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M&A Call

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Presentation

Operator

Good morning. My name is Amy, and I will be your conference operator today. At this time, I would like to welcome everyone to The Hartford call to announce its agreement to acquire The Navigators Group. [Operator Instructions]

Sabra Purtill, Head of Investor Relations, you may begin your conference.

Sabra Rose Purtill
SVP, Investor Relations

Thank you. Good morning, and thank you all for joining us today. Today's call and webcast covers our announcement to acquire Navigators Group, a leading specialty underwriter headquartered in Stamford, Connecticut.

The news release and presentation addressing this future acquisition are available on our website. In addition, the 8-K, which summarizes the major provisions of the agreement, is also available on our website.

Our speakers today include Chris Swift, Chairman and CEO of The Hartford; Doug Elliot, President; and Beth Bombara, CFO. Following their prepared remarks, we will have time for Q&A.

Just a few comments before Chris begins. Today's call includes forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and actual results could be materially different. We do not assume any obligation to update information on forward-looking statements provided on this call. Investors should also consider the risks and uncertainties that could cause actual results to be different from these statements. A detailed description of those risks and uncertainties can be found in our SEC filings.

Our commentary today also includes non-GAAP financial measures. Explanations and reconciliations of these measures to the most comparable GAAP measure are included in our SEC filings as well as in the news release, which is available on our website and also on our slides.

Finally, please note that no portion of this conference call may be reproduced or rebroadcast in any form without The Hartford's prior written consent. Replays of this website and an official transcript will be available on The Hartford's website for at least 1 year after this call.

Christopher Jerome Swift
Chairman & CEO

Good morning, and thank you for joining. Earlier today, we announced the agreement to acquire Navigators Group, a global specialty underwriter for $70 a share or approximately $2.1 billion in cash. We have been attracted to Navigators' expertise and track record of underwriting profitability for quite some time and are very excited about the future potential this transaction provides.

The combination of our 2 businesses will meaningfully advance several of The Hartford's key strategic initiatives: it enhances our Commercial Lines' market presence with Specialty and E&S capabilities. It broadens and deepens our product offerings with expanded industry verticals. And it expands our geographic underwriting reach with an international presence.

Importantly, we see compelling growth potential in cross-selling the combined product offerings to our respective customer bases. This acquisition brings together 2 like-minded organizations with compatible cultures focused on disciplined underwriting, innovation and financial performance. Finally, the transaction is expected to generate attractive financial returns in the low double-digit range over time.

In a few minutes, Beth will cover some of the key financial impacts of the transaction. Earnings expectations will be refined between now and closing based on our go-to-market strategies and

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integration process. Currently, we expect that within 4 to 5 years, the acquisition could contribute annual core earnings approaching $200 million, excluding amortization of intangibles.

An important driver of the financial returns on this acquisition is greater profitable growth. While there are some expense efficiencies, they are not the primary driver of future returns. Like us, Navigators' primary focus has been on organic development with a strategy centered on adding products and talented people. Together, we anticipate additional momentum from several opportunities.

First, as Doug will discuss, Navigators brings underwriting expertise, industry and product verticals and a global platform that can help us accelerate initiatives we recently launched. Second, with our expanded market presence and product offerings, we can offer more products and services through a shared distribution network, enhanced by The Hartford's brand and financial strength.

Both Navigators and The Hartford have successful business relationships with the industry's top brokers and agents. The acquisition will further strengthen those partnerships and the coverage solutions that we can tailor for customers.

We also look forward to maximizing the potential of Navigators' Global Reinsurance business. It's a relatively small part of their business with about 13% of gross written premiums and is comprised of traditional P&C reinsurance, A&H and other product specialties. This business is an efficient way to participate in certain U.S. and international markets.

Together, we are confident that we can accelerate profitable growth. I look forward to welcoming Stan Galanski and his leadership team and the 820 Navigator employees worldwide to The Hartford. Our organizations share a common culture and a commitment to attracting and retaining top talent. And we look forward to working together with our future colleagues.

Now I'll turn the call over to Doug for his perspective on the benefits this acquisition brings to The Hartford.

Douglas Graham Elliot
President

Thank you, Chris. We're very excited about joining forces with Navigators as we continue our journey to become a deeper and broader commercial underwriter. As we've discussed with you many times, we believe that success in today's property and casualty market requires specialization that comes from highly skilled talent with extensive local market and industry knowledge. Agents, brokers and customers demand a partner that understands risk and is capable of solving their broad needs for protection, risk management and service. Navigators' team and product offering are an excellent complement to our strategy, capabilities and culture.

Let me highlight a few areas where we believe this combination accelerates our business plan. Throughout their 44-year history, Navigators has been known for their expertise in marine liability, cargo, specie and hull insurance. In more recent years, with innovation and entrepreneurial spirit, they have been adding capabilities in other specialty areas, including excess casualty, environmental liability and life sciences. Navigators' build-out of their excess and surplus lines strategy in the wholesale market is distinctive and respected. These capabilities are highly complementary with our own initiatives in industry verticals such as marine, construction, technology, life sciences and energy as well as our expansion into surplus lines.

In addition, Navigators' Lloyd's platform and recent international expansion initiatives will extend our capabilities and geographic reach, adding a U.K. and European underwriting presence that we do not presently have.

We have been impressed with the technical depth and market knowledge of the Navigators leadership team. They clearly know their business well and have developed a well-earned reputation in the market as highly skilled underwriters and business professionals. We are convinced that the combination of The Hartford and Navigators results in a stronger, more diversified commercial lines company that is even better positioned to compete in the marketplace.

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Navigators' product and industry specialization will expand our risk-taking skills and add to our growing industry verticals. In areas such as management and professional liability, we will immediately increase our scale and market presence, providing a better platform for profitable growth. Together, we bring a more comprehensive suite of product, underwriting and service capabilities, including our market-leading workers' compensation offering, to address the diverse needs of our agents, brokers and customers.

In the months ahead, we will work on our plans to maximize the strategic and financial value of this acquisition. As we further evaluate our opportunities, we will make decisions about our operating model, assessing the most effective market strategies for various product lines and industries. From my vantage point, I see ample opportunity for us to accelerate our businesses and build value for our shareholders, customers and distributors.

I'll now turn the call over to Beth.

Beth Ann Bombara
Executive VP & CFO

Thank you, Doug. I just wanted to touch on a few key financial and transaction items. The $2.1 billion purchase price can be paid in cash from existing corporate resources, including those at the holding company and dividends from subsidiaries. We will also evaluate financing alternatives between now and closing, which would reduce the utilization of our current resources. To be clear, we do not intend to issue common equity to fund this acquisition.

Our debt levels will increase slightly at closing due to Navigators' $265 million of debt, which will result in a modest increase to our total debt-to-capital ratio, excluding AOCI, which was 25% at June 30, 2018.

The actual impact of the acquisition on our income statement and balance sheet will depend on many factors, including: the timing of the closing; purchase accounting impacts, such as intangible assets and goodwill; integration cost and acquisition-related charges, including transaction costs and any changes in loss reserve estimates that are deemed necessary.

We currently expect the total impact on 2019 shareholders' equity to be immaterial but could be modestly negative primarily due to integration costs and acquisition-related charges. Excluding integration costs as well as acquisition-related charges, we expect the acquisition to be immediately accretive.

For 2020, The Hartford expects the acquisition to be accretive to core earnings by $60 million to $95 million. This is comprised of a contribution by Navigators of $110 million to $145 million in core earnings, offset by a reduction of approximately $50 million in The Hartford's net investment income after tax due to the cash used to fund the acquisition. I know that many analyst models may already reflect a reduction in net investment income due to assumptions about share repurchase programs in 2018 and 2019, which we do not include in our outlook.

As we further refine our go-to-market strategies and purchase accounting adjustments, we will update our earnings estimates, including 2020 intangible asset amortization expense currently estimated at $15 million to $30 million, after tax. As Chris mentioned, we expect the combination of revenue growth and expense synergies to generate higher earnings beyond 2020 as we will realize the full potential of the acquisition.

Finally, we expect to close the acquisition in the first half of 2019, subject to regulatory approval and the Navigators' shareholder vote. We expect the shareholder vote to occur by year-end 2018. Navigators' founder and certain other shareholders, who own together about 22% of outstanding shares, have agreed to vote in favor of the transaction.

There are various regulatory approvals necessary for us to acquire Navigators. In addition to approvals by regulators in the U.S., principally New York, which is Navigators' state of domicile, we will need approval from a number of international regulatory bodies, including the U.K. Prudential Regulatory Authority, the U.K. Financial Conduct Authority, the National Bank of Belgium and the Luxembourg financial regulator. We also will need to obtain various consents from Lloyd's of London related to Navigators Syndicate.

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With that, I'll now turn it over to our operator, Amy, to repeat the instructions for asking a question as we begin the Q&A session.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Kai Pan with Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

So my first question is about potential revenue growth opportunity as well as cost savings. Because you said in 4 to 5 years, it will be -- Navigator will contribute about $200 million ex amortization, which is about 60% more than sort of like 2020 contribution, which is $110 million to $125 million. That implied about 12% to 15% annual growth over the 4- to 5-year period. I just wonder, like could you elaborate more about where do you see the revenue opportunities as well as the potential, like you said, modest expense savings opportunities?

Christopher Jerome Swift
Chairman & CEO

Sure, Kai. It's Chris. I think that the revenue assumptions going forward are -- we could talk about it, but I would also say, importantly, I think we've been realistic with the loss cost assumptions, too, increasingly modestly as we take on some of these new product lines. But I think our models would really point to more of a premium growth rate in the 5% to 6% range. I think there are expense saves that Beth has mentioned. I would also say I think there's opportunities to increase the portfolio yield. So you put it all together, and that's why we're comfortable if you look out, as I said, that, that 4- to 5-year range, we could see core earnings ex amortization of intangibles in that $200 million range. Beth, would you comment any more on expense synergies or some investments?

Beth Ann Bombara
Executive VP & CFO

Yes, so a couple of things. One, I just wanted to also be clear that in the contribution that we talk about from Navigators in 2020, that, that would be inclusive of amortization of intangibles. So when you're comparing it to the number that Chris gave, which was ex that, you need to make that adjustment. And then, as it relates to expense synergies and things we put in our model, we're currently modeling about $20 million after tax in expense synergies that we'd anticipate being able to achieve in the near term. And then obviously, over a longer period of time, we will continue with applying The Hartford's continuous improvement procedures and so forth to continue to look to find ways to find efficiencies going forward.

Kai Pan
Morgan Stanley, Research Division

That's great. My follow-up is sort of like if you step back and see the alternatives for buybacks, for example. So the deal is probably 14 to 19x earnings, the Navigators' earnings 2020. But if you buy back your share, probably like 10x earnings. So I just wonder, can you also elaborate your thought process of considering alternatives, including buybacks before you do the deal? And does the deal means that the buyback will be pushed back further, like after 2019?

Christopher Jerome Swift
Chairman & CEO

Yes, Kai, what I would say is again, we found this transaction financially attractive in addition to all the strategic benefits that Doug and I have talked about. So in relation to buybacks, we think it's attractive. I mean, what it means for the future is, as Beth said, I mean, there's quite a process here, or here to get approvals, which we expect given our reputation and our capabilities. But it's going to take some time, probably early 2019, March, April-ish time frame. And then we look at our financials and we do generate capital, but we're still integrating and digesting the Aetna acquisition. We will begin to determine our go-to-market strategies here, build excess capital. So I'm not prepared to really talk specifically about capital

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management plans as we approach the end of '19 and into '20 now. But all I would tell you is I still believe we will generate significant excess capital over time. And as we approach the right time, we'll tell you what we're going to do with it.

Operator

Your next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'd like to talk a little about the go-shop provision. And given the 30 days, if another suitor comes with a higher offer, are you going to chase it? Or is this $70 a best and final?

Christopher Jerome Swift
Chairman & CEO

Josh, yes, the deal does contain a go-shop and a no-shop, where over the next 30 days, Navigators does have the opportunity to solicit proposals. So we granted them that opportunity. We think $70 is a fair value for the shares. And I'm not going to speculate on what's going to happen if any suitor emerges. We stand by -- we negotiated, I think, a fair transaction for both parties, believe in it. That's why we're talking to you about it today. And we'll see what the future holds.

Joshua David Shanker
Deutsche Bank AG, Research Division

And in terms of your own positioning in the area that you're picking up on Navigators, when you look at the sort of synergies from a revenue perspective, how many of those lines do you have some sort of current market share in? And how much is going to be brand-new to you? And then why do you expect to be the best operator in those areas?

Douglas Graham Elliot
President

Josh, this is Doug. It's a multifaceted question, so let me just take a few of the pieces and then we can explore further if you'd like to. Clearly, they've got a terrific E&S wholesale operation that they have built out. 2 years ago, we purchased Maxum. We've been growing the Maxum franchise. But they do add deep expertise there. And I think our wholesale strategies clearly are accelerated with the combination. They also, aside from marine and their financial products, have some excellent specialty offerings in the retail space. And I'm thinking specifically about their excess casualty program, their environmental strategies and some of their life science work. Those are all accelerants to early work that have been going on here as a company and pivotal to some of the success that we have ambition for in Middle Market over the next 3 to 5 years. So very excited that their complete array of products offer opportunities for us to do more. There are places that we both compete. And I think immediately, we develop a scale opportunity in the marketplace. But there are also products, like life science, that we are moving into. And they've had a presence for several years, that day 1, we hit the market with a much more aggressive approach.

Joshua David Shanker
Deutsche Bank AG, Research Division

And in terms of the places where you have duplicate capabilities?

Douglas Graham Elliot
President

Well, I think that is to be worked on over the next 6, 9, 12 months. And we will figure out how to lever the combination of both of those businesses to create a bigger competitor in the marketplace. I didn't mention -- Josh, I didn't mention international. I certainly should have. Obviously, our footprint outside the U.S. is very, very small. And the fact that Navigators has been outside the U.S., they have a Lloyd's platform; they've got physical locations in 9 cities around the world; and they have experienced a number

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of products and a number of rollouts, I think that gives us an acceleration there to think more globally, which is an important part of our strategy over the next 3 to 5 years as well.

Operator

Your next question comes from the line of Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Two questions. First of all, can you spend some time and opine on how do you feel about Navigators' reserves? And do you foresee some adjustment to those?

Christopher Jerome Swift
Chairman & CEO

Yes, Amit, I'll provide some comments and then Beth will follow up. I would say again during the process of coming to this point, and we had the opportunity to do significant due diligence and meet the management teams, understand the strategy, typical stuff, but I would say we spent an exceptional amount of time on reserves, so -- and you know the old adage, you get 3 actuaries in a room and you're going to have 3 different opinions. And I think that's -- honestly, our view is there's a range of outcomes here that Beth will talk about. But the $70 a share that we confirmed with our offer here, I think reflects a wide range of outcomes that make us comfortable with the negotiated purchase price. But Beth, what would you add?

Beth Ann Bombara
Executive VP & CFO

Yes, just to add to that, as Chris indicated, obviously, when you're evaluating reserves, there's always a range of estimates that depend upon underlying judgments and methodologies. And as we look overall through the diligence process at the reserves, they're within a reasonable range. But as we look to harmonize kind of our judgments and our processes, there could be areas where we determined that our best estimate is slightly above where they are. And we will take that into consideration between now and closing and make any adjustments that we feel is appropriate. But as Chris indicated, as part of our process of just looking at the underlying valuation and where we came up from a price perspective, we took all that into consideration. So if there are some reserve adjustments that we conclude we should record, that doesn't change our view on the overall attractiveness of this franchise.

Amit Kumar
The Buckingham Research Group Incorporated

Got it, that's helpful. The only other question, and I will get back in the queue, first, can you sort of just maybe even talk about the background of this deal? Who approached whom? I'm sure there were other companies on the short list. And what happened at the end of it, why you ended up selecting Navigators versus there's definitely some other companies, too. Maybe just talk about how this came about.

Christopher Jerome Swift
Chairman & CEO

Yes. What I would say, and obviously, you'll read it in their proxy, but from our perspective, I'd first just start with this is -- it has been and is an attractive property to us. We've been very impressed with the underwriting talent, the claim talent, the support talent that Navigators has. The leadership, its entrepreneurial can-do, open-up-new-markets approach. So it's been attractive to us for a while. How that management team and their board involved others, I really don't know. But I would say that over the last 3 years, we've made acquaintances with Stan Galanski, their CEO. We've stayed in contact informally. But I would say earlier this year, March, April-ish, is when there was an informal outreach about seeing if there's anything we could do. Thought about it, we engaged then in a period of what we would say was exclusive. And we came to this point. So I'd say pretty quickly, over the last 4 or 5 months, we figured out that we could get something done. And here we are today.

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Operator

Your next question comes from the line of Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

So my first question is just digging through the financing and paying for this transaction. On your last quarter's call, you guys said that you would end this year with about $2 billion at the holding company. I know you look to keep about 1 to 1.5 of annual dividends and interest at the holdco. Would that -- would the financing of this deal maybe cause you to go the low end there? And then can you talk through -- obviously, dividends from the subs this year were lower due to the Aetna deal. Just in terms of dividends we could expect next year, I thought maybe some of that might have been second half-weighted whereas this deal closing in the first half. Just correct me if I'm wrong. And then if you can just say how high you might let your leverage go to finance the deal.

Beth Ann Bombara
Executive VP & CFO

Sure, I'll cover off on that. So yes, as we look at sort of pre this transaction and holding company resources at the end of the year, kind of in that $2 billion range. And that was predicated on just other things that we might do as well relative to things like contribution to pension plan and so forth. So it's probably a little bit more than that. You're right in that we typically target 1 to 1.5x interest and dividends. And I think the combination between that excess capital we have as well as taking some dividends from the subsidiaries, I think we can put ourselves in a good position that we would still be within those thresholds. And we had talked about dividend in '19 potentially being more in the second half. And so we might look to accelerate some of those as we think about paying for this transaction. And then, as far as our debt leverage, one of the things that we're also just evaluating is, as you know, we do have some debt that's maturing in January. Obviously, that's in our debt ratios today. And so when I think about just resources that we would use to fund this transaction, where previously we were thinking of paying that maturity down and not issuing debt, we might consider issuing debt to sort of fund that. So again, I wouldn't anticipate that our leverage ratios would increase very significantly from sort of the pro forma that we're describing today. But there might be an opportunity for them just to go up a bit. And then we would look to manage them down as we continue to generate earnings, which obviously improves our equity position. And then we also have maturing debt in 2020 that we could look at as far as continuing to pay down and get back into levels that are a little bit lower than where we are today.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, that was helpful. And then my second question, if we look at Navigators' cat exposure, they had about 7 points of cat last year. Just how do we think about their cat exposure going into wind season? And I'm assuming, just given, I mean, their smaller reinsurance exposure as part of their bigger portfolio, that there is no collar on this deal if, in fact, we have a pretty strong hurricane season this year.

Christopher Jerome Swift
Chairman & CEO

Yes, Elyse, it's Chris. Between Doug and I, let me see if we can paint a picture for you. So we do understand their exposures using 1:100 return periods, 1:250. I would say that we believe they have a robust reinsurance program. So I'm not sure if that's changed over the years, given their experiences. But what's in place today, we think is very robust. So it nets down to, I'll call it, on a 1:100 basis or a 1:250 basis on the information we have, in that $35 million to $40 million range. So again, within our tolerances and our balance sheet and our capital position, I think that's very manageable and tolerable. Doug, what would you add?

Douglas Graham Elliot
President

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The only thing I would add, Chris, is that we spent a considerable amount of time with their reinsurance group, their leadership, Clay Bassett, and very comfortable how they manage aggregates, their disciplined by geography, et cetera. So looking forward to becoming partners. And we think they've got a very disciplined group there on the cat side.

Operator

Your next question comes from the line of Mike Zaremski with Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

First, a follow-up to Kai's question, so -- and I will say that I don't know Navigators that well and I think a number of people on this call don't appreciate Navigators as well and we'll get to know them over time. But if I look at their historical ROE, it's been about 7%. And you're playing close to 1.7 book. And so, I mean, you feel you can earn a double-digit return over time. So it implies that you think Navigators can meaningfully improve its ROE. And so even if I take into account the modest expense saves and the 5% to 6% premium growth, I guess it implies that I shouldn't be thinking about the 7% ROE as being reflective of what you -- there might have been items in there that suppressed it. And so maybe there's like structural items you feel we should better understand about Navigators, which were suppressing its historical ROE.

Christopher Jerome Swift
Chairman & CEO

Yes, I understand the question, Kai. But as we tried -- or, excuse me, Michael. As I responded to Kai, I mean, it is about growing the premium base with, I'll call it, a slightly higher loss ratio and using our financial strength, our distribution networks, cross-selling in a more effective way. There are some modest expense saves. I do think there will be, I'll call it, a good lift in the investment portfolio with our asset allocation philosophy and methodology. And ultimately, I think that the view that I have, along with Doug, is that 1 and 1 is going to equal 3 here. And we'll be able to contribute to their underwriting process, contribute maybe in risk-taking in different ways to help drive a higher ROE. Because as you said, historically, it's been in that 7%, 8%, 9% range. And we're an ROE-focused company. And I think there's a tools methodology approach mindset that I think we'll be able to bring to the organization, as Doug said, in a partner way. But Doug, what would you add?

Douglas Graham Elliot
President

Mike, I will also add that we have, I think you know, invested mightily over the last decade in data science and data analytics. And I think we'll offer something in that regard as we work hard together on improving underwriting results across the board both at The Hartford and also at Navigators. So I'm excited about the tools we've built. And I'm excited to share them at the appropriate time with Navigators.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay, that's helpful. And my last question, you -- it's tougher for us to appreciate, but you talk about this strengthening your value proposition to agents and customers. And so maybe you can kind of update us on whether strategic goals post this deal -- I know this deal will take some time to work through. But does this kind of fulfill your desires in Commercial Lines if we're thinking over the long run? Or are there still ambitions to maybe move upmarket or whatnot?

Christopher Jerome Swift
Chairman & CEO

Yes, what I would share with you, Mike, is that we are always pushing ourselves to be the best as -- that we could be, as Doug said, the best underwriters with, we think, outstanding distribution, with a broader array of products and underwriting skills and industry support as the world gets very, very specialized. So I think this acquisition goes a long way to establishing -- to contributing to our desires

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and vision and aspirations. But it will never be completely satisfied in that we're always going to push ourselves to do more. I think what's particularly attractive to me is some of the international capabilities that we pick up through their Lloyd's presence, their larger London market presence and a beginning of a European strategy. So The Hartford's vision and strategy is focused around small to Middle Market in select specialties and select activities and national accounts. But our bread and butter, and I think our value added over the long term, is going to be in that SME to specialty area to playing at the smaller end of national accounts and financial lines and things like that. So we're very mindful of what we think we're good at. We're very mindful of where I think the market allows you to make adequate returns. And really, going upmarket in a major, major way isn't part of our vision at this time.

Douglas Graham Elliot
President

Mike, let me just add another thought, too. As we think about our Small Commercial franchise, which we're very proud of, over time, it will have a bit more of a specialty edge to it. And I think Navigators helps that process, number one. Number two, we've talked over the last several years about our focus with our Middle Market franchise. 8 years ago, 7 years ago, when I arrived, heavily dominant with workers' compensation. We've been working to increase our skill and our product offering in the Property & Casualty space. Say, we've made quite a bit of progress. But this acquisition also gives us the ability to have more product faster in that area, which we think is pivotal for us as we grow our franchise over the next 3 years. So very excited about what we can do together, pleased with our progress. But I do see some accelerants here with Navigators, they've been deep in the casualty side. And I think we'll learn a lot as we come together.

Operator

Your next question comes from the line of Ryan Tunis with Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

I guess, for Chris, it's been a pretty busy 12 months at Hartford M&A-wise, a couple of deals. I guess, looking out to the close of this, presumably there's going to be some integration process. Should we think about mid-'19, headed into 2020, are we kind of through the trying to grow through M&A aspect of, I guess, the life cycle at Hartford? Should we think about, I guess, kind of more of a balanced form of capital return at that point as you're integrating Navigators? Or should the takeaway from this be it's still indefinitely there's an appetite for M&A versus any other form of capital return that extends until told otherwise?

Christopher Jerome Swift
Chairman & CEO

Yes, thank you, Ryan. I would say you framed it fairly well, right? So very pleased with the Aetna integration as we've reported periodically to you. As we get into early '19, there's some major hurdles, milestones that we feel very comfortable on achieving. So I believe that integration is on track and it is going to achieve or slightly exceed some of the goals that we've put out there. This one's a little different, right, where Aetna was like a full integration into our tools and technology. And we were using some of the things we acquired there. This is a little different, where they have their own process and systems and legal entities. So the integration here, from a back-office side, probably is going to be a little lighter. And as Doug alluded to, it's more what are the best go-to-market strategies that we need to have to capture and win additional business. So that's probably going to take, I would say, most of '19 to sort of sort through and be in a good position and rebuild the balance sheet. I think from there, philosophically, I think you know me pretty well, I mean, we still want to invest in our businesses to make them distinctive, to make them competitive, to differentiate ourselves and offer value to our customer agents, our customer customers and have our people feel proud. So we always are going to have a mindset of, "How do we get better?" And we've always had a mindset of, "Can we build?" As Doug just said, over the years, I'm really proud of what we've built and created. And we'll bring that organic mindset. But there's also part of us that is also going to be aware of opportunities that can accelerate things that we want to achieve.

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But these 2 acquisitions go a long way. And I again reserve the right to sort of say that maybe beginning in '20, we could think about capital differently. But as we sit here today, we still want to invest. We still want to be the best we can be and grow and offer more products and services through our agents and to ultimate customers. And we'll see what develops. It's hard to forecast what's going to -- what's the world going to look like in 2020 and beyond. So we'd like to keep our options open and really see what develops.

Ryan James Tunis
Autonomous Research LLP

That's helpful. And then actually, an unrelated one for Doug. But I guess, with earnings, looking back at earnings, there was a much more cautious stance at Hartford around workers' comp than pretty much any competitor. And I guess, with that in retrospect, I'm curious if Doug has any updated thoughts. I know it's actually been a month, but I guess, just kind of trying to square that triangle on why did it sound like there was somewhat of a pickup in inflation at Hartford that we haven't necessarily seen as an industry phenomenon?

Douglas Graham Elliot
President

Ryan, yes, I don't have much of an update. I can tell you we're spending a lot of time looking at our books of business, evaluating all of our lines, including workers' comp. I can't speak to the other carriers that we compete with. But I stand by my remarks on the second quarter that it's an important line for us. We pay attention to trends. And we'll react to what we see in our book of business in the ensuing months ahead.

Operator

Your next question comes from the line of Bob Glasspiegel with Janney Montgomery Scott.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

You did a very good job on the strategic basis for the deal. I need a little bit more help on the financial side. The numbers you used on accretion sort of used a 2.3% cost of financing. I'm sure you used a more rigorous analysis than that as your hurdle rate. But what hurdle rate do you use on paying 70% over book from a financial point of view for a payback to be in line with what you want to get?

Christopher Jerome Swift
Chairman & CEO

Thanks for the question, Bob. Sorry, we can't square your triangles, as they say. But I would say we use our cost of equity capital as a hurdle. I would say we estimate that in the 8.5%, 9% range today. So this deal, again -- and when you get 2, 3 years out, exceeds that, so -- and we don't view exceeding it as anything but we want to try to be as wide as we can in the spread of our equity cost of capital. So we understand we mix in debt and maybe other securities from time to time, that gets our overall cost of capital down. But we measure hurdle rates as our cost of equity capital over a reasonable period of time.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

So 9% on $2.1 billion would be -- you need $180 million of earnings power from the deal in 2 to 3 years. Is that a fair statement?

Christopher Jerome Swift
Chairman & CEO

Yes. And that's why we -- that's why I made the statement I did is that when you get out a little further, 4 to 5 in this particular case, given these growth aspirations that we have, we approach that $200 million range ex amortization of intangibles with -- I would say we capitalize that cost, so we don't penalize ourselves. So that's why we back that out philosophically. We know it's an expense. We don't ignore it. We

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include it in core earnings. But when Beth and I look at our capital allocation in our models, we do back that out.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

One last question, what's the breakup fee?

Christopher Jerome Swift
Chairman & CEO

There's 2. One is during the go-shop period, it's basically 2%. And then there's, what the deal lawyers call, a no-shop period, that it jumps up to 3.25%. So view it as a 2%. And if after 30 days, someone emerges, it goes up to 3.25%.

Operator

Your next question comes from the line of Yaron Kinar with Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

My first question is around the reinsurance portion of the operations. I realize it's pretty small on pro forma base. But I thought that this was maybe an area that you were little less interested in being involved in. So I was just curious, is that a core business for you? Or would you view it as a core business? And if so, is it a business that you'd also be looking to maybe explore some alternative capital growth opportunities in?

Christopher Jerome Swift
Chairman & CEO

Yes, what I would -- we tried to frame it in our comments is that it's about 13% of reinsurance is defined as 13% of their gross written premiums. But if you really subdivide that, Yaron, is that 7-ish percent of that reinsurance premium is traditional P&C reinsurance. And again, we put some slides together to sort of give you that, but -- so half would be traditional. The other half, we would say, is A&H and other specialty lines that are ways of getting into markets, in essence, a synthetic direct basis. So we're intrigued. Yes, obviously, it's part of the acquisition. We want to try to maximize it. So yes, we'll look to continue to allocate capital to that division but measured against risk-adjusted returns that we think are appropriate over a longer period of time. And if it passes that hurdle rate, great, and -- but yes, I'm optimistic, given how they use reinsurance in certain territories to enter and try to grow profitably. So I think their strategy is -- I'm looking forward to learning more about it because I'm intrigued by it.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Okay. No, that's helpful. And then my second question is just about the broader kind of premium growth assumption for the Navigators business. So I think you talked about 5% to 6% growth that you're building in, which is, I think, roughly in line with Navigators' multiyear growth average but certainly lower than what they've been posting the last couple of years. And between that and kind of the deceleration from recent years and your cross-selling opportunities, I'm just curious as to why it would be 5% to 6% and not continuing this improving trajectory that you're thinking of.

Christopher Jerome Swift
Chairman & CEO

Well, look, I mean, we debate all the time what is an appropriate growth mentality, because, I mean, you could grow a lot faster, but you're going to have poor underwriting results and probably not the profitability you want. So we're trying to strike what we think is the right balance with their product sets, our product sets and creating a growth environment that makes prudent sense to grow and maximize ROEs at the same times. And that's what we believe is accurate. As Doug just alluded to, I mean, workers'

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comp is under a little pressure right now, still a profitable line. But you've got to be really select in how you want to target growth balanced against ROE. Doug, but what would you add?

Douglas Graham Elliot
President

I guess, the only other thought is that their markets really do extend outside of the U.S. and around the world. And there are certain product niches in parts of the world where, I would say, pricing is rather soft. And they have commented on their prior quarterly calls. So they're managing all of their niches and verticals aggressively and I think being very thoughtful about that. But all their markets don't exist the same way today. I think there are spots where they're competing differently based on what they think are financial return opportunities in the market as they exist.

Operator

Your next question comes from the line of Meyer Shields with KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

So a quick modeling question. Can you talk about the, I guess, premium leakage and P-GAAP adjustments that are included in the 2020 core EPS outlook?

Christopher Jerome Swift
Chairman & CEO

Premium leakage and P-GAAPs. I'll look to Beth on P-GAAPs. I think on premium leakage, Doug, it's modest. I mean, again there's good complementary nature of these 2 franchises. We share a lot of the same distribution relationships. So we don't see any shock losses coming or dis-synergies in the premium leakage. So I think it's managing retention in a price environment that makes sense is our basic going-in assumption. Doug, but...

Douglas Graham Elliot
President

And also included in our modified expectations of top line, I think it's all rolled together. And because the transaction is legal entity different than certainly the Aetna transaction, I look at that renewal dynamic a little bit differently in this combination with Navigators.

Beth Ann Bombara
Executive VP & CFO

Yes. And Meyer, as it relates to purchase accounting adjustments, I'm assuming you're referring to sort of amortization of intangible expenses. And as I said in my remarks, the numbers that we gave for 2020 include a range of about $15 million to $30 million after tax. So obviously, we'll be truing those up as we go through the process of just doing all of the purchase accounting adjustments that come with the balance sheet. But that's what's embedded in those numbers right now.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, perfect. Second question, if I can, Beth, you talked about possibly truing up Navigators' reserves to your best estimate. Hartford, obviously, has been sort of increasing the excess of recorded reserves to the best estimate. Would you expect to have too the same standards on the legacy Navigators' reserves?

Beth Ann Bombara
Executive VP & CFO

Yes. So again, we'll look at the overall reserves and, as I said, harmonize them with our methods and judgments. We don't necessarily target a specific number as you're referring to it. But we'll take that into

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consideration. And as I said, I think that there then may very well likely be some adjustments that we'd make to kind of true it up to our best estimate.

Operator

Your next question comes from the line of Jay Gelb with Barclays.

Jay H. Gelb
Barclays Bank PLC, Research Division

I was looking at the, let's see, the Slide #24, the Navigators financial highlights. So I can see that in the first half, the company generated a return -- a core return on equity of right around 10%. In prior years, it had been lower. And just trying to get your view on where you see this -- where you see Navigators' ROE kind of coming in on a normalized basis as it stands currently and then as part of The Hartford.

Christopher Jerome Swift
Chairman & CEO

Yes, I can't comment, Jay, on Navigators and their history. All I could comment upon is what we think we could do with it going forward. And that's what I said is I think we could get it to a low double-digit range over time as we integrate, as we cross-sell, as we sort of lift our combined premium base and maximize our distribution power that I think that the 2 organization has. I'm confident, highly confident we can get that into the double-digit range.

Jay H. Gelb
Barclays Bank PLC, Research Division

I appreciate that. And then I'm just trying to square your comment, where I believe you said, within 4 to 5 years, Navigators could add $200 million to after-tax core earnings excluding amortization of intangibles. If I take their first half results, which were around $120 million of core earnings after tax, is there that much expense synergies or other synergies that could get that $120 million to $200 million?

Christopher Jerome Swift
Chairman & CEO

No, that's commented upon what we think in terms of expense. So that's $20 million. But the components of how the math is going to work is ultimately growth, modest expense saves, NII, we think we can add NII, net investment income, to their portfolio and overall margin improvement with our ROE mentality, our data and analytics, our tool sets. That's the equation.

Operator

Your next question comes from the line of Scott Frost with State Street Global.

Scott Frost
State Street Global Advisors, Inc.

You touched on this a little bit with Elyse's question. And the change I heard from a credit perspective was that you may issue debt in January versus previous plans to pay that maturing debt down. That sounds like a modification of previous leverage guidance but not a change. Is that the right way to look at it? Are you still planning to target a low 20% leverage by 2020?

Beth Ann Bombara
Executive VP & CFO

Yes, Scott. So yes, so I was talking about the fact that as we look at the resources that we'll utilize for this transaction, the fact that we do have maturing debt in January, as we said, we would explore other financing options. And that's what we're taking into consideration. So might take us a bit longer than we originally said relative to kind of getting down to lower leverage ratios, but I still think overall, when we look through '19 going into 2020, that we're still on that path. But we want to just keep our options open as we sort of think about the best way to finance this transaction.

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Scott Frost
State Street Global Advisors, Inc.

Okay. But just to clarify, you're still planning to target a low 20s percentage by the end of 2020. Is that my understanding? Or is it...

Beth Ann Bombara
Executive VP & CFO

Yes, mid- to low 20s is -- yes, what we said before is mid- to low 20s is what we're targeting.

Scott Frost
State Street Global Advisors, Inc.

And just a follow-up, I think for interest, [all those] agencies, I think had you in a leverage band of sub-30%. I mean, do you expect any negative reaction from rating agencies? Or how would you characterize your conversations with them regarding this transaction?

Beth Ann Bombara
Executive VP & CFO

Yes, I think they were very constructive and kind of understand how we're thinking about this.

Operator

Your last question comes from the line of Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Yes, just a couple of quick questions. Are you contemplating retaining the Navigators brand? Or is this a vehicle to really push The Hartford brand out into international markets?

Christopher Jerome Swift
Chairman & CEO

Mark, those discussions have just initially kicked off. And we'll spend time over the next 6 to 9 months of deciding how we do market ourselves. Obviously, there's enormous strength in The Hartford brand. There's also a great recognition of Navigators brand, particularly in some of their deep-rooted products. So we're open on that. And I think Stan and his team will add a lot of thought and we'll come up with what we think it is the best decision for the overall franchise.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

And I guess, related to that, considering that there's not a lot of synergies particularly planned over the near term, can you elaborate a little bit more on some of the integration costs? I mean it wouldn't sound as though a lot would be expended on relocations and headcount adjustments and things of that sort. So I'm just trying to get an idea of what goes into the kind of $70 million to $110 million.

Beth Ann Bombara
Executive VP & CFO

Yes, I'll take that. So again, as we think about the synergies here, there's obviously some expense. As we said, it's modest. But it's also on just our go-to-market strategies. And in order to really set ourselves up best to do that from an integration perspective, we do need to make sure our systems are able to talk to each other. So if you're comparing that cost to just expense synergies, it might look high. But we're really looking at it more broadly as we bring sort of the Navigators' operations into our environment that really allows us to maximize our ability to use our tools and so forth. So we really need to think about it from both sides, revenue and expense.

Mark Alan Dwelle

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RBC Capital Markets, LLC, Research Division

And then a last real quick question, if I may. Do you intend to kind of show this as a separate operating division? Or will this be embedded within the Commercial Lines segment?

Christopher Jerome Swift
Chairman & CEO

Yes, Mark, I think again preliminary, right, we haven't really started to plan activities in integration, but I do envision sort of a global specialty segment. I think we'll have to work together to find what that is, Doug. But I think in addition to our standard Commercial Lines, our national account presence of have a specialty -- a global specialty segment, that makes sense to us. So those are some of the things that we'll work on. And obviously, once we close the deal, we'll announce what we're going to do.

Operator

This concludes our question-and-answer session. I will now turn the call back over to Sabra Purtill for closing remarks.

Sabra Rose Purtill
SVP, Investor Relations

Thank you, Amy. We just wanted to appreciate your availability today to join us for short -- at short notice to discuss our agreement to acquire the Navigators. Obviously, we have lots of materials on the website, including, as I mentioned, the 8-K. So if you have any additional follow-up questions, please do not hesitate to contact the Investor Relations team today. Thank you very much, and have a good day.

Operator
This concludes today's conference call. You may now disconnect.

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