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Argo Group International Holdings, Ltd. NYSE:ARGO

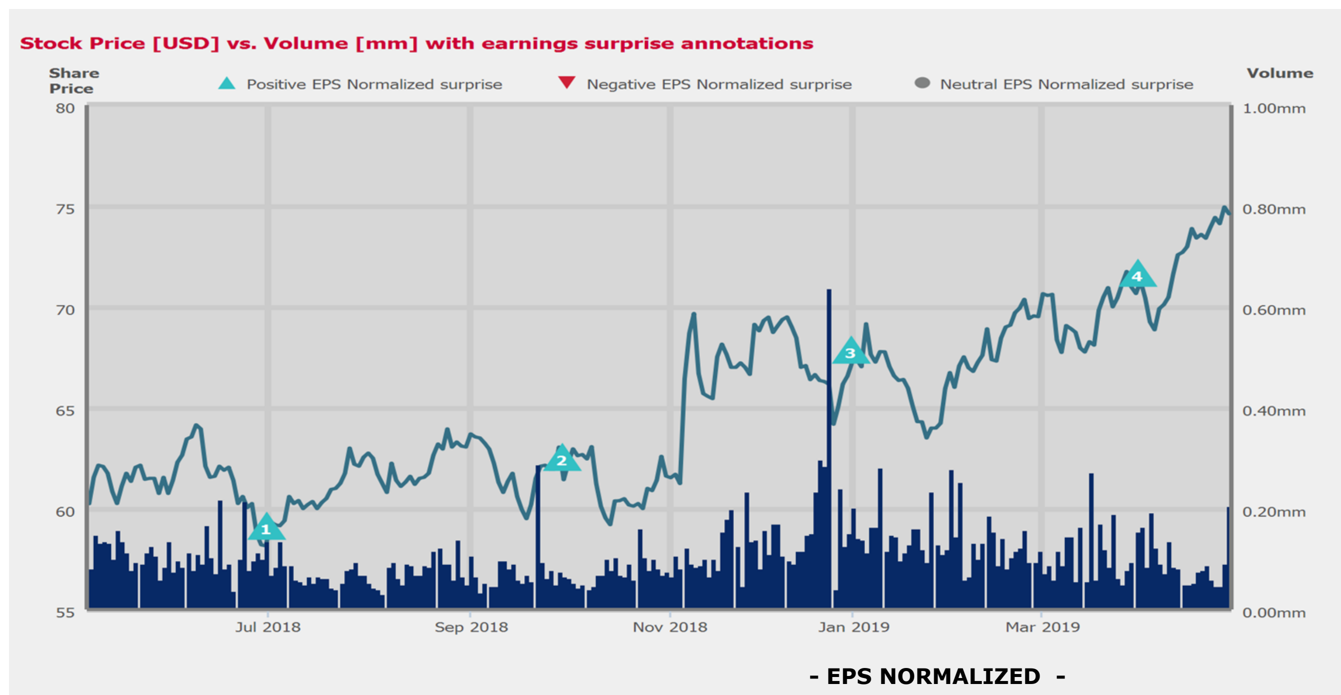
FQ1 2019 Earnings Call Transcripts

Monday, April 29, 2019 9:15 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.03	1.18	▲14.56	1.10	4.11	4.58
Revenue (mm)	519.02	509.20	▼(1.89 %)	507.05	2037.65	2161.45

Currency: USD
Consensus as of Apr-25-2019 10:27 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	0.89	0.95	▲6.74 %
FQ3 2018	0.62	0.68	▲9.68 %
FQ4 2018	0.13	0.55	▲323.08 %
FQ1 2019	1.03	1.18	▲14.56 %

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Presentation

Operator

Good afternoon, and welcome to the Argo Group's 2019 First 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 Bernstein, Senior Vice President of Investor Relations. Please go ahead.

Susan P. Spivak Bernstein
Senior Vice President of Investor Relations

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

Presenting on the call today is Mark Watson, Chief Executive Officer; Mark Rose, Chief Investment Officer; and Jay Bullock, Chief Financial Officer. As the operator mentioned, this call is being recorded.

As a result of this conference call, Argo management may make comments that reflect their intentions, beliefs and expectations for the future. Such forward-looking statements are qualified by the inherent risks and uncertainties surrounding future expectations generally, and may materially differ from actual future results involving any one or more of such statements. Argo Group undertakes no obligation to publicly update forward-looking statements as a result of events or developments subsequent to this call. For a more detailed discussion of such risks and uncertainties, please see Argo Group's filings with the SEC.

As you know, the purpose of this conference call is to review our first quarter results. We are not going to discuss or take questions with respect to our 2019 Annual General Meeting. And instead, refer you to our definitive proxy statement and other materials we have filed with the SEC, which are available free of charge from the SEC website, from the Argo website or by contacting me at Argo Investor Relations. I will now turn the call over to Mark Watson, Chief Executive Officer of Argo Group. Mark?

Mark Edmund Watson
President, CEO & Director

Good afternoon, and let me add my welcome to today's call. We're off to a good start this year as we delivered strong results in the first quarter. Our strategy of focusing on profitable underwriting and relationships, portfolio investment and disciplined capital allocation is clearly delivering value to shareholders.

We continue to build a unique company with the breadth of products and differentiated businesses across many of the key markets in the world. And we are not done. We continue to build competitive scale in each of our key operations.

Our focus on building and investing in our business, including in digital technology, has generated strong growth and improving operating efficiencies in challenging market conditions in recent years. We certainly haven't been waiting around for the markets to turn, rather we've been building a business that could thrive in various market cycles, a business that strongly considers the future 5 to 10 years down the road, not 5 to 10 months down the road. This will be our path forward as well.

We'll not lose sight of how this business will perform over the long haul despite any pressure to make short-term guided decisions and changes. A hardening market for premium rates is terrific for us as it is for all industry players. But unlike others -- like some others in the industry, it's not the defining component of our growth. Providing great service and innovative products to our clients is what defines us. Our financial results reflect the success of this strategy and should generate a return on equity of 700 basis points above the risk-free rate or approximately 10% in this interest rate environment.

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From a margin standpoint, we expect to improve our underwriting margin for a combined ratio by 100 basis points annually over the next 2 years allowing for more normal loss expectations, keeping in mind the exogenous events of last year and the year before. And a combination of our continued investments in technology and growth -- and growing the business should provide us with the scale we need to improve underwriting margins. Over the past few months, we've spent time with many of our investors, and the feedback from almost all was the same: keep executing on your strategy that is building long-term value for shareholders.

We've heard many of you that we should be focusing on ROE on a GAAP basis and we agree as it better signifies the value creation of the business by more accurately reflecting changes in the investment portfolio. In the first quarter, our annualized return on average shareholders' equity on a GAAP basis was 20% versus 5.5% in 2018. Furthermore, annualized adjusted operating return on average shareholders' equity was 9.1% in the first quarter of 2019 versus 8.1% in the first quarter of last year, and 6.3% for the whole year of 2018. We're clearly seeing a lot of progress in overall profitability. As I previously mentioned, our opportunity to increase margins will continue to come from driving efficiency in our operations, leveraging technology to make our business more efficient and deriving more value from each dollar we spend.

During the first quarter, we improved our combined ratio or our margin by 100 basis points versus last year to 94.8% this year from 95.8% a year ago. Our U.S. operations are well-established and well-known in the area of Excess and Surplus Lines. We've been growing and scaling our international footprint, which allows us to achieve desirable geographic diversification, and now we have the benefit of applying some of the key best practices from the U.S. in this growing platform as well.

Over the years we've demonstrated through our loss ratios that we're very good at selecting risk. Now we're onto improving our efficiency while maintaining our advantage in risk selection. We've known this is the natural next step in our long-term strategy, which is focused on maximizing our core functions of risk selection and investment portfolio management and amplifying those results with wise capital allocation.

Ultimately, all of this leads to profitable growth, solid return on capital and superior growth on our book value per share. To demonstrate our progress in the 2019 first quarter, book value per share increased 8% to $55.23 compared to $51.43 at December 31, 2018, inclusive of cash dividend. As we've always said, we view the growth in book value per share over time as the key metric to demonstrate value creation. I should say it's book value per share plus dividends paid. As we go through the current financial highlights, you'll see the progress we're making.

We reported net income of $91.2 million or $2.63 per diluted share, up approximately 4x from the prior period a year ago. Overall gross written premium grew 7.1% to $761 million from $711 million in the first quarter last year. We continued selectively targeting premiums with the best loss ratios, leveraging our investments in -- and leveraging our investments in digital technology.

In 2019, as planned, we retained less premium, primarily due to an increase in ongoing strategic use of third-party capital. When we talk about the operations in more detail, you will see that retentions in the international business are lower than in the U.S. as we cede more risk to our third-party capital providers. Jay will take you through additional details in just a little bit.

Overall, the contribution from underwriting income increased by 26.6% this year to $21.9 million from $17.3 million a year ago. In the quarter, margins improved as well driven by better loss and expense ratios versus the year ago. The loss ratio, excluding catastrophe losses in prior year development, improved to 56.6% from 57.2% in the year ago period. Net investment income decreased 5.8% to $33.9 million compared to $36 million in the 2018 first quarter due to a lower contribution from our alternative investments.

This portion of our portfolio is reported on 1- to 3-month lag and reflects the volatile markets in the latter months of 2018. We have cautioned that results from these investments would be lumpy as they've been in the past couple of -- as they have been in the last couple of quarters. The earnings contribution from alternative investments in the 2019 first quarter was $1.9 million compared to $8.7 million in the prior year.

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Net investment income on the core portfolio increased 17.2% to $32 million compared to $27.3 million in the 2018 first quarter and the increase was primarily due to an increase in the invested asset base and higher investment yields. And Mark Rose, our Chief Investment Officer, will go through all of this in a bit more detail in just a minute.

Now let's talk about our U.S. operations. We continue to leverage technology in our U.S. business, creating significant efficiencies, driving down costs and enhancing customer service. Each consecutive quarter as we look at the targeted growth and the improvement in margins, the benefits of our digital investments become increasingly more evident.

In the U.S. operations, gross written premium in the 2019 first quarter was $411 million, which was up $38 million or about 10% compared to the first quarter of 2018. This growth was achieved in property up 41%, professional up 28.5% and specialty up 17%.

Liability was down modestly from the prior year. We continue to execute on our strategy to target select business lines and at the same time, manage our risks and exposures. As I mentioned earlier when discussing overall premium growth, the retention of net written premium to gross written premium was 60.5% in the first quarter as part of our ongoing strategic use of third-party capital, including reinsurance, most notably, from our property business.

Margins in our U.S. business continue to improve with a 90.9% combined ratio in the 2019 first quarter compared to 93.9% a year ago. The underlying combined ratio excludes catastrophic losses in prior years -- sorry, the underlying combined ratio when excluding catastrophic losses and prior year reserve development improved to 90.9% from 92.7% in the first quarter of this year versus last year.

Moving on to our international operations. So far, we've focused on digital investments on growing the U.S. business. Going forward, the strategy is to take what we've learned in the U.S. and apply it to our international business as well. We're executing on that strategy in several ways. We're implementing similar protocols in the international operations that drove growth and margin improvement in the U.S.

Turning to this quarter's results. Gross written premiums in the 2019 first quarter were up 3.7% to $350 million compared to the first quarter of last year. Growth was achieved in property, liability and specialty lines as a result of an increase in new business and favorable rate changes.

Growth is partially offset by the decision to nonrenew select cyber accounts in our liability line, which was also true in our U.S. business. The underwriting income for the -- for 20 -- for the first quarter of 2019 was $9.2 million compared to $15.8 million for the first quarter of 2018. The lower contribution from underwriting, primarily reflects the strategic use of reinsurance and third-party capital to manage risk exposure, modestly higher -- there was modestly higher catastrophic losses in this year's first quarter and a $3.6 million decline in favorable prior year reserve development.

Moving on to discuss our digital business transformation. Our adoption of technology solutions has been a strong driver of our success and remains a key strategic priority. Leveraging digital tools and process optimization has not only increased efficiency and scale, but has also improved our risk selection.

I want to share with you a recent statistic I read in a Forbes article. "The amount of data we produce every day is truly mind-boggling. There are 2.5 quintillion bytes of data created each day at our current pace, but that pace has only accelerated with the growth of the Internet of Things. Over the last 2 years alone -- sorry, in the last 2 years alone, 90% of the data in the world was generated." I'm not even sure how many quintillion bytes that is, but it's a lot. We're taking advantage of this in our Argo insights platform, where weekly we're consuming multiple terabytes of data and running it through -- that's not as much as quintillions of bytes, and we're running it through machine learning algorithms, which both highlights the unique risk factors to the underwriters as well as helps to price complex risks.

Not only will this have an impact on the loss ratio through better risk selection and consistency of underwriting, but reduces the amount of time spent analyzing each risk so that we can get to more business. Early on, we're seeing significant improvement in underwriting efficiency. What we've learned with our new technology proves the old -- disproves the old saying that there is no bad risk, just bad price, which is wrong in our view. There are actually bad risks that we've chosen to exclude, and this

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risk management is why we are seeing better loss ratios in the business where we're able to apply these algorithms.

As previously discussed, our quick-quoting applications continue to scale without us needing to add head count. In the first quarter, our pilot project for self-serve producer-quoted premiums increased 36% over the fourth quarter of 2018. It's early, but this is a positive sign as our producers continue to get over 80% of their automated quotes in a matter of minutes with over 90% of them continuing to use this digital self-service method versus returning to paper submissions that they e-mail to us.

This, combined with our continued efforts to automate underwriting for our high-volume, small-risk businesses resulted in 21% of our total U.S. gross premium for casualty flowing through one of our digital systems in the first quarter. We only expect this percentage to grow as we add lines to our digital platform.

All the examples I've just discussed are driving the improvement you're seeing in our reported results. An added benefit is being able -- is being viewed as the preferred specialty carrier, providing automation and innovative products for our distribution partners.

Changing topics, let's talk about capital management. In February, your Board authorized an increase in the quarterly dividend by 15% to $0.31 per share. Over the past 3 and 5 years, our quarterly dividend has increased at a compounded rate of more than 20%. Our capital management strategy has not changed. Our top priority remains deploying capital to the businesses capable of delivering attractive returns in a reasonable time period.

We also have a strong track record of returning excess capital to shareholders. Between stock buybacks and dividends paid, we returned over $650 million of capital to shareholders between 2010 and the end of the first quarter of 2019. And over the same time frame, we grew our equity base from $1.5 billion to $1.9 billion or a combined increase of capital generated of over $1.1 billion. Additionally, the market value of Argo has grown from just under $1.2 billion in 2010 to over $2.5 billion today.

So to summarize Argo's performance in the 2019 first quarter, our business has shown significant strength and agility in a competitive market and is strongly positioned. As a result of growing in target areas where we see the most profit potential, our loss ratio continues to improve, and our expense ratio continues to improve as we remain focused on scaling our business and managing cost.

Looking forward, while we expect investment performance and capital management to contribute -- to continue to contribute to growth in book value, we're focused squarely on our business results driven by underwriting income to achieve a 10% return on equity. And I say this every quarter, but we have the right team in place with the right skill sets and experience to continue driving value for all of our shareholders.

And we look forward to updating you on our continued progress going forward. I'm now going to turn the call over to Mark Rose, to talk about our investment portfolio in more detail.

Mark H. Rose
Chief Investment Officer & Senior VP

Thanks, Mark, and good afternoon. I will take you through Argo's investment performance for the quarter. The first quarter total return was 3.1% or up $148 million compared to a decline of negative 0.4% in the first quarter of 2018. You may remember the first quarter of 2018 when the capital markets sold off after a very strong 14-month rally.

This year, Q1 was a mirror opposite with the capital markets rallying a big rally after experiencing a major sell-off we all remember in the fourth quarter of 2018. The sell-off was driven by the Fed's rate hikes and strong outlook, which consequently softened after the December sell-off.

In 2019 first quarter, our portfolio participated in a market-wide rally and all asset classes. During this time, the S&P was up 13.6%, the U.S. aggregate investment-grade bond index returned 3%, the leverage loan index was up 4% and the high-yield bond market was rally -- rallied 7.4%.

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Correspondingly for Argo, our core bond portfolio, which is approximately half the duration of the U.S. aggregate index was up 2.2%. Argo's equity portfolio was up 16% and its noninvestment-grade credit portfolio, which includes a mix of both bonds and bank loans was up 6.5% for the first quarter of '19. We continue to maintain a stable mix of asset classes with 65% in core bonds, 8% in equities, 7% in noninvestment-grade debt, 7% in alternatives and 12% in short term and cash.

Our reported net investment income was $33.9 million for 2019 first quarter comparing favorably, as you heard, to last quarter's $29.4 million, but below 2018 where we had $36 million.

Driving net investment income growth both sequentially and year-to-year was growth in the portfolio and higher yields, which was offset on a year-to-year basis in comparison with the alternative investment portfolio. Alternative income for the first quarter was $1.9 million. As we commented on last quarter's call, we hold approximately $135 million in private equity structured funds, which report on a quarterly lag. So the first quarter 2019 results are actually the numbers from fourth quarter 2018. Furthermore, we hold a smaller portfolio of long-only and hedge funds. These funds are counted on a monthly lag, so the Q1 numbers include the toughest month of December in the fourth quarter of 2018.

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

Jay Stanley Bullock
Executive VP & CFO

Thanks, Mark, and good afternoon, everyone. I'll make a few comments and then we'll open it up for questions.

The financial results for the 2019 first quarter continued the positive underlying trends in our business, and the strong start to the year positions the company well to meet our financial goals. The quarter's financial results make evident the benefits from our investments in talented people and better tools and business processes especially in our U.S. operations, which continue to generate strong results and measured growth. At the same time, the work that's been put into the international operations is evident in the segment's return to a solid underwriting margin. The company is well positioned to generate long-term profitability and growth leading to enhanced shareholder value.

The 2019 first quarter financials also demonstrate that we are on track to meet our stated financial goals, too. Number one, improve our combined ratio by 100 basis points annually. In fact, the 94.8% combined ratio in the 2019 first quarter was 100 basis points better than the prior year. Two, continue to reduce the expense ratio through operating efficiencies and scale. Our expense ratio is down 40 basis points on a quarter-over-quarter basis. Further, excluding the effects of reinstatement premiums and certain onetime costs, our expense ratio was 37.8%, an 80 basis point improvement.

Finally, on a year-over-year basis, our nonacquisition costs were flat to 2018. So our expense management efforts combined with the 7.1% growth in gross written premium continues to drive progress towards margin enhancement. And finally, three, generate on average -- a return on average shareholders' equity of 700 basis point above the risk-free rate. Our quarterly operating income of $41.1 million or $1.18 per share generated an annualized 9.1% return on average equity.

Let me go through a few of other -- a few items of further explanation in the quarter's numbers. As Mark mentioned, overall the business grew on a gross written premium basis by 7.1%, which, of course, is a function of both the increase to business volumes and a better-than-anticipated rating environment. One particular item, which deserves a bit more explanation with regard to premiums, is the quarter's retention levels.

As noted during the year, last year and on the fourth quarter call earlier this year, we strive to be an originator of the best-performing risk and will retain exposures that fit within our risk and volatility appetites. Through the use of third-party capital, including certain strategic reinsurance programs, we are essentially originating a portion of risk on behalf of third parties. And we increased this mechanism in the second half of 2018 and headed into 2019. This is most pronounced in the quarter by way of the change in relationship of gross -- of net to gross written premium. In the quarter for the group, the retention was just under 48% versus a retention ratio of 52% in the prior year's first quarter. That said, the first

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quarter was impacted by the treatment of certain outwards reinsurance treaties, and as such, we expect the retention for the year to be just under 60% or slightly less than last year.

Touching on the U.S. operations. Gross written premium rose by 10.2% to $410 million compared to the 2018 first quarter. Mark referenced the growth by product. It's worth noting that the growth in property is somewhat exaggerated by the introduction of our funding program without which GWP in that line grew by 6.8%.

This quarter, there is a noticeable difference in retain -- in net retained premiums compared to a year ago. The gross to net written premium retention ratio in the 2019 first quarter was 60.5% consistent with the fourth quarter of 2018, but compared to 66.8% in Q1 2018, primarily due to the increased use of reinsurance program and the aforementioned new fronted program in property.

Turning to margins in the U.S., we're pleased with the loss ratio, which improved 3 points to 56.5% in the 2019 first quarter from 59.5%. The calendar year loss ratio, excluding catastrophe losses, improved 1.8 points to 56.5% from 58.3%, primarily reflecting higher premium rates and business mix shift.

In addition, in the first -- in the 2018 first quarter, there were several non-CAT weather-related loss events that were not repeated in the 2019 first quarter. Underwriting income rose 55% to $24.8 million from $16 million in the 2018 first quarter. A 4.4% increase in net earned premiums, a 180 basis point improvement in the current estimated loss ratio and continued positive prior year development for the quarter of $4 million, reflect the effects of scale, efficiency, underwriting discipline and digital initiatives.

Moving to international operations. Gross written premium of $350 million rose 3.7% from the 2018 first quarter. This growth is primarily attributed to property and liability lines in the Bermuda and European insurance operations. Benefiting from new business opportunities and higher premium rates, Bermuda insurance line -- lines represent approximately 58% of the quarterly increase in growth.

The growth in the European insurance lines relates to the acquisition of Ariscom in the 2018 first quarter. Net retained premiums as a percentage of gross written for the 2019 first quarter were 32%, down from 35% in the 2018 first quarter. This, again, is part of the increased use of third-party capital, primarily in the reinsurance property lines. As a result, property lines both net written and earned premium are down.

The loss ratio for the 2019 first quarter was 56.2% compared to 52% for the 2018 first quarter. The increase in the loss ratio reflects modest unfavorable prior year reserve development this year compared to favorable development in 2018. Coupled with a small CAT loss reported in the segment against the CAT-free quarter last year.

When adjusting for these 2 items, the underlying trend demonstrates the stability of the results in the quarter with the current accident year ex-CAT loss ratio up 80 basis points year-on-year, more a function of business mix and a few discrete attritional losses than to underlying changes in the core loss ratios.

The loss ratio in the 2019 first quarter was also impacted by an increase in ceded reinsurance premiums paid as a result of higher ceded loss recoveries on prior catastrophe events. A couple more items to note. As we discussed in prior quarters, we've evaluated the impact of U.S. and other jurisdictional tax changes to our expectation of consolidated effective tax rate. After further analysis and a clearer understanding of the implication of such changes, we've lowered the assumptions used in the calculation of operating earnings to a 15% tax rate, down from our prior assumption of 20%.

We believe the new assumption is appropriately conservative as demonstrated by the current quarter's effective tax rate of just under 10%. This quarter's provision also included some adjustments to prior year taxes -- to prior tax years, which when taken into account would produce an effective tax rate of approximately 13.5%.

Following up on Mark Rose's comments on investments, our core portfolio continues to perform quite well with the contribution to net investment income growing 17.2% in the 2019 first quarter due to higher invested asset base and improved investment yields. The 2019 first quarter benefited from improved financial markets with volatility was significantly less than the 2018 fourth quarter. As a result, the change

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in value of equity securities resulted in an unrealized gain of $54.2 million through the income statement, a positive swing compared to the unrealized loss in the 2018 fourth quarter.

While the change in unrealized losses on fixed maturity securities in 2018 of $75 million reported through AOCI swung to a gain of $61.6 million at March 31, 2019. Quite a reversal in such a short period of time. All of which along with the strong contribution from underwriting results contributed to the quarter's growth in book value per share, which as Mark mentioned, was 7.4%, 8% with the inclusion of dividends. Operator, that concludes our prepared remarks. And we're now ready to take questions.

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Question and Answer

Operator

[Operator Instructions] And our first question comes from Jeff Schmitt of William Blair.

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

A question on the expense ratio, and I think you had mentioned in your opening remarks, Mark, that you think it would come down about a 100 basis points per year for the next couple of years. And just looking in at the U.S., it was flat year-over-year, there were some investments in the business in that still. How much of that overall improvement is going to come from scaling versus those internal investments coming down or are you at sort of a run rate ongoing expense for that?

Mark Edmund Watson
President, CEO & Director

Well, we're always going to be spending money on technology, particularly with the rate of change. But I think I said this last quarter, I think we're kind of over the hump on big expenditures. I think now it's more iteratively as we see opportunities. But as I was mentioning in my remarks today, I think that a lot of the things that we have going on that I've highlighted today and in previous quarters, were hitting 5% of the business, maybe 20% or 30% of the business maximum so far in the U.S. So there's still a lot of opportunity to roll a lot of the -- a lot of other lines of business onto some of the technology platforms or digital platforms that we've created.

So I think a lot of the scale that Jay alluded to is in part writing more business in general, but I think it's also rolling more business onto the digital platforms that we've created. So I do see the opportunity for an improvement in expense ratio in the U.S. as well as in international. And as -- I think, Jay and I both said today, we're really just getting going with some of the things we think we can do with our technology in our international business, particularly in London. And the good news is that we -- through a lot of trial and error in the U.S. and in Brazil over the last 5 years or so, we don't have to go through all that trial and error again to deploy some of our know-how that we've figured out. And I would also add, I think -- I didn't say this today, but I think I said this last quarter, the cost of technology continues to come down. And we find ourselves in a really good spot, in that we can now afford technology that was otherwise unavailable before. And we're not locked into these -- while we all have legacy systems, we're not locked into these legacy systems that cost $100-plus million to build and maintain.

So we're trying to get to the cloud as fast as we can, and that's not free, but it sure is scalable.

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

Okay. Do you have a sense on how much of the U.S. business you could put on that platform, and likewise, international as you shift there?

Mark Edmund Watson
President, CEO & Director

Yes. Well, the goal -- so the goal is 100%, right? I mean I get that that's somewhat aspirational. But the goal is a 100%. Do I think that 70% or 80% in the short run is achievable? The answer is yes. Do I think that's true in international? That may take a little longer just because of the Lloyd's construct, but I think, we'll certainly get 30% to 50% of that on -- and it will come on, I think, at a faster rate in the U.S. But again, we're just getting going.

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

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Okay. And then just one real quick on the underlying loss ratio in the U.S. down close to 200 basis points. Can you provide any more color there on what sort of drove that?

Jay Stanley Bullock
Executive VP & CFO

Well, I mean, it's a couple of things. One, and I've -- maybe I'll just go back to one of your earlier questions and that was about the expense ratio. We're seeing growth in some businesses like surety that are going to drive up -- that are going to keep the expense ratio elevated as it contributes to that business. Likewise, we're seeing -- we're writing more surety business, that drives the loss ratio down. The other thing that was really driving the result in this quarter relative to last year was some underlying property losses that hit in the first quarter of last year. They were weather-related losses that weren't -- wouldn't have been characterized as a CAT. You may recall it was kind of a bad winter.

Mark Edmund Watson
President, CEO & Director

Yes. I think the way I characterize it a year ago was, we have a certain amount of property or CAT activity that's not hurricanes and earthquakes. And we think these things are going to happen at a certain level, and then every year it always seems to be more. And the other thing we always talk about are losses that we think will happen about every -- from an actuarial perspective about every 18 months. And we had more -- we had an abundance of those in the first quarter a year ago.

Operator

Our next question comes from Bijan Moazami of Compass Point.

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

You had a phenomenal growth rate in the professional lines. If you could talk about what's driving that. Is it pricing? Market share gains? What are the kind of products that drives that? Also, if you could walk me through why you're buying a lot more reinsurance for this particular line?

Mark Edmund Watson
President, CEO & Director

The professional business is growing for a number of reasons. First, we've hired a number of talented people that had originated a fair amount of risk. And I think -- Bijan, I think, we've been talking -- I know we talked about this last quarter a little bit, but I think we've been talking about it for the last 3 or 4 quarters. So I would expect that rate of growth to moderate this year on a written basis as those underwriters kind of fill up their portfolio. And of course, there is a lag between written and earned. So I suspect that our earned premium this year will continue to be more than we would normally expect just as written was a year ago.

As for why we buy -- why we would buy a lot of reinsurance on this book, whenever we're growing something quickly, I like to buy a little more reinsurance than we might otherwise, just to make sure that we didn't get something wrong and add in more volatility than we expected. And of course, we always think that buying reinsurance is a good hedge against volatility in general. And depending on whether we -- assuming we get the math right, sometimes it's a less expensive way to capitalize the business on our own balance sheet.

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

Are you getting a lot of rates, too?

Mark Edmund Watson
President, CEO & Director

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Yes. So I think that as you've heard on the other calls this quarter and the previous quarter, pricing is finally starting to move up across the board in professional liability.

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

Okay. On the property lines, obviously you're not retaining much of that business anymore. So is it fair to assume that your catastrophe exposures or catastrophe losses is going to dramatically decrease going forward? And more importantly, is that business becoming really a fee business at this kind of retention?

Mark Edmund Watson
President, CEO & Director

So I -- yes. And that's the point I was trying to make at the end of the fourth quarter and also at the end of the third quarter. If you look at our CAT results for the second half of last year on a net basis versus the year before, yes, I think, dramatically different is probably the right word to use, particularly given that the number of CAT events or exogenous events last year was pretty similar in both number of events and the total financial impact at an industry level, at a gross level for us. But you can see that the net -- the difference in net was quite considerable. Fortunately, it's about where we predicted it would be a year ago. I think we could have done without paying all the losses but it was nice to see that they came in about where we thought they would when we were predicting at the end of 2017 what would happen if a number -- if a similar set of events happened in 2018.

As far as fee business, yes, I think that is a good way to put it. That's what -- that's why Jay and I are both referring to when we say that we're originating risk on behalf of others. So we're underwriting on their behalf and we're getting a fee for it. With all of the CAT activity this past year, meaning 2018, it's kind of hard to see that flow through the P&L. But I think we'll get -- we'll have a chance to see more of that in 2019.

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

Is that capacity here to stay?

Mark Edmund Watson
President, CEO & Director

Yes. Remember, most of -- I shouldn't say, remember, most of that capacity is in the form of capital supporting both of our syndicates. And so far, our capital providers seem pretty pleased with us. What I was saying about the fee income is a lot of it is based upon profitability. And so given the amount of activity in '16 and '17, we haven't had a chance to earn the fee income that we think we would on a normalized basis.

Operator

Our next question comes from Matthew Carletti of JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Just a few questions. Just want to follow up, Mark and Jay, on some of the pricing comments you made. You referenced a few times stronger pricing in certain areas, and you just mentioned professional lines. Outside of, I think, CAT which is one of the more obvious ones, are there other areas you'd point to in your business that you're seeing some significant pricing movement?

Mark Edmund Watson
President, CEO & Director

Well, let's start with CAT, it's the easiest. So both reinsurance and property are finally moving up, particularly the D&F property in London that was CAT-exposed. That's mid-teens on up. And remember, we were talking about getting rate increase although it was more modest a year ago. We also talked about

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reducing the size of the portfolio if we couldn't get the rate increase that we wanted. For -- here is what I would say for our other lines of business. On average, we're seeing single-digit rate increases, not double-digit rate increases. But keep in mind that our portfolio mix is not the same as everyone else.

And when you look at our loss ratios that are running in the 50s across the board -- by the way, that's U.S. and international, we don't necessarily need that much rate increase. We'll take it, but that's why I was making the point in my opening remarks that I think what really moves the needle for us the most, is just continuing our portfolio optimization that we've been working on for the last several years and continuing to use the digital platform and creating algorithms to help us select risk. And also continuing to drive scale on our platform so that we're less dependent upon rate increases. Having said that, if the market price goes up, we're going to be a beneficiary of that just as much as our competitors will be.

Matthew John Carletti
JMP Securities LLC, Research Division

Right. Okay. Next question just relates to -- you mentioned in your prepared comments about the more flattish year-over-year result and liability being the result of some nonrenewed cyber exposures. I was just wondering if you'd give us a little color there. Is that -- was that just price? Was it aggregation? Was it you weren't comfortable with terms? What led to you nonrenewing a chunk of business in both segments there?

Mark Edmund Watson
President, CEO & Director

Yes. So it was mainly a recognition on our part. So this is just our point of view that the market price for the very large cyber accounts is mispriced, particularly the top end of programs that are now hundreds of millions of dollars. And we thought it was better to just sit on the sidelines and wait for the market to not only reprice some of the cyber programs that are out there, but also restructure them as well.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then last question, just looking up at the strong growth in property, which you've talked about a bit. Just wondering, is there -- should there be any -- based on your expectations for the year, is there anything that should make that more front-end weighted versus spread across the year? Would you expect a strong-ish level of growth out of property across all the different renewal periods?

Mark Edmund Watson
President, CEO & Director

Well, no. I think the market in general for CAT-exposed property is front-end weighted for the first 7 months of the year. So you should -- you'll see more activity and more change next quarter and then modestly in the third quarter. But I think you'll see the most amount of change this quarter, particularly for non-U.S. business and a little bit more change for the U.S. business in the second quarter.

Operator

Our next question comes from Christopher Campbell of KBW.

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

I guess my first question is kind of the adverse development in international. I guess just where is that coming from? And is any of that like Jebi-related?

Jay Stanley Bullock
Executive VP & CFO

The answer to the second question is no. It was $800,000. So it was really small amounts in various places. It just ended up when you counted it all up, it was on that side of the ledger on the international front.

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Mark Edmund Watson
President, CEO & Director

Yes. But to go back to Jebi, we did -- on a gross basis, we did see some development in Jebi, but our retro program picked it up.

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

Got it. But I know you guys are -- you obviously buy a ton of reinsurance, but I mean, like how are you guys approaching that going into mid-year where we're hearing, like, rumors of, like, potentially rate increases. How would that influence your reinsurance buying strategy?

Mark Edmund Watson
President, CEO & Director

That's a really good question. So when we think about reinsurance, there is a number of different factors that go into it. One is managing volatility. Another is the substitute form of capital. And the third is just looking at the price of reinsurance relative to whether we want -- what it -- we're always looking to see if we can generate a better return on capital if we kept the risk net on our books versus laying it off.

So I mean depending, Chris, on how reinsurance pricing goes up, that may -- we may want to decide to keep more net, particularly if we're getting price increase as an insurer. And so my guess is that there will be a lot of movement in our reinsurance programs this year. I suspect that we'll add more to some and let others go depending upon price, but so far for our reinsurance programs that we're buying, price has been pretty flat since the 1st of January.

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

Okay. Got it. And then on the Lloyd side, I know you reinsure it. I mean there is 2 ways you can do it there, but like what are you seeing in terms of your pricing over there?

Mark Edmund Watson
President, CEO & Director

Yes. So remember that most of the reinsurance program, there isn't really reinsurance per se, it's third-party capital supporting our syndicates. And in fact, the majority of the capital supporting our syndicates is third-party capital. So that's kind of the largest form of laying off volatility that we have. As far as the reinsurance programs that we've got that have come up for renewal so far, again, they're renewing relatively flat.

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

Okay. Great. And then just one last one, the international expense ratio was kind of roughly flat, and I know that was one area that you were targeting for improvement. I guess just when should we start to see that your action is starting to take hold there?

Mark Edmund Watson
President, CEO & Director

Well, I'm going to give the same answer I always do, which is, it's going to be lumpy, but if we look over a period of time, that's a year or more, I think, we'll -- we should start to see some improvement, but some of it is also mix of business. And one of the things that I've talked about on the last 2 or 3 quarters is this reality that sometimes acquiring business is very expensive. And so I have really been pushing my colleagues in London, in particular, to look at how much coverholder business we've got where the acquisition cost is literally 30 to 40 points and reducing that a bit this year, well, more than a bit this year.

Now in the short run, that may have a corresponding increase in nonacquisition costs as we allocate fixed costs over less premium. But my guess is, it's kind of a push when you lighten up one and then allocate

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the rest. So I think it's going to be lumpy over the next few quarters, but as we're always saying, what matters most is the loss ratio. And I just want to make sure that we really get our product mix right in our international business. So as we reallocate our portfolio, I think we'll see acquisition costs come down -- or have the acquisition cost ratio come down and we'd like to try and hold the nonacquisition expense ratio flat at the same time.

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

Got it. And does the acquisition cost ratio, does any of that, like, the improvement that you're planning, does any of that include, like, increased ceding commissions just by ceding more business you get more of your expenses reimbursed?

Mark Edmund Watson
President, CEO & Director

That's a good question. But in this instance, that really doesn't come into the fray.

Operator

Our next question comes from Greg Peters of Raymond James.

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

I guess I'd like to start by going back to your operating target of 700 basis points over the risk-free rate, current ROE objective. And in your comments, Mark, you added a caveat, which was allowing for normal loss expectation. So I thought maybe for a second you could go back and revisit that and clarify what you meant by that?

Mark Edmund Watson
President, CEO & Director

Yes. My point was, if we have a year like last year or the year before, it's hard to imagine that we would have had an ROE of 10 points. Now you would expect in the less volatile year to make it up. And that's kind of what we've seen in the first quarter of this year. We had -- last quarter, we had the capital markets impacting ROE in a negative way, and this quarter they were impacting ROE in a positive way. Last year, particularly in the third quarter and the last 2 quarters of 2017, we had a more than average level of CAT activity. So I was just trying to point out that there will be some volatility depending upon what's going on in the world around us.

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

Well, just as a follow-up on that, is there -- I mean when we think about our projections, curious what -- how you're thinking about CAT impact on the consolidated loss ratio in any given year?

Mark Edmund Watson
President, CEO & Director

Yes. So I think given how we have repositioned the portfolio on a net basis, I think 3 to 5 points, depending upon how much activity there is in a year, is a reasonable starting point.

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

Okay. Yes. I'm about to repeat or try to repeat a comment that Jay made. So if I make it -- I make a mistake with it, I apologize and you can correct me. But I believe, Jay, in your comments you said that the net premium written to gross premium ratio is running around 48%. And then you went on further to say that -- or suggested it should be running around 60% for the full year. Assuming I'm repeating it correctly, is there any specific cadence on how that ratio might evolve over the remaining 3 quarters?

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Jay Stanley Bullock
Executive VP & CFO

Cadence, I -- if you go back and look at last year as a proxy, the numbers would have been 52, 63, 63, 61. That would have been the quarter-over-quarter -- that would have been a quarterly progression last year. What I suggested was, I think, when the dust settles this year, it will be slightly below 60. So I think starting out with that lower number this year, you can kind of benchmark it off of what you can see in the numbers from last year.

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

Okay. That actually is helpful.

Mark Edmund Watson
President, CEO & Director

Yes. I don't see that -- Greg, I don't see that much difference throughout the rest of this year and going forward. It might be a point or 2, but that's ...

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

Okay. And I mean the final question will be around the ongoing discussion you have with shareholders around your investments in technology, data analytics and algorithms. It feels like algorithms, data analytics have all replaced the rhetoric management uses on all conference calls. And it's just not you. We're hearing from everyone use those buzzwords. And when I think of data analytics and algorithms, I think of data scientists sitting in a room, crunching through numbers. And there's a lot of other companies that have a lot more scale and size to invest in that type of initiatives. So I'm curious about your initiatives and the balance you strike between doing it in-house and then using outside vendors and just adding some more color around what you've been doing there is always helpful.

Mark Edmund Watson
President, CEO & Director

Okay. Well, I just want to say that we've been using those buzzwords for a while. It's interesting when you asked the question about the difference between doing it in-house and using third-party vendors, when we started doing this in-house a couple of years ago, we did so because there were very few third-party vendors. And now they're popping up everywhere. And actually, at a meeting that we had a couple of months ago on technology, we were talking -- we're always talking about how we want to allocate our resources on building technology. And what we're quickly realizing is there is so much more available today that third parties have already created that we don't have to build a lot of our digital things that we were doing years ago. And so our shift is focusing more and more now towards trying to find best-in-class technology that we can apply for ourselves instead of trying to create it for ourselves.

And also, while I didn't talk about it this quarter, I think you all have heard me in the past talk about how our workforce has really changed a lot while our head count hasn't really changed too much. We have many more data science -- well, we didn't have any data scientists a few years ago. We have many more actuaries today. We have software engineers today. We have a lot more people that are very focused on data and figuring things out from an automated perspective, which is why we made the point that we've been able to grow so much without having to add head count in general, but add underwriter head count in particular.

And so particularly for our small account business, it's much more about -- and I'm saying this figuratively, not entirely literally, it's much more about a portfolio approach than just risk-by-risk, but for our large account business, it's still very relationship-driven and very much risk-by-risk. So it's really opposite ends of the spectrum. So we'll try and come up with some new buzzwords next quarter, but I do think that we've kind of -- we, the industry, has kind of hit a tipping point in recognizing that there is technology available and we'd better be using it.

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

Right. I know you value your distribution partners, but we're also hearing in -- on the distribution side investment in technology, and it seems like there is risk for disintermediation. And I know you're not going to throw your distribution partners under the bus on a conference call, but can you talk a little bit about what you're seeing in that side of the business because distribution isn't a very expensive proposition for any insurance company?

Mark Edmund Watson
President, CEO & Director

Well, that's right. And so one of the things that I've said on previous earnings calls is that I didn't think there would necessarily be disintermediation in any one part of the value chain. But I thought there would be disintermediation in the sense that those that have figured out how to use technology effectively will be able to reduce the cost it takes to deliver the product to the end user, the policyholder. And I thought that those that were not investing in technology would get left behind over time. And I think that you're slowly starting to see that a little bit now. But if you think about my remarks from earlier today in distribution, the point -- one of the points I was trying to make is and we've made it really easy for our distribution partners to engage us and that makes it less expensive for them to deliver the policy to the business owner.

So I think you'll see us all get connected. I think that we, underwriters, are good at evaluating and selecting risk. And I think that brokers are really good at helping business owners understand what risk they need to insure and the best way to go about it. And most importantly of all, and this is particularly true for the larger accounts, providing choice in a whole account solution to the business owner. One of the things that I -- we're so good at slicing ourselves into little specialties that it makes it impossible for -- sorry, it makes it very difficult for us to provide a one-stop shopping opportunity for a business owner. And so the broker plays a very valuable role in that they kind of bring all the different products in the market together and deliver them more seamlessly than we underwriters are capable of doing right now. And again, I'm talking about larger accounts that are more specialized. For small bot policies, we'll see how that market evolves.

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

Okay. I guess the final comment I'll make is, and you guys can respond, is that with the lower tax rate going forward, it seems like you've lowered your combined ratio targets in essence -- in an effort to hit your 700 basis points over the risk-free rate return hurdle. So I think -- go ahead.

Mark Edmund Watson
President, CEO & Director

I'm going to answer for Jay. I think the reality -- I don't think that's -- I mean that may be an outcome, but that -- the reality is we keep looking at what we're paying in tax every quarter, and this has been going on for a few years now. And the reality is that our effective tax rate looked a lot more what -- like what Jay just described, and I think our auditors are really leaning on us to think hard about what our effective tax rate should be.

Operator

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

Mark Edmund Watson
President, CEO & Director

I'd like to thank everyone again for dialing in this afternoon. It's not a lot of time to digest between when we report and this call and I appreciate everyone's diligence. And I also really appreciate everyone's diligence at Argo. Everybody has worked really hard this quarter and the financial results are a reflection

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of everybody's hard work. And I'm thankful and look forward to talking to you all at the end of the second quarter.

Operator

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

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