S&P Global
Market Intelligence

James River Group Holdings, Ltd. NasdaqGS:JRVR

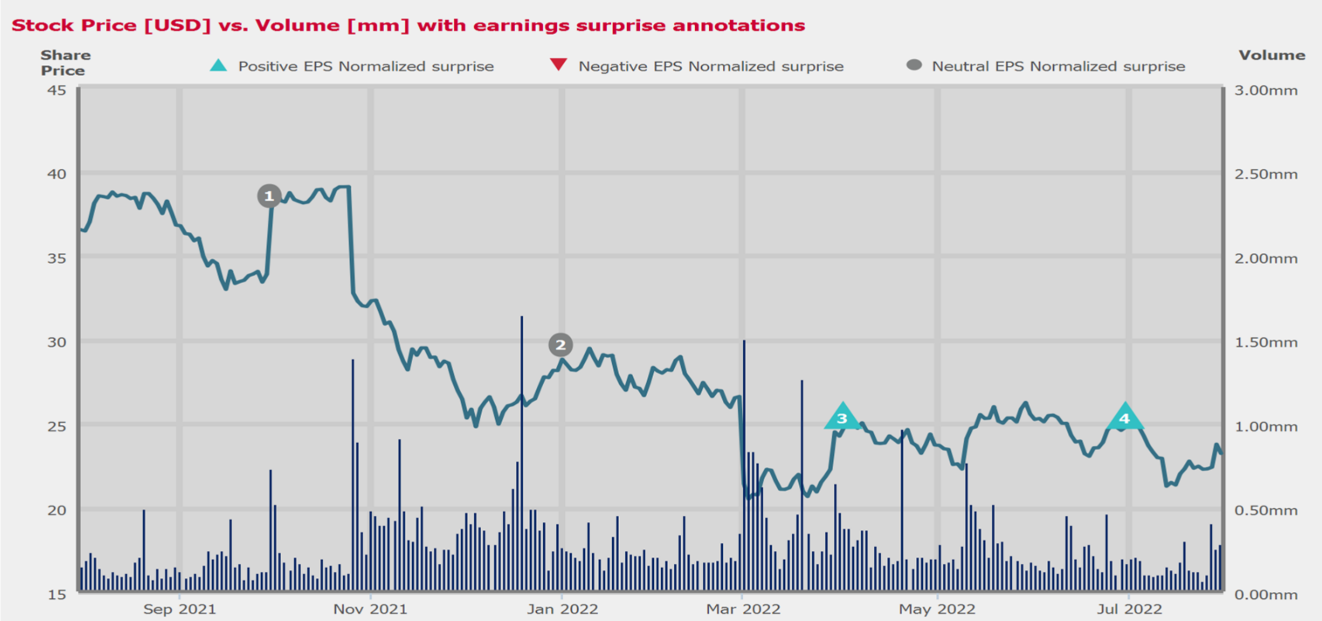
FQ2 2022 Earnings Call Transcripts

Tuesday, August 02, 2022 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.50	0.52	▲4.00	0.52	1.94	NA
Revenue (mm)	200.07	184.81	▼(7.63 %)	200.93	801.15	NA

Currency: USD
Consensus as of Aug-02-2022 6:07 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	(0.64)	(0.72)	NM
FQ4 2021	0.09	(1.81)	NM
FQ1 2022	0.26	0.37	▲42.31 %
FQ2 2022	0.50	0.52	▲4.00 %

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Call Participants

EXECUTIVES

Brett Shirreffs
Senior VP of Finance, Investments & Head of Investor Relations

Frank N. D'Orazio
CEO & Director

Sarah Casey Doran
Chief Financial Officer

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Mark Douglas Hughes
Truist Securities, Inc., Research Division

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

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Presentation

Operator

Welcome to the James River Group Second Quarter 202 Earnings Conference Call. My name is Hilda, and I will be your operator for today. [Operator Instructions]

And now I would like to turn the call over to Mr. Brett Shirreffs, Head of Investor Relations. Mr. Shirreffs, you may begin.

Brett Shirreffs
Senior VP of Finance, Investments & Head of Investor Relations

Thank you. Good morning, everyone, and welcome to the James River Group Second Quarter 2022 Earnings Conference Call.

During the call, we will be making forward-looking statements. These statements are based on the current beliefs, intentions, expectations and assumptions that are subject to various risks and uncertainties which may cause actual results to differ materially. For a discussion of such risks and uncertainties, please see the cautionary language regarding forward-looking statements in yesterday's earnings release and the risk factors of our most recent Form 10-K and Form 10-Qs and other reports and filings we have made with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statements.

I will now turn the call over to Frank D'Orazio, Chief Executive Officer of James River Group.

Frank N. D’Orazio
CEO & Director

Thank you for that introduction, Brett. Good morning and welcome to everyone on the call. I'm pleased to be back with all of you today to provide additional color on our second quarter as our strong operating momentum has continued throughout the first half of the year.

Undoubtedly, we remain a leader in the E&S market, and our teams across the entire organization have executed exceptionally well on their business plans. We've been able to capitalize on market opportunities while optimizing portfolios that haven't met our profitability expectations. We've done this while also building out our enterprise risk management framework and making other investments across the platforms to make sure James River becomes a stronger and more profitable underwriting company.

These efforts have resulted in very strong financial results for both the second quarter and for the first half of the year, as we posted a 91% combined ratio in Q2 and a 94.2% at the midway point of the year. Our adjusted net operating return on tangible common equity came in at 19.9% for the second quarter and 15.5% on a year-to-date basis. These are excellent results by any measure and are driven by our focus on delivering consistent underwriting profits. To that end, I'm extremely pleased that all 3 of our segments produced an underwriting profit during the second quarter, demonstrating the strong earnings potential of our company.

I referenced enterprise risk management just a moment ago. And to just expand a bit on that topic, ERM has been a key priority for the executive team and our Board since I joined the company almost 2 years ago. We've remained focused on building out our enterprise risk management discipline by adding staff and functional expertise while embedding our new risk framework into the fabric of the organization. We expect that integrating these processes throughout our business will continue to enhance the organization and lead to more stable returns across the company over the longer term.

Turning to macro conditions briefly. And remaining mindful of the state of the broader economy, the majority of the markets that we operate in remain quite healthy. We are confident in our near-term outlook for growth at attractive margins, and our balance sheet remains strong. Our renewal/retention levels remain extremely high, and we feel certain that we are producing positive rate change well in excess of our view of loss cost trend.

Clearly, the excess and surplus lines marketplace continues to benefit from pockets of industry dislocation as admitted market underwriting discipline remains broadly in force, driving sustained pricing improvement in the E&S sector. Rate increases in our book during the second quarter were the strongest level that we've seen in a year. In aggregate, we've experienced renewal rate increases for 22 consecutive quarters or 5.5 years, compounding to 58.1%.

As a reminder, the rate change information that we have historically cited is exposure-adjusted, level-setting any changes in limits, attachments and exposure bases that occur at the transaction level. This is a pure rate change model.

We have not seen any overall change in market dynamics that would lead us to believe that our pricing momentum in E&S should not persist through at least the end of this year, if not longer. Our franchise value, relationships with wholesale distribution and expertise in the SME space leave us well positioned to serve our clients and generate attractive returns for shareholders.

Before I turn it over to Sarah, let me share some additional highlights from the results of our second quarter. In our E&S segment, we experienced strong rate increases, significant premium growth and notable profitability. Driven by a 14.1% positive renewal rate change, gross premiums increased 24.6% while net premiums grew by 22.8%. Consistent with our results last quarter, we saw broad-based positive growth in rate trends across the segment with 10 of our 13 underwriting divisions experiencing double-digit premium growth for the second consecutive quarter. Our largest underwriting divisions led the way in terms of growth.

Excess Casualty and general casualty were both up more than 30% from the prior year quarter, with continued strong trends in our renewal book. Submission activity continues to remain robust, particularly in our renewal portfolio, where we have a much higher conversion ratio.

As alluded to previously, renewal rate change increased sequentially from 8.4% in the first quarter to 14.1% in the second quarter. As we've experienced over the last few years, rate changes have fluctuated a bit from quarter-to-quarter, and we expect that dynamic is likely to continue. On a year-to-date basis, our renewal rate change is 12%, which is comfortably ahead of both our planned rate increase and expected loss cost trends for the segment.

For the quarter, the headline rate increase is driven by some of our larger underlying divisions, like Excess Casualty, but we also had double-digit rate increases in a number of product lines, including general casualty, sports and entertainment, health care and excess property.

From our perspective, we think it's safe to say that, for a few of these classes, certainly for excess property and excess casualty, capacity still remains fairly tight for many industries. Carriers have reduced their risk appetite and are offering compressed limits, and that hasn't abated. This dynamic has allowed us to push rate, and I think the organization has done a very good job of making our underwriters aware of the rate thresholds they need to meet or exceed based on our 2022 plan.

From a profitability perspective, our E&S combined ratio was 83.8%, again, broadly consistent with our results from the first quarter of this year. Underwriting income came in at $22 million, our third consecutive quarter of segment underwriting profit greater than $20 million.

In Specialty Admitted, results followed many of the same trends we shared last quarter as our top line was impacted by continued rate pressure in the workers' compensation market. This was particularly evident in our program focused on the California marketplace.

In total, our workers' compensation-related premiums declined approximately 14% during the second quarter and 13% on a year-to-date basis. We have been carefully managing through what has been a countercyclical workers' compensation market for several years and have remained disciplined to reduce our top line when and where appropriate.

The remainder of our ongoing fronting and program business experienced solid growth during the second quarter and continues to build scale and diversification. Excluding workers' compensation and a program partner that was acquired late last year, our fronting and program business premiums have increased approximately 20% during the first half of the year. We have continued to add new programs in the quarter, while fee income for the segment increased 8% from the prior year quarter to $5.9 million.

Turning to Casualty Reinsurance. We wrote $8 million of premium during the second quarter as we non-renewed or reduced our participations on several treaties. We continue to be very selective with our authorizations and prospective participations in this segment. The combined ratio for the segment was 93.2% and included no reserve development, resulting in $2 million of underwriting profit for the second quarter.

Overall, we're excited by the performance of the group and the broad contributions to earnings from each of our underwriting segments as well as the growth in our investment income. Market conditions remain favorable for our business, particularly in the E&S sector, and we are investing in our platform with the goal of continuing to generate attractive long-term returns for shareholders. For all of these reasons, we firmly believe the outlook for James River is very strong.

And with that, let me turn the call over to Sarah.

Sarah Casey Doran
Chief Financial Officer

Thanks, Frank, and good morning, everyone. James River had another solid quarter, delivering $20 million of adjusted net operating income and moving further into a strong 2022. This included $16.8 million of underwriting profit and $14.7 million of net investment income, each on a pretax basis. Operating income was up approximately 44% from last quarter and over 6% from the comparable quarter last year.

For the first half of the year, adjusted net operating return on tangible common equity was 15.5%. Even adjusting for the change in accumulated other comprehensive income, which benefited our and most competitors' returns on tangible common equity this quarter, our ROTCE accelerated meaningfully from the first quarter of this year.

Our reserves remained stable and we are recognizing $1.5 million of favorable development in our Specialty Admitted segment this quarter. As in many prior quarters, that is due to prior accident years in workers' compensation dating back to 2016. As we did between the first and second quarters of last year, we slightly raised our workers' compensation-related loss pick this quarter given the impacts of continued soft rate and some activity in the book.

Our competitive expense ratio of 25.8% was largely identical to that of last quarter, and a continued advantage we enjoy as compared to others with similar business models.

As mentioned earlier, investment income was $14.7 million this quarter. We are starting to see the benefit of higher new money yields in the fixed income portfolio. Income from that part of the portfolio in particular was $15.2 million as compared to $13.4 million in the first quarter of this year.

Overall, our weighted average book yield improved sequentially from 2.75% to approximately 3% during the quarter and current reinvestment rates are about 100 basis points ahead of that. Our portfolio duration is 4.2 years. We expect that over 20% of our existing portfolio will have the opportunity for reinvestment or reset over the next year. Cash flow from operations continued to be strong at $73.9 million this quarter and about $140 million year-to-date.

Lastly on investments, realized losses were about $17 million this quarter, largely due to our senior secured bank loan portfolio and less so to our investment-grade preferred portfolio. In total, our equity exposure, which is largely preferreds; and bank loan portfolio, represent about 11% of our portfolio, including cash.

AOCI declined $58.6 million during the second quarter. As a reminder, we tend to hold substantially all of our fixed income maturities in an unrealized position until they mature, and average credit quality of the fixed income portfolio remains A+.

We ended the quarter with tangible common equity of $376.7 million in tangible equity of $521.6 million, which includes the Series A preferred we issued during the first quarter. The decline was driven by the second quarter rise in interest rates.

While the interest rate moves impacted GAAP equity, our key rating agency and debt facility leverage ratios exclude the impact of AOCI changes and also give significant or full equity credit to the preferred securities in our capital structure. Given this, as per our debt facilities, our leverage ratio was 23% this quarter, unchanged from last quarter.

In conclusion, James River ended the second quarter in excellent financial and strategic position. We have ample capital to operate in the current environment and continue to see very attractive opportunities to invest and continue to scale our company.
And with that, let me turn it back to the moderator to open the line for questions.

Question and Answer

Operator

[Operator Instructions] We have Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. Frank, you had mentioned that pricing is well ahead of loss cost inflation. Are you seeing any kind of movements there in the loss cost? I think you pointed out how, in workers' comp, soft pricing and maybe some activity in the book, I think, is the way you described it. It was motivating you to pick up the loss picks there. But are you seeing anything more broadly around inflation?

Frank N. D'Orazio
CEO & Director

Sure. So we increased our view of loss cost trend for 2022 at the end of last year. I think we've spoken to this before, with trend for our portfolio in the mid-single-digit range, with certain lines of business perhaps as high as maybe 200 basis points or so higher. And we look at all of our assumptions regularly as part of our quarterly review process. In the event we feel we need to make a change, as we did with workers' comp, we address it.

And when you think about our portfolio as well as some of the more concerning areas relative to inflation. Remember, our excess property unit is less than 5% of our E&S segment, commercial auto is even smaller. So when we discuss loss trend, we tend to focus on the difference between our view of loss trend in a particular line and exposure trend for that same product line.

So in essence, we view exposure trend as a bit of an offset to loss trend. And fortunately, the markets we operate in have remained fairly healthy. And I would suggest the majority of our portfolio captures inflation-impacted exposure bases. So those jumps in exposure are being captured in our premium formulas.

But from a rate perspective, we've been collecting positive rate change now in the E&S portfolio for 5.5 years or so. So you asked more broadly. At the halfway point in 2022, with rate change at positive 12%, we're not only well in excess of our view of loss trend, but ahead of our rate change assumption in our 2022 business plan. And that speaks to margin expansion, especially when you consider that we collected 13% of positive rate in both 2021 as well as 2020.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then when it comes to the economy, anything you're seeing in your SME client base that makes you think there's any kind of slowdown that's ongoing? And in the context of that, I don't know if you can quantify the impact of audit premium in the quarter, but would be interested in any details there.

Frank N. D'Orazio
CEO & Director

Well, I would say, despite some of the broader U.S. macro concerns, our insureds continue to see solid economic fundamentals. We're not seeing any negative issues just relative to revenues or exposure basis at this point. We see exposure growth show up in our premium formulas at this juncture.

Just relative to premium audits, yes, it's a component of what we see on a quarterly basis. Premium audits occur over the course of the entire year. It's just something that we capture in addition to renewal and new business as well. But I wouldn't see any kind of perceived trends there at this -- at least at this juncture.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then, Sarah, maybe -- I hear what you're saying about new money yields 100 basis points higher, excess of the portfolio, or turnover. Should we assume maybe an extra 20 bps of portfolio yield per quarter? 20, 25 bps, similar to what you saw in Q1 to Q2?

Sarah Casey Doran
Chief Financial Officer

That's not an unreasonable assumption, Mark, I think.

Operator

Next question comes from Meyer Shields from KBW.

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

Sarah, if I can follow up on that question. When we talk about new money yields for James River, have you seen a meaningful change in the third quarter to date?

Sarah Casey Doran
Chief Financial Officer

Yes. I think that the best I can say is, compared to where we are on a book yield basis, it's about 100 basis points higher. So we're up above 4% there, Meyer. I think across our composite portfolio, it's not terribly different from where the end -- from where we were at the end of the quarter, so over the last month or so. But that's how I'd frame that in terms of what we're looking at current reinvestment rates across the whole portfolio.

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

Okay. Fantastic. A couple of other small questions. First of all, any changes in ceding commission rates, specifically within E&S?

Frank N. D’Orazio
CEO & Director

No, not anything to speak of. You're talking about the override just relative to what we appreciate in terms of the ceded treaties, Meyer?

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

Exactly, yes. That's right.

Frank N. D’Orazio
CEO & Director

Fairly consistent with past years relative to our major core renewals that just came up at midyear.

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

Okay. That's good news. And then final question. You've talked and shown for a while a lot of growth in Excess Casualty. Can you talk about the tail of that line of business relative to, I don't know, general casualty or the overall non-Uber portfolio of a few years ago?

Frank N. D’Orazio
CEO & Director

Sure. So let's talk about the portfolio first a bit. We tend to be a first excess player, right? So we're playing right over -- right in excess of primary the vast majority of the time. So we're not a high-excess player, we're not a mezzanine player. We're writing right over primary. And the tail is certainly going to be longer than your primary general casualty layers.

But our limits are still fairly tight even on a gross basis. I would say well over 90% of our limit profile is $5 million or less on a gross basis. So it's not as long as you might think or as long as you may think of just relative to tail concerns with other excess players that play throughout a program, top of the tower and mid-tower or et cetera.

So we have top products in there. You can have GL exposures, you can have auto exposures, et cetera. So that, depending on what the primary exposure base is driving the risk, it's going to obviously speak to the tail of that component of the book. But not -- I would say, not out of the realm of how we think about it to be a couple of years longer than, let's say, our primary GL.

Operator

Our next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of them here. First, Sarah, I think last quarter, you were telling us maybe 19% to 21% of the tax rate. It was lower this -- a little lower this quarter. Is 19% to 21% still the number we should be thinking about?

Sarah Casey Doran
Chief Financial Officer

I think it was right around 21% for the year. That's probably where we'll end up. Obviously, a little bit different from where we are in the quarter, Brian. So I would think about it in terms of that. And that's -- I think just as a quick reminder, that's due to the losses that we experienced in Bermuda related to the LPT in the first quarter that's going to push up the effective tax rate.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. Terrific. And then, Frank, I was just curious. You obviously seen a nice improvement in your rate activity or rate levels in this quarter, whereas a lot of the people in the industry are experiencing a moderation and meaningful deceleration in rates achieved. Why do you think that is, that you all are different?

Frank N. D’Orazio
CEO & Director

Well, again, I've seen some of the same dynamics that you're referencing, particularly in the admitted market. Like I said in my earlier comments, I think the headline increase just relative to rate for us is driven by some of our larger underwriting divisions, like Excess Casualty, where we saw rates at double-digit increases. But also a number of other kind of specialist areas, including sports and entertainment, health care, excess property definitely. I mean, we're generally seeing healthy rate increases across our E&S segment.

And in most underwriting divisions, renewal rate changes have been well ahead of where we expect them to be in 2022. So broadly favorable market conditions, I think, suggests that we can continue to push the pricing momentum that we have, certainly throughout the rest of the year.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. That's great. And then, I guess, my last question, just curious. Any noticeable differences in just kind of submission activity now that we're a couple of quarters away from just all of the stuff that was going on?

Frank N. D’Orazio
CEO & Director

Well, it's been a real positive in terms of where we've seen growth in our submissions. Again, like the first quarter, we saw double-digit increases in our renewal submissions, 16 points up quarter-over-quarter in the second quarter. And for us, that's just very efficient use of our underwriters' time because our conversion ratios are so high on our renewal book. So we continue to see that as very steady growth over prior, just relative to holding on to our renewals longer, which is great, again, particularly given the rate change we've been experiencing over the last couple of years.

Operator

[Operator Instructions] Next in line, we have Tracy Benguigui from Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

I'm wondering if you could provide additional color on taking up your loss picks for workers' comp. We're hearing from others that there is a exposure component on the wage side. So I think indemnity represents 50% of claim. So would want to hear a little bit more on why you have a more adverse view. Particularly as well, you made a few comments about a few other considerations.

Frank N. D’Orazio
CEO & Director

Sure. No, I'm happy to do that, Tracy. So we've been talking about the rate erosion in our workers' comp portfolios, particularly in California, for some time, as rates have been softening for several years.

And it's important to just note that, again, we have 2 very distinctively different portfolios, one focused in the Southeast, and the other, a California program. So we're not a 50-state writer.

We were very disappointed to see the recommended rate increase that was put forward to the California workers comp rating bureau shot down in the last few weeks. So the recommendation, as we understood it, was for an increase of a bit greater than 7%. For us, pricing for our large California workers' comp program for 2022 is down roughly 13%, which is certainly greater than anticipated. And we recognize wage change as an offset, but not enough to make up that gap. So we're trying to be responsive and maybe conservative in the current accident year.

As for the releases, we've been writing individual risk workers' comp for a long time at Falls Lake or Specialty Admitted, and we've been writing our large California program since 2016. Frankly, market conditions and our retentions have been different along that continuum. And we look at our reserves quarterly and felt comfortable with the actions that we took just relative to the release.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

In which years were the releases coming from?

Frank N. D’Orazio
CEO & Director

A number -- this is -- it's not a huge number in any one given year. And again, we've written these portfolios in both instances for a number of years. So it's really across a number of years.

Sarah Casey Doran
Chief Financial Officer

I think I said it went back to 2016, Tracy. So kind of started there and working more currently.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. I mean, how do you think about experience, because it is a long tail line? Do you think enough time has passed since 2016?

Sarah Casey Doran
Chief Financial Officer

We're very comfortable with our reserves. We've had continued and consistent redundancy in those old years. Again, if you think about what that book is, small Southeastern exposure in those years for the most part. And then obviously, the California book, we're looking at 6 years out. I think we're pretty comfortable with where we are and have been very conservative here.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Got it. And the last question. So you've given us guidance that casualty premiums will go down $100 million this year versus last. And if I just look at the first half of the year, premiums are down by $64 million. So how should we expect the cadence to look like then, second half of the year? Will it slow down?

Sarah Casey Doran
Chief Financial Officer

I'll let -- Frank, do you want to take that one? Or...

Frank N. D’Orazio
CEO & Director

Well, I would just say broadly, again, if you think about where we finished the year in 2021 and the fact that you said we're going to take $100 million out and where we finished through the halfway point, we're kind of there or kind of on the pace that you might expect.

And Sarah, I don't know if you want to add to that?

Sarah Casey Doran
Chief Financial Officer

Yes. I would just say that the first half of the year last year was significantly larger than the second half of the year, Tracy, just to kind of put that in context. Not every quarter is even. And that's one way to frame it.

I think the other piece is, as we said, as Frank said in his comments, we're going to look at every single renewal and every single opportunity in a quarter-by-quarter basis and make those decisions as the market comes to us. I don't think we're going to be beholden to write anything or do anything. So I think those will be, to some degree, real-time decisions. But I would also point to the cadence in the books over the course of last year.

Operator

At this moment, we have no further questions. I will now turn the call to Mr. Frank D'Orazio, Chief Executive Officer, for final remarks.

Frank N. D’Orazio
CEO & Director

Thank you. And I want to thank everyone listening on the call for their time today and for the questions we received this morning. We look forward to speaking with you again in a few months to discuss our Q3 results. Thank you, and enjoy your day.

Operator
Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.