S&P Global
Market Intelligence

Argo Group International Holdings, Ltd. NYSE:ARGO

FQ4 2018 Earnings Call Transcripts

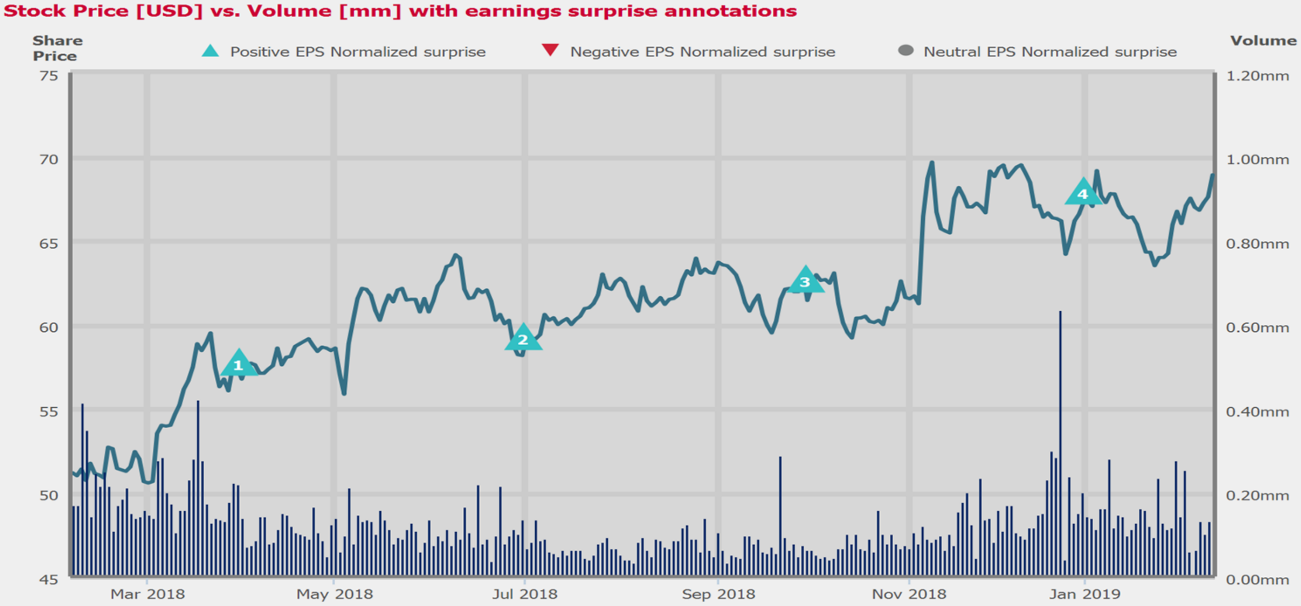
Tuesday, February 12, 2019 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	0.13	0.55	▲323.08	0.99	2.72	3.22	
Revenue (mm)	458.20	402.60	▲(12.13 %)	544.80	1857.42	1801.80	

Currency: USD
Consensus as of Feb-12-2019 12:31 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	0.82	1.05	▲28.05 %
FQ2 2018	0.89	0.95	▲6.74 %
FQ3 2018	0.62	0.68	▲9.68 %
FQ4 2018	0.13	0.55	▲323.08 %

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Call Participants

EXECUTIVES

Jay Stanley Bullock
Executive VP & CFO

Mark Edmund Watson
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Chief Investment Officer & Senior VP

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Presentation

Operator

Good day, and welcome to the Argo Group 2018 Fourth Quarter Earnings Conference call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Susan Spivak with Investor Relations. Please go ahead.

Susan P. Spivak Bernstein
Senior Vice President, Investor Relations

Thank you and good morning. Welcome to Argo Group's Conference Call for the fourth quarter, and calendar 2018. Last night, we issued a press release on earnings which is available in the Investors section of our website at www.argolimited.com. Presenting on the call today is Mark Watson, Chief Executive Officer; Mark Rose, Chief Investment Officer; and Jay Bullock, Chief Financial Officer. As the operator mentioned, this call is being recorded.

As a result of this conference 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 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 conference call. For a more detailed discussion of these 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 Edmund Watson
President & CEO

Good morning, and welcome to today's call to discuss our fourth quarter and year-end 2018 earnings.

We achieved meaningful progress in 2018. We optimized our platform to reduce exposure to catastrophe events by more effectively leveraging our risk management and capital structure. We made progress toward driving down our expense ratio, we grew top line by 10%, and we focused our efforts on the businesses with the best loss ratios.

We continued bringing technology into our U.S. business, creating significant efficiencies, driving down costs and enhancing customer service. Importantly, ROE is headed in the right direction. Excluding the recent accounting change to incorporate the change in fair value of equity securities, the ROE was 8.3% for 2018.

The current accident year, excluding catastrophe losses in both the U.S. and international businesses improved in 2018. The expense ratio in both the U.S. and international businesses also improved moving us towards our long-term ROE target of 700 basis points above the risk-free rate, which currently approximates a 10% ROE. All of this was accomplished in a challenging environment for both insurance and financial markets underscoring the resilience and agility of our business.

There is no doubt our business is performing solidly and shareholders have been rewarded as a result. However, we still have much work to do. At the end of the day, we're confident that we're continuing to build a unique and differentiated business, one that is best-in-class and delivers strong returns for shareholders.

With that, let's dive into the details of our results. Last night, we reported adjusted operating earnings at $0.55 per diluted share for the fourth quarter of 2018, up from $0.01 in the 2017 fourth quarter. For the full year of 2018, adjusted operating income was $3.22 per diluted share, up significantly from the $0.16 per share that we reported in 2017, again, a huge improvement.

Let's talk about how we got there. The improvement in results specifically reflects, first, strong risk management and the restructuring of the 2018 reinsurance and retro programs to reduce earnings volatility, as I discussed on our last quarter's earnings call. The net loss impact to earnings in 2018 was less than half of what it was a year ago in 2017. This, notwithstanding, the fact that the number of catastrophic events and the economic impact of them was not much less than it was a year ago.

Net catastrophe losses went from $145 million in 2017 to $62 million in 2018, or to say it a little bit differently when you think about the P&L, almost 9 loss ratio points from a year ago to just over 3 loss ratio points today. So I think, we can say again for the second quarter that the way that we managed our portfolios for cat risk this year versus a year ago, had a significant impact to volatility and in a very positive way.

The second thing that happened in the year is that our loss -- our core loss ratios remained very strong. If you exclude the catastrophic events, then our loss ratios improved from 61.8% in 2017 to 58.9% in the fourth quarter of 2018. And equally important for the full year of 2018, the loss ratio excluding catastrophes was 57.8% from 58.6% in 2017.

Third, our targeted growth in selected markets. In addition to improving our loss ratios, we were able to grow the top line by almost 16% in the fourth quarter of 2018, and almost 10% year-over-year to $3 billion for the year 2018.

We're growing the business at a very favorable pace, and improving margins. And as you heard me say before, and I will talk about in a little bit, this is while we're readjusting portfolios and letting business go.

Fourth, we had meaningful improvement in the expense ratio. The good news is not only were we able to improve our loss ratio and grow at a healthy rate, we also were able to lower our expense ratio by 260 basis points from 40.4% a year ago to 37.8% in 2018. If you adjust for catastrophe-related reinstatement premiums, the expense ratio for the fourth quarter was 36.7% compared to 39.5% a year ago, for even a little bit more improvement, which reflects lower acquisition costs and the benefits of scale associated with an overall increase in net earned premiums relative to expense.

More specifically, in regards to the expense ratio, in the second half of 2018, we took further action designed to keep our focus on expense management. Kevin Rehnberg is now the Chief Administrative Officer and will help lead the efforts to maximize the efficiency of our businesses group-wide. And also at the end of last year, we realigned the management structure of our International Operations, appointing Matt Harris to serve as the new Head of our International Insurance business. And I'm happy to say that Jose Hernandez is still in the chair for international and helping me in the strategic level.

With the loss ratio in a good position, the expense ratio improving, and strong growth adding scale to our existing platform, we're moving toward our targeted return on capital of 700 basis points above the risk-free rate, which as I said a minute ago, gets us to a 10% return on capital. Also, as our underlying results demonstrate, we made a lot of progress in 2018, and now, we have our aim clearly focused on 2019.

Turning to our U.S. operations, in particular. 2018 was a very good year in the U.S. We saw momentum build each quarter, and ended the year strongly positioned to meet our own high growth and profitability goals for 2019. In both the fourth quarter and calendar year 2018, the U.S. operations generated strong top line growth and top quartile loss ratios. In fact, we achieved record-breaking top line growth as gross written premiums rose about 12% in both the fourth quarter and in 2018 compared to the same periods in 2017.

Since 2013, we have grown our U.S. top line premiums 11% a year on a compounded annual basis. In fact, growth would've been higher had we not been shedding unprofitable business as we shifted the mix towards portfolios of risk with the best loss ratios, which include professional, surety, and construction. And just to put things in perspective, we've shed over $0.5 billion of premium over the last several years.

And as more growth comes from the retail business, we're also spending less on acquisition costs. We attribute much of the success in the U.S. to our adoption of technology, which is the key strategic priority, the results of which you can see in our 2018 numbers.

The use of digital tools and process optimization has not just increased efficiency and scale but has also helped in risk selection and in knowing businesses not to underwrite. So far the digital investments have been limited to improving the U.S. business. Going forward, the strategy is to take what we've learned in the U.S. and leverage the process to improve our international business. We're executing on that strategy, and I will provide more detail on our digital initiatives in just a moment.

Moving -- now moving on to our International Operations. For the full year, gross written premiums were up 6.4% in 2018 compared to 2017. International underwriting results in both 2018 and the prior year were impacted by a high level of catastrophe losses and masked the improvement in the core business as evidenced by the accident year loss ratio excluding catastrophe losses. Even with -- our results improved by $125 million from a loss of $111 million in 2017 to a little over $6 million in underwriting profit in 2018. And that gives us a -- that was with a non-cat loss ratio at 58.8% in 2017, going down to 57% in 2018.

To just break down the International business a little bit more. In our London market business, like others in the market, we spent much of 2018 remediating some of the areas of our insurance portfolio, where performance has not met our expectations. Rather than wait for pricing improvements, we made aggressive changes to our strategy, dropping unprofitable businesses and concentrating instead on risks whose pricing has the marginal -- has the most margin potential. These actions are similar to those taken in the U.S. a few years ago, to build a portfolio of risk-generating best-in-class loss ratios.

Moving on to Bermuda. Our Bermuda insurance platform showed strong growth in the fourth quarter and calendar year 2018, giving us both scale and product diversity. We saw an immediate benefit in 2018 of combining the 2 reinsurance platforms, Ariel Re and Argo Re. With reduced volatility and greater strength of the combined platforms, we have now made the transition to a risk originator on behalf of third parties.

Let's talk about digital a little bit more now. During the course of the year, we made a -- we did a number of things, and I think that you can see that the investments that we made several years ago are benefiting our current results. Today, we're investing for the future, we're confident that our digital efforts are driving positive financial results in our underwriting process. And as the results become more measurable, we'll be able to communicate exactly how our investments are being translated into stronger returns.

I'll provide a bit more color here, and will continue to update you as we progress on this initiative.

First, digital tools have streamlined the underwriting process by cutting the time it takes to respond to broker submissions, from days to hours. Also, we embarked upon a key tenant of our digital strategy, which is to have our digital products run key processes, and the first version of this is now deployed for our high-volume business, where we can handle most submissions now in under an hour, and that's about 75% of our high-volume business, particularly our E&S operations. We're now well positioned heading into 2019 to further automate key elements of that process, providing even faster decisioning out of our distribution partners than their insurers.

Next, we're beginning to see an improvement in loss ratios in the businesses where we leverage digital tools in risk selection and pricing claims and reserving. I will talk about an example shortly, where we used the tech -- where the use of technology in the claims process restored profitably to an underperforming business line.

And at the same time, headcount at the company has been stable, thus improving scale. We built our digital team without growing our overall staff. In fact, we haven't had to add staff that would have previously been required to scale up the business, and we've avoided backfilling certain positions as they have come open. Or to say things differently, as we've been dialing up digital and dialing up our premium, our headcount, group-wide, has remained relatively flat.

Let me discuss a couple of specific examples. First, to size up the effort, our digital budget last year was measured in millions of dollars, not tens of millions of dollars. On businesses where the team has been focused, we've seen significant growth. One example is our Casualty Lines unit inside our Excess and Surplus Lines business. Over the past 2 years, that business has grown by $80 million from $285 million to about $365 million in 2018 due in large part to the tools and process enhancements brought about by our digital investment. That business comes with a contribution margin of approximately 17%, in other words, what is left over after we set up the loss reserve and pay to acquire that business. And that margin -- at that margin, those investments added over $15 million over the past 2 years to the unit's underwriting result. So you can quickly see how success can more than pay for the cost of the entire digital effort. That's what leads me to want to invest more.

Second, let me point out how investment in technology helped to restore profitability at Argo Insurance, one of our retail subsidiaries in the U.S. One of our original investments is in an insurtech company, called Gleason Technology, which we initially made in 2014. The Argo Risk Tech platform has allowed us to deploy a sensor-based inspection platform to 100% of our supermarkets clients' locations over the last 30 months.

The platform has enabled nearly 200,000 inspections per day, every day to prevent customer accidents. This proactive plan activity has allowed our retail niche to swing to a consistent loss ratio under 57% in 2018 from a loss ratio of 98.9% in 2015.

Additionally, in late 2017, we launched the ability of our clients to report customer accidents in real time on the same platform, which is a key advantage in our claims process. And the reason for that is there's a direct correlation between the length of time our clients take to report the incident to the cost of a claim. With the most recent success of this claims reporting component of the Argo Risk Tech platform, we will be expanding its use in this capacity in 2019 to other Argo business units.

Again, getting closer to our customer needs and executing with digital tools are key components of our overall strategy. What does all this mean in real dollars? After posting a $17.3 million underwriting loss in 2015 at Argo Insurance, the 2018 underwriting profit was $2.8 million, a huge percentage improvement.

So let's move on from the operations and talk about capital management a little bit more. We're finally stable -- we're -- sorry, we're financially stable and operationally nimble with the ability to go in and out of markets and to take our available capital and put it quickly into opportunities as they arise. If we do not see immediate opportunities, we've demonstrated that we will repatriate to shareholders. As you know, our #1 priority remains deploying our capital into the businesses where we see attractive returns. We will be disciplined in these efforts, and will carefully weigh what these investments mean in terms of shareholder value.

However, if we do not see opportunities to redeploy the capital in the business, we will return capital to our shareholders through share repurchases and envision to quarterly cash dividend through both stock and special cash dividend to shareholders. As stewards of our capital, I think we've done a good job investing in our businesses and at the same time, last year, returning approximately $70 million of capital to our shareholders in the form of stock repurchases and our annual cash dividend.

In addition, we issued a onetime special dividend of 15% earlier in the year. And between stock buybacks and dividends paid, over the past several years, we've repatriated over $635 million of capital since 2010.

So in summary, our business shows significant strength and agility in a difficult market. Our underlying underwriting results continue to improve. We are growing in the areas where we see the most profit potential. The expense ratio is improving, and we are focused on cost discipline. We expect the combined -- the combination of the above to push us towards our long-term ROE target of 700 basis points above the risk-free rate and ultimately generate higher returns for our shareholders.

We look forward to updating you on our continued progress at the end of our first quarter. And with that, I would like to turn the call over to Mark Rose, our Chief Investment operator -- excuse me, our Chief Investment Officer to talk about investment. Thank you, operator.

Mark H. Rose
Chief Investment Officer & Senior VP

Thanks, Mark, and good morning. I will take you through Argo's investment performance for the quarter. The fourth quarter total return was negative 1.7%, which was lower than the 1.1% positive in the fourth quarter of 2017. For the full year, total return was negative 0.6% versus a positive 5.6% in 2017.

Our weak quarter occurred in the midst of the eighth Fed hike in approximately 2 years, while several economic and market indicators were beginning to weaken.

Our equity portfolio declined $76 million in the quarter driving the lion's share of our losses. As you probably have observed, the capital markets have so far experienced a significant recovery in 2019. While the quarter end and year are far from over, we are pleased to say that so far, our total portfolio has recovered its entire market value -- I'm sorry, entire market value decline of the fourth quarter in 2018. The risk portion of our portfolio has recovered half of its fourth quarter decline.

Our reported net investment income for the quarter was $29.4 million, and $133 million for the full year 2018. This compares favorably to net investment income of $129 million in 2017, which excludes the impact of a onetime sale of a strategic investment.

Driving net investment income growth in 2018 was a larger portfolio and higher rates, which was offset by a weaker fourth quarter in alternatives, which was negative $0.9 million.

One heads up, we hold approximately $135 million in private equity-structured funds, which report on a quarterly lag. So the first quarter of 2019 will be their fourth quarter of 2018. This may contribute to another weak quarter in the alternative contribution to net investment income. With that, I will turn the call over to Jay Bullock, our CFO.

Jay Stanley Bullock
Executive VP & CFO

Thanks, Mark, and good morning, everyone. I'll focus my comments today on some key highlights and explanations to the financials we reported last night and then we'll take questions.

From top to bottom of the financial result, 2018 was a year of improvement. We achieved growth in our most profitable business lines, maintained best-in-class current accident year loss ratios, reported our 14th consecutive year of overall positive prior year development, saw a significant reduction in losses from catastrophic events that were almost as large as those in 2017 and made material progress towards our long-term goal of reducing our expense ratio.

With this progress, we saw a return to underwriting profitability with $36.2 million of underwriting income in 2018 from a loss of $111.3 million -- $113.3 million in 2017. Similarly, we reported a significant increase in our adjusted operating income, which for 2018 was $111 million compared to $5.5 million in 2017. The combined ratio for 2018 of 97.9% was 9.3 points better than the prior year.

A couple of items of note related to revenue. In the U.S. segment, the growth in gross written premium in the quarter outpaced the growth in net written premium. As noted in our release, the proportion of retained premiums was impacted in the quarter by reinstatement premiums paid post loss events, other strategic changes to the reinsurance structure, and to a lesser extent by growth in certain fronted business.

In the International segment, as noted, the growth in gross written premiums was pronounced in the property division. This was the result of inwards reinstatement premiums in our reinsurance business, and to a lesser extent, by the expansion of our European business. The percentage growth is somewhat exaggerated here as the fourth quarter base is a relatively small number on a gross written basis.

The overall loss ratio for the quarter was 62% compared to 66.9% in 2017, and for the year was 60.1% compared to 66.8%. For the quarter, the current accident year loss ratio, excluding cats, improved to 58.9% from 61.8%, and for the year, to 57.8% from 58.6%. This despite a large -- despite a number of large marine and energy losses experienced in the fourth quarter in the London operation.

The important thing to note here is that both the International and to a lesser extent, the U.S., reported improvement in the current accident year ex-cat loss ratios for the quarter and the year. And particularly, the underwriting actions that were implemented in 2017 and 2018 in our international business are more clearly flowing through the results.

In the fourth quarter of 2018, development on prior year reserves was favorable by $13.9 million compared to a favorable development of $12.6 million in the fourth quarter of 2017. Favorable development for the year was $18 million compared to $8.2 million in 2017. Both the U.S. and International segments contributed to that result.

Finishing up on margins, the expense ratio for the quarter improved by 230 basis points compared to the 2017 fourth quarter, while the annual expense ratio improved by 260 basis points. Excluding the effects of net reinstatement and cat-related premium adjustments, the expense ratio was 36.7% in the 2018 fourth quarter compared to 39.5% in the same period of 2017. As footnoted in the release, the outwards reinstatement premiums in the quarter were approximately $9.4 million compared to $3.5 million in 2017.

The adjusted expense ratio continues to reflect the effects of our efficiency in digital initiatives. During 2018, our non-acquisition expense was essentially flat, while at the same time, gross written premium was up by $260 million or almost 10%.

Moving to some other topics, impacting the financials. Following on Mark Rose's comments on investments, our core portfolio continues to perform quite well with net investment income growing over 25% for both the 3-month and year ended December 31, 2018. However, due to market volatility experienced in the fourth quarter of 2018, our alternative investments reported a loss of approximately $1 million. And as Mark mentioned, due to the lag in reporting, the first quarter's result will include the highly volatile December result, offset by the recovery in the first 2 months of the year.

A couple of more items to note. The tax benefit in the fourth quarter of 2018 was $16 million, reflects the income attribution from our main taxing jurisdiction. Essentially, we had income in Bermuda and, given the mark-to-market of the equity securities, net losses in the U.S.

As we've discussed in prior quarters, we continue to evaluate the impact of U.S. tax changes in our tax planning strategies and believe the tax changes in the U.S. and other international jurisdictions may support a lower expected tax rate. We'll be updating that in the future.

Next to the balance sheet. The biggest impact on the capital accounts in 2018 was the volatile financial markets. The change in equity securities resulted in an unrealized loss of $105 million in our income statement -- through the income statement, while the change in unrealized losses on fixed maturity securities in 2018 was $75 million, reported through AOCI. As mentioned, much of that has been recovered in the first weeks of 2019.

So in conclusion, our long-term objectives are well supported by targeted growth of our top line, underwriting discipline as evidenced by strong current accident year ex loss ratios, improving expense ratios reflecting both scale and operating efficiencies, and a strong risk management framework. Operator, that concludes our prepared remarks, and we're now ready to take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Christopher Campbell with KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

My first question is on the expense ratios, and then the ROE discussion. I guess, meaningful pickup in the expense ratio for the year. It is kind of still around 38%. I guess, how low do you think this could go in '19 and '20? And then what levers do you think you need to pull to help close that ROE gap and what would be the timing of that?

Mark Edmund Watson
President & CEO

So, Chris, this is Mark. So over the next 18 to 24 months, our focus is to close the underwriting margin gap by another 200 to 300 basis points. We think most of that will come from expense ratio improvement. We do believe there'll still be some underwriting improvement as we continue our portfolio optimization across the group. I think a lot of that improvement will come -- well, actually, I think, it may come evenly from both parts. And -- but I think, the most opportunity right now for margin improvement comes with expense ratio improvement. That's a combination of getting more impact from the digital initiatives that you heard me talk about earlier. So think about auto -- we have an opportunity to automate more things, and as I said in my remarks earlier, we've been able to grow without having to add payroll. And so I think, continuing to grow, and keep expenses growing at a lower rate than the top line will help improve margin. And then the last part is distribution. In some parts of the group, our distribution is very expense -- the cost of acquiring customers is just too expensive. And look for us over the course of 2019 to talk about business that we're letting go of, and while that may have a dent on the top line a little bit, it will still have a meaningful positive impact on the bottom line. So I think, over the next 18 to 24 months, we -- our goal is to improve underwriting margin by another 200 to 300 basis points, and that gets us to our targeted return on equity.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Great. That's very helpful. And then I'm just thinking also on the ROE. So is -- I'm not sure exactly where you guys ended the year, but is the asset -- is the investment asset duration still pretty meaningfully below the liability duration? And then I guess, just even if it is still that way, if they were more normalized and matched, I guess, how much ROE could you pick up from that as well?

Mark Edmund Watson
President & CEO

Well, let me let Mark Rose answer the first part of that question, then I'll have Jay answer the second part.

Mark H. Rose
Chief Investment Officer & Senior VP

I'm sorry, could you repeat the first part once?

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Yes. Just in terms of the asset duration, I remembered the last numbers in my mind, or you guys are maybe at 2.3, or low 2-year investment asset duration, where the liability duration of the underwriting portfolio might be around 4. So I guess, just what are the current numbers on that? And then just what would be the ROE bump?

Mark H. Rose
Chief Investment Officer & Senior VP

Yes. So when you look at the portfolio duration, it's driven by multiple factors. One is some portfolios are offsetting assets that are shorter, but they need to hold more assets because of the statutory requirements in those portfolios. So what we find is, we are holding more high quality fixed income assets versus our liabilities overall. So with more assets, we simply run a shorter duration than the liability duration. And we're still roughly matched. So we're kind of over hedged in safe assets to begin with. So we can -- we have the freedom to manage that duration, a, for fitting, and b, we also look at duration of risk on when we think interest rates could be volatile.

Jay Stanley Bullock
Executive VP & CFO

And, Chris, off to your second question, and that is if we extended -- I think, the question boils down to if we extended duration to match or exceed liabilities, we could take the bet on either side, what would the impact be on ROE? It's really as much a risk management question as anything, based on the fact that the yield curve has been, and -- continues to be, and has been, so flat. So you can get a marginal increase. Just look at the difference in the 2 and the 10 or the 10 and the 30, you can get a very marginal increase in ROE. And it's factually correct that, that would generate more income, but you are taking kind of a leveraged bet on where you are on the curve, and it's kind of an asymmetrical outcome if rates really do start to increase. So that has been largely what's driven the decision to maintain a shorter duration over the last several years. You can look at it in hindsight and say, you left some money on the table, which we did. But from a -- but based on the risk management decision, I would do it again. It's the right thing to do because it always looks like the rates should move up as it does currently.

Mark Edmund Watson
President & CEO

And the benefit of being shorter on the curve is that you can reinvest faster when the rates do move up. So you do get a pickup later on.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, got it. Very helpful. And then I guess, can you just discuss the approach to your 1/1 reinsurance renewals? I guess what percentage of your programs renew at 1/1? And then just what are your thoughts just in terms of increasing limits, decreasing retentions, third-party sessions, those kind of things?

Mark Edmund Watson
President & CEO

Okay, well that was a series of very broad questions that we can spend an hour answering. So for 1/1, we were able to -- actually it's a really good question, Chris, because at 1/1, we were able to keep both our reinsurance programs and our retro programs and the capital supporting our business intact for 2019, structurally, almost exactly the way that we did for 2018. And I think, that's a huge feature of our risk management in terms of our ability to manage volatility. And also, it just reemphasizes that for our cat exposure in particular, that we're still originating risk for others given that most of the risk we push out to the capital markets and other third-party capital providers beyond just our traditional reinsurers and retro sessionaires. So we're really, really pleased that we were able to put the same structure in place for '19 that we had in '18. In terms of business coming in the door for our reinsurance business, we readjusted place -- where we sat on some of the programs, taking a little bit more in some places where we could get rate, and perhaps walking away from a couple of accounts, where we didn't think we were getting paid. Most of the loss-affected business doesn't really renew until later in the year. So how things played out on the 1st of January, I don't think is a very good indication of where they will be at the end of the first -- well, really the second quarter. So I think the best time to really kind of talk about market commentary may be a little bit at the end of the first quarter, but much more so in the second quarter. And also, it's just a pleasant reminder that about 90% of our business is insurance, not reinsurance. And we've been able to renew -- I guess, we probably renewed a quarter of our business, insurance business, reinsurance programs at the first of the year, and the rest of them will come through the next 6 months of the year.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, great, well, that's very helpful. And then just one final one on Lloyd's. I guess, just what are you seeing in the casualty lines, and pricing over there? And then just in terms of market discipline, can we get an update on that?

Mark Edmund Watson
President & CEO

Well, I talked about it a little bit in my remarks earlier, but if I just kind of speak generally about the market. I think that the top decile initiative that Lloyd's initiated last year was helpful to the market. We had started making some changes in 2017, and a lot of the initiatives that Lloyd pushed through last year, we were already in the middle of. And we kind of saw that when it came time to file our business plan for 2019. We were able to have Lloyd's approve our business plan almost as is. We still have all the classes of business, whereas most of our competitors were encouraged or pushed to eliminate 1 or 2 lines of business, or more depending upon the Syndicate. And that's because we had already reduced our exposure to several lines of business. So I think, there's still -- look, the London market is very competitive. And we've been focused on originating risk across the group, not just in London. But I think that the changes that were made in the latter half of last year at a market level, are now enuring to the benefit of us this year, keeping in mind that when we talk about what we view as rate increases over the course of 2019 relative to '18, maybe less than some of our competitors because of the changes that we made in portfolio, and rate increases that we were able to drive from '16 to '17 and '17 to '18.

Operator

Our next question comes from Bijan Moazami with Compass Point Research.

Bijan Moazami
Compass Point Research & Trading, LLC, Research Division

I guess I have a question for Jay and a follow-up for Mark. I guess, Jay, if my math is right, your corporate expenses went from 6.5 points of earned premium in the fourth quarter of last year to 2.3 points of earned premium in the fourth quarter this year. Could you spend a little time in terms of why there was a big drop in there? And what we should be considering your run rate number going forward?

Jay Stanley Bullock
Executive VP & CFO

Yes, Bijan, I would focus more on the overall group numbers. The items last year, there were some transition expenses related to our IT outsourcing that were retained at the corporate level. And so last year's corporate numbers would be slightly higher. So if you think about that, there's a portion that's being allocated to both segments this year that wasn't last year. As I said, our overall spend was relatively flat this year, and yet we were able to achieve growth. And so I would -- so my point is, is that, I think, what you see this year is a reasonably accurate reflection of the overall cost base for the organization.

Bijan Moazami
Compass Point Research & Trading, LLC, Research Division

Right. So about $10 million, $10.5 million in corporate expenses, correct, per quarter?

Jay Stanley Bullock
Executive VP & CFO

If you did -- if you reversed into the math, that's what the math would show you, yes.

Bijan Moazami
Compass Point Research & Trading, LLC, Research Division

Perfect. And the follow-up I guess for Mark, international operation, 98.5% ex-cat combined ratio. If you make some kind of an allocation of corporate expenses and considering that it has a higher catastrophe exposure than the rest of your business, are you guys earning your cost of capital in that business? And if not, with all the expense initiatives and rate increases, would you be getting to that point by the end of 2019?

Mark Edmund Watson
President & CEO

Yes, well, so clearly, when you have a year with a lot of cat activity, it's hard to earn your cost of capital. When I look at the changes that we've made to the portfolio, including where we allocate our -- well, when I look at how we allocate the amount of cat that we want to keep net among the different parts of the business, clearly, we're going to allocate the capital, or we're going to allocate the capacity where we think we can get the highest return. So not surprisingly, our property exposure has come down year-over-year in London. And there's a chance that it will come down a little bit more this year. But a lot of the change that we wanted to make in our property portfolio, we made last year in terms of cat exposure. I think this year is more focused on making sure that we actually have the right structure for the property programs that we're still underwriting, excluding cat. I think that's the biggest opportunity for improvement.

Operator

Our next question comes from Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I just guess I wanted to step back. We're well into the fourth quarter earning season, a lot of insurance companies have reported. And this new accounting standard where you guys are being forced to run through unrealized gains and losses has really affected and impacted the book value per share calculation for almost everyone. And I'm just curious about management's perspective on evaluating performance. I know one measure that insurance companies used to use as a gauge for value creation would be just book value growth plus dividends. And I'm just curious about your perspective on this, Mark and Jay?

Mark Edmund Watson
President & CEO

Jay, I'll let you go first.

Jay Stanley Bullock
Executive VP & CFO

Well, yes, I mean, look, I think, since I've been here, we've been pretty consistent about not running the business to react to changes in accounting. It's the fundamentals about creating value, about cash flow and about book value generation over the long run. So that mark-to-market on the equity portfolio, that's running through the income statement, used to be on the balance sheet. So it was a component of the change in book value. It now amplifies a positive or negative result on the P&L, but as you will note on Page 21 of our press release, we've tried to give you a look at the ROE without that change, which was 8.3% for the year. So we're trying to make sure that people can reach back and sort of what they're familiar with, and move things around a bit. But it really hasn't changed the way that we've thought about running the business, or the composition of the portfolio. The composition of the portfolio is really based on where we see the best value in the capital markets, and coupled with a focus on the risk allocation to the underwriting business versus the risk allocation to the investment business.

Mark Edmund Watson
President & CEO

Yes, I think what it highlights is that there is a fair amount of volatility on both sides of the balance sheet. And as Jay just said, the balance sheet gets mark-to-market every quarter. I'm not sure that there was this much emphasis or discussion. And as you and others have heard us say repeatedly for a long time, our focus is -- really is on growth at book value per share plus dividend. And so I guess, this comes back to, and highlights that there is some volatility in everyone's investment portfolio, because we're managing -- at least in our case, we're managing it to a total return basis. And I look at how much the portfolio is already up in the first half of this quarter, and so we've made back the majority of the downside that we saw in the fourth quarter. And it's also just a reminder that when we think about growth in book value per share, there's 3 things that make it happen. And I touched on all of them earlier -- well, I touched on 2 of the 3 and then Mark Rose touched on the third. It's underwriting, the underwriting result; the total return on the investment portfolio; and capital management. And so, the new accounting change does add more volatility, but I think over time, we're rewarded for taking a more total return approach to our investment portfolio just as we're rewarded for taking a certain amount of risk net on our balance sheet.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Great, that's a good answer. So I have 2 other questions. Again, in the context of commentary, we've heard from so many other companies that have reported, it seems like the pricing environment, and I know you commented a little bit about reinsurance, but just more broadly speaking, it seemed like the pricing environment is stable to slightly positive, at least that's what we've heard from many of your peers. Maybe you could spend a second -- or more than a second, how about a minute -- and just add some color around your specific areas of concentration, and how you see pricing developing through the year?

Mark Edmund Watson
President & CEO

Yes so in my remarks earlier, I was talking about the parts of the group where we saw the most margin opportunity and I highlighted a few of them, our surety business, Argo Pro, and some of our Casualty business. And I think that when I look at the margins there, so not just the loss ratio, but the all-in expense, so underwriting margin. Look, I think, things are priced pretty well for our portfolios, I think, they are priced pretty well where they are, and we can grow with market pricing, where it is. Having said that, we are seeing some improvement in the market in general, almost across-the-board, but it's low single digits. Now for business that's underpriced, so think, cat exposed property or transportation, which we've been talking about for years, you may recall that we exited most of our transportation business 5 years ago. And so, we don't really talk too much about rate increases there because there isn't much left, whereas many of our competitors are talking about 20%, 30% rate increases. Okay, well, that's great, as compared to what? And so, when you look at where you're seeing a lot of rate increase, it's because it needs it. When there are a lot of -- again, just to come back to our portfolio, there's a lot of risk on the books today that we think is adequately priced where it is to drive margin. So for us, the opportunity and the challenge is to see for the portfolios that are underperforming, do we need to raise price? Do we need to exit? Can we find a less expensive way to originate that business? So there are a number of levers that we're trying to pull depending upon the exact line of business and geography that we're talking about. So that's still kind of a general answer, but it's hard to get any more specific without drilling into $10 million and $20 million portfolios that we have. But I think that the market trend is moving upward, the market trend does need to move upward. And as competitors exit different markets, that presents opportunity for us. And you're starting to see a fair amount of product exit in London. You're seeing market exit in other parts of the world. And again, that presents opportunity for us, just as there was a fair amount of consolidation and restructuring a few years ago that we talked about in the marketplace, where we thought that would be an opportunity for us. It was, and so we just need to keep looking at where we can get the best return on our allocated capital going forward and improve our operations where we need to.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Thanks for that answer. I wanted to -- I just wanted to, I guess, finish up with a question around reserve development. And again, in the context of what I've seen from other companies report, not only for the quarter but for the year-end, it seems like it's been a mixed bag. As you noted, Mark, a number of companies in the transportation space have reported challenging reserves, we've seen a number of companies report not only quarter-over-quarter but year-over-year declines in favorable reserve development, and by contrast, you guys have reported an improvement in favorable year reserve development, prior period. So I was just curious, and I know you don't budget things like this, but I'm just curious about your perspective of the moving pieces within the favorable reserve development, and how we should think about that going forward?

Mark Edmund Watson
President & CEO

Well, if you look at our prior reserve development over the last 14 years, it's been positive, and we're very proud of that. And we're very focused on making sure that continues. As my colleagues on the board said to me years ago, before it was positive, that's a high-class problem. And I say it that way because if you over reserve, then you may price -- if you set your loss picks too high, then that means you may have overpriced your product, and you're subject to adverse selection. I think one of the -- I think there's 2 reasons why you see less positive prior year development than you might have in the past. If you go back 5, 10 years ago, we as a market expected more loss cost inflation that we've seen. And we priced that into our products. And when that didn't happen, that led to lower expected -- or lower paid losses than we expected. And so, that of course, resulted in positive prior year development. And the second thing is, we as an industry have a lot more data today, and we're able to more precisely price our product. And so, I think, a lot of us have -- don't need to hedge quite as much to get it right today, as we did perhaps a decade ago. Certainly, those 2 things are true for ourselves. But I think that those are a pretty good reflection of most of the better-performing companies in our industry. I mean, there are others that may have under-wicked it a little bit for different reasons, but as we all know with the accounting changes that happened a couple of decades ago, it's a lot harder to do that today than before. So I think, there is a lot more precision around people's loss picks. Certainly, for mature books of business, there's still a lot -- a higher margin of error for new business, but for people, who've got seasoned book of business -- books of business, they've got a lot more data and can be more precise. And so I think, that leads to a little bit less prior year development, plus or minus.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. Great. And then just 2 items just to come back from comments on the call, just to clarify. One was around your tech spend, it didn't sound like it was a significant budget, but is still an item. And then secondly, Jay, your comments around tax rate assumptions going forward. Just if you can reiterate that for me, I'd appreciate it.

Mark Edmund Watson
President & CEO

Yes. So I think I said in my remarks earlier that we've been spending millions of dollars a year, not tens of millions of dollars, but we're starting to get a benefit that we think can be measured in tens of millions of dollars, which encourages us to really think about how we can push a little harder in 2019, particularly take the know-how in the U.S. and redeploy it in our international business. Jay, you want to talk about taxes.

Jay Stanley Bullock
Executive VP & CFO

Yes. I think what I said on the -- well, I know what I said. What I said a moment ago was with the changes -- and we've all been reacting to the changing tax environment throughout this year. We're still tweaking the structure a bit. But it looks to me, like our long-term assumption on what we expect the tax rate to be, which by the way, if you look historically over the last 10 years, that 20% expected tax rate was pretty close. It looks like we may feel that, we're moving into a period, where it's slightly below that. So the idea, I think -- sorry, from our perspective is the expectation may be somewhere in the high-teens as opposed to 20%. And we'll make that change as we report earnings in -- throughout the year.

Operator

Our next question comes from Bob Farnam with Boenning and Scattergood.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

I have 2 questions, one is on the change in the reinsurance program from 2017 to 2018, just to get an apples-to-apples comparison on the cats, have you done an exercise to look to see what, for example, 2018 would've looked like if you didn't change the program versus what it is now?

Mark Edmund Watson
President & CEO

Well, no, but if you think about, what I said earlier, that our cat -- that our net exposure this year was about half of a year ago, it is probably the same. So if we had the same program last year as this year, we would have had twice as much loss this year as we did.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Yes, okay.

Mark Edmund Watson
President & CEO

Bob, I'm just generalizing, but that's a notionally correct amount.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Yes, I'll keep that in mind. Mark, with your comments on the digital initiatives, the grocery store example that you gave, I'm just curious, just so how does technology help to lower losses in a grocery store?

Mark Edmund Watson
President & CEO

So what were -- there are all these sensors around the premises that measure -- well, in this case, the example I was using would be, water spilled on the floor, which causes slip and falls. And so, this allows us to make sure the people who are out checking the -- so basically grocery store employees walk around and make sure that everything is okay, and as they walk around the sensors, capture them. And also we have sensors that figure out whether there is water on the floor, we have sensors that check for food temperature. There seems to be a sensor for everything, I'm exaggerating to make a point. But what -- so, the premises owner, in this case, a supermarket, is able to more quickly see if there's something that's happened that might cause an accident of somebody that slips and falls.

Robert Edward Farnam
Boenning and Scattergood, Inc., Research Division

Right. So you have basically sensors located throughout the grocery store to capture this type of data?

Mark H. Rose
Chief Investment Officer & Senior VP

That's right.

Operator

Our final question comes from Jeff Schmitt with William Blair.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

The growth in the U.S. continues to look really good. I think it was around 12% throughout the year. Could you discuss what was the level of rate in premium growth you're seeing just in the E&S book?

Mark Edmund Watson

President & CEO

It's been a pretty even mix between our E&S business and our retail business. And it's a little lumpy from one product to the next, but we're seeing pretty good growth in general, both in our retail business and our E&S business.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

I mean, I guess, are -- you're not seeing higher growth in E&S with some of these digital efforts, I guess, or with AIG and Lloyd's sort of pulling out of the -- pulling back in the market?

Mark Edmund Watson
President & CEO

Well, we are, but at the same time, we've had a lot of success with our retail businesses as well. And so, I mean, we've just been very fortunate across the board in both of our businesses. You're right that as those big guys pull back that, that is market opportunity for us. But we're also seeing market opportunity in our retail business as well. And that runs at a better margin, so we're more focused on that.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay, yes, which I was going to ask, how our margins in E&S sort of holding up? Or how does the combined ratio look?

Mark Edmund Watson
President & CEO

Yes, so I mean, the difference is only a couple of points. So everything is holding up right now. We're just trying to figure out where we can get the most leverage out of the product initiatives that we've started. And when I think about what we've done with digital, I mean, you're right that there has been more E&S benefit, but I would say as the year progressed last year, more and more of it was focused on retail. And that's just kind of been a function of who in the company has been in the queue. So I think you will see equal opportunity. We will see equal opportunities for us, for both E&S and retail, going forward. And I would say, I'm pretty bullish on both, not one over the other.

Operator

This will now conclude the question-and-answer session. I would now like to turn the conference back over to Mark Watson, CEO, for any closing remarks.

Mark Edmund Watson
President & CEO

Thank you. And I would like to thank everyone at Argo, who worked their tail off last year. As I said at the beginning of the call, our underwriting results are in part masked by the volatility from, again, an extraordinary year of cat activity and a fair amount of capital market volatility in the fourth quarter. But when I look through all of that and look at how we finished the year, I think we finished 2018 in the strongest place we've been. And I'm really appreciative of all of my colleagues at Argo for all their hard work, and I'm really looking forward to talking to everyone about 2019. And with that, operator, that concludes my remarks.

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