ARGO GROUP

Get there together

Letter to Shareholders
Mark E. Watson III
Chief Executive Officer

A heartfelt note to our friends in Texas.

As I prepare to send out this letter to shareholders, Hurricane Harvey has made landfall in many Texan cities and towns. High winds and torrential rains continue to cause catastrophic damage and injury, and we all know that the effects will be felt for months. So before we talk about ourselves, we should first recognize the courage and tenacity of our clients, colleagues and relatives in the storm's path. We pray that your families are safe and that the days ahead turn quickly to better fortune.

Right strategy. Right team. Right size.

Argo exists to help businesses stay in business. As a specialty underwriter, we build innovative solutions for hard-to-place risks and deliver them through a network of distribution partners where we have close, creative relationships. Together, our ultimate focus is always our customers. I suspect that's part of the reason that *Forbes* again this year named Argo Group in their 2017 list of *America's 50 Most Trustworthy Financial Companies*.

During the first six months of 2017, we achieved profitable growth in our U.S. Operations, Bermuda and Latin America, managed a complex and difficult market at Lloyd's, and generated strong investment returns. Steady on our strategic course to be a leading, global specialty underwriter, we once again achieved strong results for our shareholders.

In our first six months, gross written premiums grew to $1.286 billion, up 19% compared to $1.080 billion over the same period last year. Due to a number of non-recurring expenses such as transaction and restructuring costs for Ariel Re in the first quarter, our combined ratio was 98% compared to 95% for the 2016 first half. The loss and expense ratios were 58% and 40% respectively, compared to 56% and 39% for the 2016 first half. These figures reflect a number of sizeable one-time expenses in the first quarter. As a result, net income was $82.7 million or $2.67 per diluted share, compared to $58.6 million or $1.89 per diluted share for the 2016 first half. Adjusted operating income, however, was $62.6 million or $2.02 per diluted share, compared to $66.9 million or $2.16 per diluted share for the 2016 first half. Similarly, loss ratio excluding catastrophes and reserve development was 57%, compared to 55% for the 2016 first half.

We took deliberate steps to broaden the scope of our investment activity, and I'm pleased to report that investment income in these first six months rose more than 30% over last year's first half to $74.1 million from $56.9 million. This was due in part to our buying and then selling a sizeable share in a surety company. Given our overall performance, our book value per share has grown 6.7% from the end of the second quarter of 2016, and the annualized return on average shareholders' equity was 9% at June 30, 2017. For the last 15 years including dividends paid, the compound annual growth in book value per share has been 10%.

Our operations are now directed and reported in a simplified two-segment structure. I will address our results in two parts. We report where risk is underwritten, not necessarily where it resides.

U.S. Operations

Our U.S. Operations include all business units formerly reporting under Argo's Excess & Surplus Lines and Commercial Specialty divisions.

For the six months ended June 30, 2017, U.S. Operations reported gross written premiums of $700 million, up $90.6 million or 15% over the same period last year. Net written premiums rose to $478.5 million from $412.9 million for the same period, with earned premiums up 9% to $450.3 million. For the 2017 first half, U.S. Operations reported underwriting income of $50.1 million, compared to underwriting income of $51.4 million for the 2016 first half. The 2017 first half combined ratio of 89% compares to 88% for the 2016 first half. For the 2017 first half, net favorable prior-year reserve development was $18 million or 4 points on the combined ratio, compared to net favorable prior-year reserve development of $11.9 million benefiting the combined ratio by 3 points for the 2016 first half.

Our increase of almost 15% gross written premiums across our combined U.S. Operations is the result of our focus on improved teams, products and systems. It's worth noting that our strong performance was made within an overall market that has been relatively static. Under Kevin Rehnberg's leadership, we have made a host of refinements with the customer in clear view. In our casualty business, where speed matters to our producers, we've reduced the time it takes to underwrite a policy from as many as 10 days to less than one. In Argo Surety, we've expanded our footprint so we can address our clients' growing needs around the globe. In Argo Pro, we've brought new products and better systems online, and added a number of new faces to a strong team, notably Mary Henderson from Travelers as senior vice president, head of financial institutions, and Dan Gmelin from Hiscox as vice president, underwriting, architects and engineers. Trident Public Risk Solutions has continued its strong performance through the first half of the year. And Rockwood – operating out of Pennsylvania for over a century – has expanded its offerings and grown considerably.

International Operations

International Operations include ArgoGlobal with Lloyd's Syndicate 1200 and Ariel Re (acquired in February), and International Specialty, which includes Argo Seguros in Brazil, Argo Insurance in Bermuda and our operations in Europe and Asia.

For the six months ended June 30, 2017, International Operations reported gross written premiums of $585.7 million, up 24% or $114.9 million over the 2016 first half. Net written premiums were $311.9 million versus $278.3 million for the same period. Earned premiums were $328.1 million versus $276.2 million for the 2016 first half. In this period, International Operations reported underwriting income of $4.6 million compared to $18.1 million for the 2016 first half, with a combined ratio of 99% compared to 93% for the 2016 first half.

There is still more supply than demand in the London subscription market. This is one of the most complex and competitive markets we have seen for some time, with sustained pressure on pricing tempting some syndicates to make unwise decisions. Not us. While conditions are tough, our strategy is solid. We exercise controlled management of expenses and refuse to chase top-line growth, preferring to wait and find risks we can underwrite more locally. Our acquisition of Ariel Re in February was greeted enthusiastically by brokers in Bermuda who now view us as a must-see provider on the island. With Argo Re and Ariel Re integrating their tools and talents, we now have superior systems, data and modelling methods that benefit our customers as much as they do Argo. In Brazil, where a quarter of our distribution is now digital, we offer a growing suite of products through more than 2,000 active brokers. In our first six months of 2017, our growth there has been solid. Argo was named the *Reactions Insurer of the Year* in Brazil for 2016, particularly for leadership in digital innovation. Under Jose Hernandez, who joined Argo last fall, our International Operations segment has a strong management team bolstered this year with the arrival of three exceptional professionals. Dominic Kirby joined us with Ariel Re and is now heading up our Argo Managing Agency in London to guide our two syndicates. Jorge Luis Cazar León moved from Chubb to run our Latin American operations, and Matt Harris arrived from AIG to direct our European and Asian operations.

Performing well in a tough environment

I am confident Argo has the right strategy and team, and in these six months we've seen once again that we are an ideal size. Our ongoing reinvention of the company has been easier because we're compact. Our service to our customers is more intimate and our response time faster. Our diversified portfolio reduces our reliance on any one product or geographic region and allows us to reallocate resources to the lines of business with better margins. And the responsibility that individual members of our team enjoy has improved the effectiveness of our decision-making. Considering the depth of experience and talent in the professionals we've been able to hire in the past 18 months, it's clear that Argo has become an attractive career move for top performers in the industry.

Our customer focus gets sharper every quarter. In these six months, we've kept that focus on distribution partners who want to interact digitally, and who intend to address and meet all the needs of each customer segment rather than offer isolated products and services. Many of our systems are designed for this integrated platform approach. In short, our relationships are intimate, our products are increasingly digital and, for our customers, working with Argo is simpler than ever before.

Helping businesses stay in business

As with all our competitors who operate internationally, we know that the situation in the London market and others like it is unsustainable. The pressure on pricing in those geographies will ease only when our industry as a whole takes responsibility and makes some deliberate changes. We must no longer refuse to adopt processes and protocols that make us more efficient. We all must commit to addressing the real, evolving needs of customers rather than dusting off well-worn products for their consumption. Brokers, sitting close to their customers, must acknowledge a duty to ask about changing needs, consider them and help us all respond. We also must resist the temptation to sell short-term solutions for the long-term needs of policyholders. Those policyholders too must admit that as long as they insist on paying bottom dollar, they will have neither the coverage nor the service they will surely need when a catastrophe hits. Lastly, investors in our industry must be rational in their expectations for returns given the environment in which we do business.

Ours is an industry designed to help businesses stay in business. We won't lose sight of our mission.

Mark E. Watson III
Chief Executive Officer