kind of expect that to improve. Just curious on why you didn't repurchase more shares as it seems like it might be a good opportunity as you think so.

A - Mark Watson {BIO 1463509 <GO>}

So the smart aleck answer would be float. But that's also the real answer. We bought back pretty much what we could last year with the average daily trading volume that we were faced with a year ago.

We haven't announced how much we bought since we reported earnings. I can tell you that we have the same approach this year as a year ago. And I think right now, you're right; with our share price still trading below book, it's very attractive. And at the last Board meeting we were debating how much capital we ought to set aside to --.

First of all, it's how much do we want to repatriate? And so, first, we run through the math of, okay, do we have enough capital to support the risk on the balance sheet, asset side and liability side? Then the second, okay, we know we've got some pretty easy growth opportunities. Do we have enough capital to support those? Yes.

Okay. Leave aside M&A for a minute and say, okay, that's in the same pot with do we have access capital -- maybe -- to repatriate? And if so, are we going to do it through dividends or are we going to do it through share repurchases?

I mentioned in the beginning of my remarks this morning that -- well, I said one thing and I should've said two. We not only did a stock dividend. But we also increased the dividend again this year. So we are always balancing both of those.

I think -- don't hold me to this. But I believe that in the last seven years, with all the dividend increases, we have now pretty much doubled the dividend over that period of time. It's somewhere around there. So just that's a notional comment everybody. I think we tried to do both and I think we will continue to do that.

We are still growing the Company. But because we are able to use other forms of capital, mainly the ILS marketplace, we don't need as much equity capital today as we did six or seven years ago. Just as an example, if you think of reinsurance as another form of capital, which it is, the majority of the reinsurance that we buy today we buy from the ILS marketplace, whether it's the sidecar that we have that supports our property cat portfolio or the cat bonds that we issue that support the property cat portfolio or just the one-off transactions that we do with some of the ILS underwriters.

That, in the aggregate, is what supports the property cat exposure to our company. Not that much of it comes from the traditional reinsurance marketplace and it allows us to free up some of our own capital as well by using that instead of our own equity capital.

Q - Unidentified Participant

Could you provide some additional color on the pricing environment in the beginning of 2015 as it relates to -- I believe you guys are still targeting a 95% combined ratio? And also where are you seeing the most attractive opportunities to deploy capital besides I believe you already mentioned surety?

A - Mark Watson {BIO 1463509 <GO>}

So the pricing environment so far in 2015 is about where we thought it would be. We have grown places where we think we have pretty good margin and let business go where we don't think we have good margin. I mentioned earlier, just as a couple of examples of things going away, was some of the property insurance in the US and some of the transportation risk.

So when you replace that with our ongoing business that we think is priced pretty adequately, it allows us to kind of keep our same return expectations because we are doing a portfolio change. So we may not grow at quite the same rate as we might otherwise. But I would rather keep generating mid-50%s loss ratios than keep growing the top line. And that's really our main focus.

I think there's plenty of opportunity this year, because of some of the investments we made a year ago, to keep moving ahead in the market this year, even though it's going to be a bit more competitive. As for other opportunities besides surety that I talked about earlier, more and more we continue to reinvest and reinvest in the small account business.

The barrier to entry keeps getting higher because you've got to have more and more investment in technology and be able to process the business more and more efficiently than even a couple of years ago. And if you look at the loss ratio, it's great; you just have to be able to access it. And so that's really where we are putting a lot of our energy or we're putting it into hiring more talent in some of our more global specialty businesses underwritten in Bermuda and London.

Q - Greg Peters {BIO 3111497 <GO>}

Let's follow up with -- you mentioned M&A. Certainly Bermuda, as you know, has been under assault from competitive pricing issues and then certainly there's been a recent pick up in M&A there. Can you talk about your perspective on the property market, property reinsurance. And what's going on in Bermuda? And what or how you see Argo's long-term positioning in that market to be?

A - Mark Watson {BIO 1463509 <GO>}

You have now seen. So I'm speaking in the past tense, a secular change in the property cat marketplace. With new sources of capital coming in. So think pension funds and/or endowment funds or what we now refer to as the ILS marketplace, that really is a substantial portion of reinsurance capacity.

And I will argue that I don't care how big the event is, it really is permanent at this point. The returns that these guys have made relative to other returns in other parts of their investment portfolio have been pretty good. I don't see that changing.

So what that has meant is that if you were a traditional reinsurance company, you've got less customers or you've got maybe the same number of customers buying less reinsurance from you because they are buying it from your competitor. And so that has led to some of the activity going on in the marketplace.

As respects our portfolio in particular, it has kind of stayed about the same size. The margin is compressed a little bit. But we still think that the margin is better than it is writing property cat insurance particularly, well, pick anywhere in the world and then having to buy reinsurance to support it.

If rates drop -- and, again, I'm going to speak notionally, not precisely. But imagine rates drop another 10% to 20%; that's a big range, right? Then I'm not sure what we will be doing as a seller of reinsurance. But my guess is we will be a much bigger buyer of property cat reinsurance around the world.

Q - Greg Peters {BIO 3111497 <GO>}

What about the consolidation aspect of what's going on in Bermuda? How do you fit that?

A - Mark Watson {BIO 1463509 <GO>}

Well I like buying from people bigger than us. So that's good. Most of the consolidation has been focused on reinsurance. And if you look at what has happened. And I think I have said this every time I've stood on this podium, there's always a reason for these transactions other than investment bankers trying to cook up a deal.

You've got to have a motivated party and the party may be motivated because one plus one equals more than two, a shareholder wants their money back, a Board loses confidence in the management team, or there's a secular change in the industry and you've got to readjust. If you look at what has happened in our industry over the last 18 months, I think you can tick every box that I just mentioned with one deal or another. I think that will continue.

We have always had M&A in our industry; it just kind of comes in waves. For us, it's a real net benefit because we've got really good people looking for places -- and we are hiring. As I said a second ago, we like having our reinsurers bigger than we are and so I'm kind of happy.

Q - Greg Peters {BIO 3111497 <GO>}

Then we are running out of time. So we will close out with just a question. If we look at your operating performance, underwriting performance particularly, the loss ratio seems to be performing very much in line with the industry, if not better than the industry. Then -- but the expense ratio, there's been a challenge there and I know you have been talking about this for some time now. Can you provide us an update on your thinking on that side?

A - Mark Watson {BIO 1463509 <GO>}

So three years ago when pricing was better and we thought pricing was going to improve, we would've thought we would've had several hundred million dollars more of premium on the books today than we do. But we have decided that pricing isn't quite right to keep adding too much more risk and so we haven't really fully utilized the platform that we've been investing in over the last few years. We're going to get there; it's just going to take a little bit longer.

But look, our combined ratio has come down steadily over the last three, well, four years now and so I think -- our return on equity last year was 12%, 11%, 12%?

A - Jay Bullock {BIO 3644311 <GO>}

11.4%

A - Mark Watson {BIO 1463509 <GO>}

11.4% and it was 8-something or 9-something the year before. So I think we're moving in the right direction.

Q - Greg Peters {BIO 3111497 <GO>}

Okay. Great. We're out of time but thank you very much for participating again this year.

A - Mark Watson {BIO 1463509 <GO>}

Thank you.