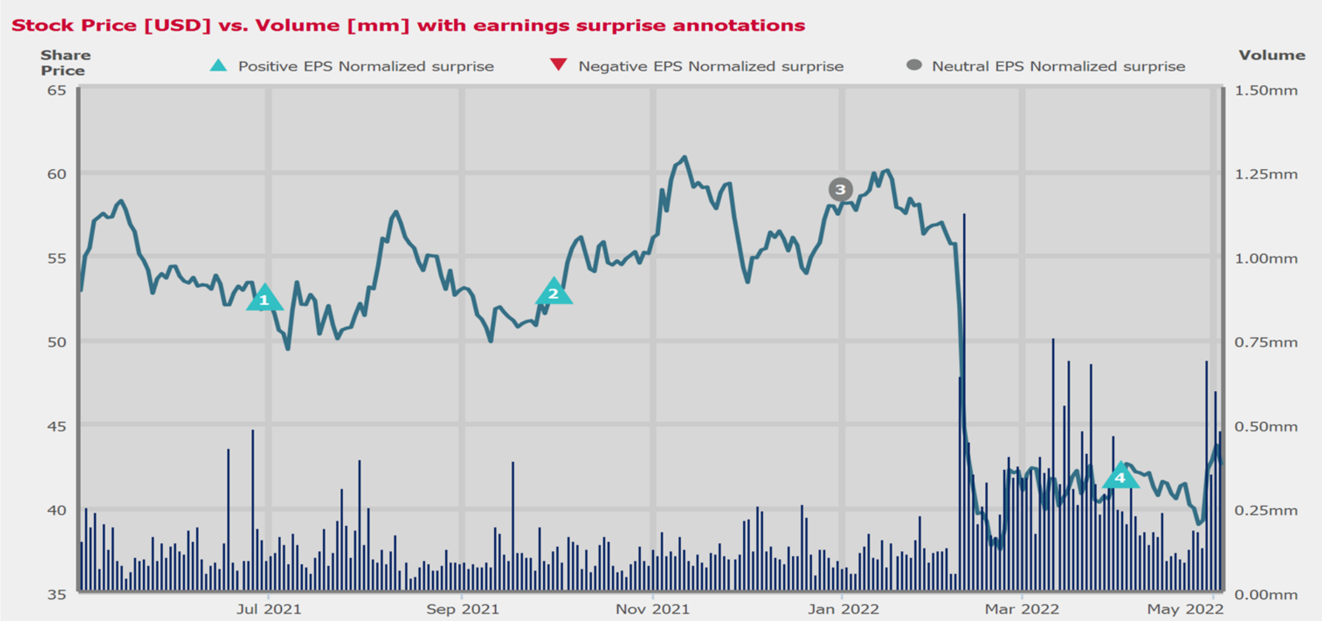
S&P Global
Market Intelligence

Argo Group International Holdings, Ltd. NYSE:ARGO
FQ1 2022 Earnings Call Transcripts
Tuesday, May 03, 2022 2:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.10	1.24	▲12.73	1.23	4.54	NA
Revenue (mm)	531.62	483.80	▼(9.00 %)	519.00	2055.80	NA

Currency: USD
Consensus as of May-03-2022 7:51 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	0.91	1.60	▲75.82 %
FQ3 2021	0.11	0.91	▲727.27 %
FQ4 2021	(2.02)	(1.77)	NM
FQ1 2022	1.10	1.24	▲12.73 %

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Call Participants

EXECUTIVES

Gregory Charpentier
AVP of Investor Relations & Corporate Finance

Scott Kirk
CFO & Principal Accounting Officer

Thomas A. Bradley
Chairman of the Board & Acting CEO

ANALYSTS

John Thomas Heagney
Dowling & Partners Securities, LLC

Matthew John Carletti
JMP Securities LLC, Research Division

Sidney Schultz;Raymond James

Presentation

Operator

Good morning. Thank you for attending today's Argo Group First Quarter 2022 Earnings Conference Call. My name is Amber, and I will be your moderator for today's call. [Operator Instructions]

I now have the pleasure of handing the conference over to our host, Gregory Charpentier with Argo. Greg, please proceed.

Gregory Charpentier
AVP of Investor Relations & Corporate Finance

Thanks, and Good morning. Welcome to Argo Group's conference call for the first quarter ended March 31, 2022. After the market closed last night, we issued a press release on our earnings, which is available on the Investors section of our website at www.argogroup.com and was filed with the SEC. Presenting on today's call is Tom Bradley, Argo Group Executive Chairman and Interim Chief Executive Officer; and Scott Kirk, Chief Financial Officer. As the operator mentioned, this call is being recorded.

During this conference call, Argo management may make comments that reflect Argo's 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. Also note that we will be referencing certain non-GAAP financial information. More information regarding these non-GAAP financial measures is provided in our earnings release.

I will now turn the call over to Tom Bradley, Argo Group Executive Chairman and Interim Chief Executive Officer.

Thomas A. Bradley
Chairman of the Board & Acting CEO

Thank you, Greg, and thank you to everybody for joining us today. Before I jump into our results for the quarter, I'd like to take a moment to discuss our announcement last week. Over the last year, Argo has instituted a number of substantive strategic initiatives, actions that we believe have positioned the company for a clear and consistent long-term path to stable growth and profitability. The Board of Directors and management team, however, do not believe these initiatives are adequately reflected in the company's current market valuation.

After much thoughtful and deliberate discussion and analysis, our Board with the assistance of our advisers has initiated an exploration of potential strategic alternatives. In this review process, our objective is simple: to maximize the value of the company's strategy and its considerable long-term prospects for the benefit of all shareholders. To that end, the Board will consider a wide range of options for the company, including, among other things, a potential sale, merger or other strategic transaction.

As is typical in these situations, there can be no assurance that this process will result in the company pursuing a particular transaction or other strategic outcome. The company has not set a timetable for completion of this process and it does not intend to disclose further developments unless and until it determines that further disclosure is appropriate or necessary. As Kevin remains on leave, I will lead the efforts with the Board to evaluate the range of potential strategic alternatives.

It's a privilege to serve as interim CEO and lead this company forward. We continue to wish Kevin a full and speedy recovery, and I'm grateful to all our Argo associates for their hard work and dedication while he has been on leave. It's an honor to work with such a dynamic leadership team and impressive employee base. You need to look no further than our results for this quarter to see their continued focus on implementing our strategy.

Now turning to the quarter. I'm happy to speak today about the strong results we reported last night. Our first quarter 2022 performance provided a solid start to the year and is representative of the continued execution of our strategic priorities of improving underwriting margins, reducing volatility and managing expenses. Our operating earnings per share was $1.24

for the quarter, reflecting strong contributions from both our U.S. and international operations and a significant reduction in catastrophe losses. Argo's annualized operating return on common equity was 11.4% and a combined ratio of 95% was driven by improvements in both the loss and expense ratio. This is directly attributable to the strategic initiatives we have implemented at Argo and positions us well in achieving our 2022 financial objectives.

Over the past year, we have highlighted our strategy to reduce the volatility of our underwriting results and allocate capital to businesses with more stable returns. Total cat losses of $8.7 million for the quarter decreased $38.8 million from the first quarter of 2021. Our efforts to reduce property cat exposure has resulted in improvements in year-over-year cat losses for 4 straight quarters. While we do have some exposure to the ongoing conflict in Ukraine, given the information available today, we do not view our net loss exposure to be significant and believe this contained in our expected loss ratios for the quarter. We will continue to monitor the situation closely and our thoughts are those with those who have been affected by the work.

We continue to explore all options to maximize shareholder value and take advantage of opportunities in the market. Consistent with that objective, we are entering into a loss portfolio transfer transaction for a vast majority of Syndicate 1200's reserves for the 2018 and 2019 years of account. This provides us with protection against reserve volatility for these years as an effective way to manage capital and begin to finalize these years of account. We do not anticipate a charge coming through the income statement as a result of this transaction.

Now turning to expenses. We continue to make progress towards simplifying our operations and driving forward our expense reduction efforts. This was evident in our first quarter results as our expense ratio of 36% improved nearly 2 points from the prior year first quarter. Importantly, we are seeing a reduction in general and administration spend as benefits from our strategic efforts to create a simpler and leaner Argo continue to materialize. Our expense reduction efforts are not complete and there are several areas that we are focusing on to drive additional expense savings throughout the year.

Given our strong first quarter results and continued expense reduction efforts, we remain confident in our ability to reach out 36% expense ratio target for full year 2022. We continue to execute on our priority of becoming a leading U.S.-focused specialty insurer as we completed the sale of Argo Seguros Brasil. We were in the [ninth inning] of that journey and remain confident in what comprises our ongoing business today. In our view, we are well positioned to continue to generate favorable underlying margins as benefits from our strategic initiatives take hold and market conditions remain attractive across most of our platform.

We continuously review lines of business and respond to environmental changes in the marketplace. We have shown the ability to proactively remediate or take underwriting actions in lines we view less favorably. In terms of underlying growth, our top line in the quarter continued to reflect strategic growth in the businesses that we want to grow. Consistent with the financial objectives we set forth for this year, net earned premium growth in our ongoing businesses was 28.8%.

We continue to feel good about the rates we're seeing and the direction of our markets. Rates increased in the mid-single digit range on average across the portfolio. And importantly, the rate we are achieving continues to trend at or above loss cost inflation expectations. Overall, I am very pleased with our results for the quarter and the progress we've been able to make on our strategic objectives.

I'll now turn the call over to Scott to discuss the results in more detail.

Scott Kirk
CFO & Principal Accounting Officer

Yes. Thank you, Tom, and Good morning, everyone. Our operating income was strong for the first quarter of 2022 at $43.4 million, driven by improved underwriting results and lower expenses. Operating earnings per diluted share of $1.24 increased from $0.44 in the prior year first quarter, while our annualized operating return on common equity of 11.4% improved from 3.7% a year ago. Now we did, however, report a small net loss for the first quarter of 2022 of $3.6 million.

Now the difference between our reported net loss for the quarter and our operating income is primarily attributable to the reclassification of historical foreign exchange losses associated with the Argo Seguros Brazil sale. This reclassification did not impact shareholders' equity as it was a transfer out of accumulated other comprehensive income into realized losses in the income statement in the first quarter.

Turning now to our consolidated operating results. Reported gross written premiums decreased by 4.7% in the first quarter of 2022. However, in our ongoing business, gross written premiums increased approximately 6.9% compared with the prior year first quarter. And we remain focused on profitable growth and remain disciplined in our underwriting approach. Gross written premium has continued to grow strongly in our International segment, driven by both double-digit rate improvement and our increased participation in Syndicate 1200.

While reported gross written premiums decreased, net written and net earned premium grew at 4.6% and 3.1% respectively. Our retention ratio calculated as net written premium divided by gross written premium increased 5.4 percentage points to 61%. And it's worth noting that after adjusting for the fronting business that we write in the U.S., our retention ratio increased 6.4 percentage points to 65% in the quarter. As we discussed previously, this reflects business mix shifts towards higher premium retention lines.

In the first quarter of 2022, we reported a loss ratio of 59%, an improvement of 7 percentage points from the 66% we reported in the prior year period. The main driver of the improvement in the loss ratio is reduced cat losses. Our cat losses totaled $8.7 million or just under 2 percentage points of the combined ratio in the first quarter of 2022. This result compares favorably to catastrophe losses of $47.5 million or just over 10 points of the combined ratio in the prior year first quarter.

As Tom mentioned, the successful implementation of our strategy to reduce property cat-related exposures, combined with a lighter cat quarter in Q1 2022, has resulted in a large reduction in our cat losses. Reserve development totaled $3.4 million in the first quarter of 2022, with modest adverse prior year reserve development in both the U.S. operations and runoff lines, partially offset by favorable development in international operations. The prior year quarter included $1 million of adverse reserve development. This quarter included $5 million of unfavorable reserve development in our U.S. operations. It is important to note that this is unrelated to the adverse development we saw last quarter and has resulted from a small number of large losses in businesses that we have exited.

The favorable development in our international business is primarily attributable to favorable outcomes on cat losses from prior years. The current accident year ex-cat loss ratio of 56.5% in the first quarter of 2022 is up marginally over the 55.6% we reported in the first quarter of last year. The current accident year ex-cat loss ratio was higher in our U.S. operations and partially offset by improvement in our international business. It's worth noting that this quarter's current accident year ex-cat loss ratio is in line with the full year of 2021. And I'll provide some additional color on the segment loss ratios a little later.

Turning now to expenses. Our expense ratio was 36% in the first quarter of 2022, a 1.8 percentage point improvement compared to the prior year first quarter. Our G&A expense ratio improved 2 points versus the first quarter of 2021, while our acquisition ratio increased slightly. As we said throughout 2021, the expense ratio was firstly going to benefit from an increase in net earned premiums and as we took actions to reduce expenses at the back end of 2020 and throughout 2021, expense dollars would also decrease. And that is showing through in the results this quarter with general and administrative expenses down from $97.2 million in the first quarter of 2021 to $90.3 million this quarter.

Now let me talk about our segment results. Our U.S. operations underwriting income of $22.5 million for the first quarter of 2022 increased $11.2 million from the prior year first quarter, while a combined ratio of 93.3%, improved 3.1 percentage points from a year ago. Gross written premium in our U.S. ongoing business increased approximately 5.1% in the first quarter of 2022. Net written premiums and net earned premiums in the U.S. ongoing business increased 12.8% and 18.6% respectively versus the prior year quarter.

The loss ratio decreased 90 basis points to 61.3%, primarily driven by lower cat losses. The current accident year ex-cat loss ratio was 58.6%, an increase from the 55.7% current active year ex-cat loss ratio we reported in Q1 2021. The difference is attributable to the first quarter of 2021, which included frequency benefits from the economic slowdown that we are experiencing from the COVID-19 pandemic. The current accident year ex-cat loss ratio in Q1 2022 is in line with the full year 2021.

The expense ratio of 32% decreased 2.2 percentage points from the prior year first quarter and was driven by a 3.3 percentage point improvement in the G&A expense ratio. The reduction in the G&A expense ratio was driven by a $7 million decrease in general and administrative expenses, coupled with a 7% increase in net earned premium in the first quarter of 2022. Now this improvement was partially offset by a 1.1 percentage point increase in the acquisition ratio due to changes in business mix.

Turning now to our international segment. And building on the results from Q4 last year, we were again seeing a strong contribution to profitability this quarter. Our international operations reported underwriting income of $13.3 million in the first quarter of 2022 compared to an underwriting loss of $21.8 million in the prior year first quarter. The combined ratio improved 23.6 points to 90.8% in the current year first quarter. This improvement was primarily driven by reduced cat losses, a reduction in the current accident year ex-cat loss ratio, as well as strong improvement in the expense ratio.

Gross written premiums in the International segment ongoing business increased approximately 11% due to a combination of increased participation in Syndicate 1200 and higher rates, which increased on average 10% in the quarter. Net written premium and net earned premium in the International segment ongoing business increased 16.5% and 27.1% respectively versus the prior year quarter. The current accident year ex-cat loss ratio improved 3.9 points to 51.5% from the prior year first quarter. The improvement compared to the prior year is due to a combination of underwriting actions we've undertaken and achieved rate increases earning through the results.

Catastrophe losses of $4.7 million during the first quarter of 2022 or 3.3 percentage points on the combined ratio compared favorably to cat losses of $26.6 million or 17.6 percentage points on the combined ratio in the prior year first quarter. The first quarter of 2021 was impacted by cat losses mainly from winter storm Uri and also included $4.4 million of losses related to the COVID-19 pandemic. We did not see any change in our COVID-related losses during the current quarter.

Catastrophe losses in the current year quarter included our current view of potential exposures in Ukraine. As Tom mentioned, based on the information we have today, we do not view our net loss exposure to the Ukraine to be significant. The expense ratio of 38.1% decreased 3.3 percentage points from the prior year quarter, driven by changes in business mix, aimed at exiting business with higher acquisition costs, which have benefited the acquisition ratio, an improvement in the G&A expense ratio reflecting a lower level of general and administrative spend.

Turning now to investments. We generated net investment income of $37.7 million in the first quarter of 2022. The decrease is due to a reduction in investment income of $6.7 million from alternative investments. Now while returns from our alternative investments have continued to be strong in the quarter, they can be difficult to predict and returns may be more challenged over the next few quarters given the recent volatility in the markets.

Favorably, however, we are encouraged by the increased contribution from our bond portfolio. Investment income in our investment-grade fixed income portfolio grew 9% compared to the first quarter of 2021 and we expect this trend to continue throughout 2022. We have seen a recovery in reinvestment rates that has continued into the current quarter for context. Our reinvestment yields were hovering around 1.75% at the end of 2021 and are now closer to 3.75% today. We continue to hold a relatively short average duration portfolio of 2.9 years.

Earlier, I talked about the difference between net income and operating income and you will also notice that our income tax expense was elevated this quarter, resulting in an effective tax rate of 109.7%. Now the increase in the effective tax rate for the current quarter results primarily from the tax treatment of the foreign exchange losses associated with the sale of Argo Seguros Brazil. I would also like to point out that our assumed tax rate used to calculate operating income increased to 19% from 15% we've used previously. Now this increase reflects our view of the distribution of profits across the company and the jurisdictions we believe these profits will be generated from.

And finally, let me talk about capital. The reduction in shareholders' equity during the first quarter of 2022 is largely attributable to $143.6 million of unrealized investment losses, net of tax in our fixed income portfolio due to the increases in interest rates. Book value per share was $41.97 as of March 31, 2022, down from $45.62 at the end of 2021. A book value per share when excluding accumulated other comprehensive income was $45.84 as of March 31, 2022, a decrease of just under 1% from $46.27 at year-end.

We continue to engage in regular communication and maintain strong relationships with our rating agencies and regulators. Most recently, A.M. Best reaffirmed our A- excellent Financial Strength Rating. We remain committed to our rating agencies and regulators in maintaining strong capital positions. Now before I turn the call back over to Tom, I wanted to offer a warm welcome to Andrew Hersom, our new Head of Investor Relations, who recently joined us and previously held IR roles of People's United Bank and Travelers.

And with that, I will now turn the call back over to Tom for some concluding remarks.

Thomas A. Bradley
Chairman of the Board & Acting CEO

Thank you, Scott. I'm really pleased with the strong start to the year. We are making solid progress in achieving our strategic goals. This is evident in the first quarter results and positions Argo well for the future. The Board, the leadership team and employees across the company remain fully committed to delivering strong results and building shareholder value. Looking forward, we are pleased with the opportunities for growth across our ongoing businesses and remain confident in achieving our 2022 financial objectives.
With that, Amber, that concludes our prepared remarks, and we're ready to take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Greg Peters with Raymond James.

Sidney Schultz;Raymond James

This is actually Sid Schultz calling in for Greg. First, I'm hoping to start with the expense ratio, just given where it came in for the first quarter and maintaining the 36% target for the year. Is there any seasonality we should consider just when looking through the balance of the year?

Scott Kirk
CFO & Principal Accounting Officer

Yes. Hi, Sid. It's Scott Kirk here. Thanks for the question. Look, nothing springs to mind, Sid, in terms of the expense ratio. Obviously, we've been working hard on that expense ratio over the last year and a bit. We've certainly taken action there. I think as we look forward, Tom said in his earlier remarks that we will continue to focus on additional opportunities, on expenses and we're going to work hard at those through this year. So, look, I think we remain committed, obviously, to the 36% target that we've set ourselves in last year to get to it this year. So, we feel good about that.

Thomas A. Bradley
Chairman of the Board & Acting CEO

Yes. And Sid, I'll add, you'll note in the remarks, Scott mentioned that year-over-year G&A expense is actually down in real dollars. So, combine that with earned premium growth, which we think will continue, and we think we're on a good path there with expenses.

Sidney Schultz;Raymond James

Okay. Yes, great. Makes sense. And then just transitioning maybe to retention. We've heard some recent comments that carriers are seeing elevated turnover with underwriters. I'm just curious maybe if you guys could comment on what you're seeing?

Thomas A. Bradley
Chairman of the Board & Acting CEO

Yes. I'd say we've seen routine turnover. It's kind of common in the post bonus season, but I wouldn't attribute anything unusual or extraordinary to what we've seen over the past 3 or 4 months.

Operator

There are currently no further questions at this time. [Operator Instructions] Our next question comes from Matt Carletti with JPMorgan (sic) [JMP Securities].

Matthew John Carletti
JMP Securities LLC, Research Division

It's Bank Holiday at JMP. A couple of really numbers questions. I mean one is -- and, Tom, I apologize, I was a minute late getting through the queue to get on, so maybe you commented on it, but the LPT transaction, can we just give a little more color there and in particular, what we should expect in terms of the impacts that show up from a modeling perspective going forward?

Thomas A. Bradley
Chairman of the Board & Acting CEO

Yes. I mean, it is a traditional LPT of those 2 years of account '18 and '19, that includes the vast majority of those reserves not really going to -- it's not going to be an income statement charge to do so. And it positions us to RITC those 2 years of account at the end of the year. So Scott, I don't know if you want to talk -- comment on the capital impact.

Scott Kirk

CFO & Principal Accounting Officer

Yes, Matt. Look, it's -- I mean, obviously, as Tom said, we're not really expecting any sort of significant income statement impact upfront. But obviously, there is a bit of an investment income drag that comes along with that, but look, not terribly significant at this point. So, I think this transaction will work well for us.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. Then the other one was I saw nonoperating expenses were up a little bit in the quarter. I think in the commentary, you referenced elevated advisory fees. With the announcement from a couple of weeks ago of kind of strategic review, should we expect that to remain elevated for a while as you go through that process? Or was it something more kind of directly related to something else that flowed through that line in the quarter?

Thomas A. Bradley
Chairman of the Board & Acting CEO

No, I think you're right, Matt. Look, I mean, they are not operating, they are a little difficult to predict on a quarter by quarter, but I think given the situation that they're certainly not going away at this point.

Operator

Our next question comes from John Heagney with Dowling and Partners.

John Thomas Heagney
Dowling & Partners Securities, LLC

I actually had a question on the LPT too, Matt kind of hit on it, but if I just think of it, so it's a traditional LPT, is there an ADC on top of that? And then how does that actually work with the reinsurance that closed? Maybe you're going to actually close those years out back in the Syndicate 1200? Can you just kind of walk through the case a little bit better?

Scott Kirk
CFO & Principal Accounting Officer

Hi, John, it's Scott here. traditional LPT, no ADC on top. Basically, what this does is just it allows us to roll this back into an RITC at the end of this year, which will give us the option to roll 2020 and if we saw fit and if the economics worked for us.

Thomas A. Bradley
Chairman of the Board & Acting CEO

And the expectation would be a third-party ROTC, not rolled back into 1200.

John Thomas Heagney
Dowling & Partners Securities, LLC

Got it. So then it would be transferring all of the 2020 accident year, I would assume 2020, '19, '18 all out to a third-party syndicate in a reinsurance to close transaction and just basically wipe those years off the books at the end of this one?

Thomas A. Bradley
Chairman of the Board & Acting CEO

Yes, John. So just for now, it is '18 and '19 with a potential for '20, but that's right.

Operator

There are currently no further questions in queue. So I'll pass the conference back over to Tom Bradley for any closing remarks.

Thomas A. Bradley
Chairman of the Board & Acting CEO

Thank you, Amber, and thank you to everybody on the call today for your interest in Argo and particular thank you to our shareholders for your support. We're here working for you. Everybody, have a good day.

Operator

That concludes today's Argo Group first quarter 2022 earnings call. Thank you for your participation. You may now disconnect your lines.