![S&P Capital IQ]

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James River Group Holdings, Ltd.

NasdaqGS:JRVR

FQ4 2016 Earnings Call Transcripts

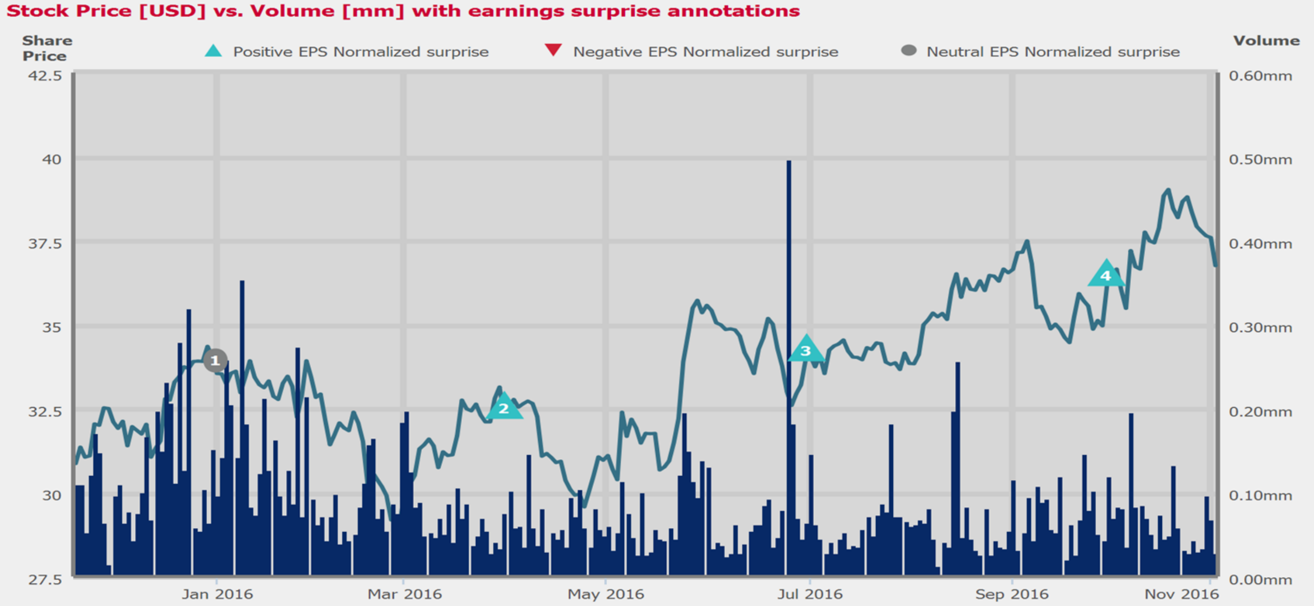
Thursday, February 16, 2017 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.65	0.77	▲18.46	0.56	2.26	2.39
Revenue (mm)	145.31	169.02	▲16.32	147.10	562.73	586.23

Currency: USD
Consensus as of Feb-16-2017 6:59 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	0.60	0.60	(1) 0.00 %
FQ1 2016	0.42	0.43	▲(2) 2.38 %
FQ2 2016	0.43	0.46	▲(3) 6.98 %
FQ3 2016	0.71	0.72	▲(4) 1.41 %

Call Participants

EXECUTIVES

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Kevin Copeland

Robert P. Myron
President, Chief Operating Officer and Director

Sarah C. Doran
Chief Financial Officer

ANALYSTS

Charles Sebaski

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

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

Randolph Binner
FBR Capital Markets & Co., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to James River Group Holdings Q4 2016 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to introduce Head of Investor Relations, Mr. Kevin Copeland. Please go ahead, sir.

Kevin Copeland

Thank you, Andrew. Good morning, everyone, and welcome to the James River Group Fourth Quarter 2016 Earnings Conference Call. During the call, we will be making forward-looking statements. These statements are based on 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 Factor section of our most recent Form 10-K, Form 10-Qs and other reports and filings we make 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 Adam Abram, Chairman and Chief Executive Officer of James River Group.

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Thank you, Kevin. Bob Myron, our President and Chief Operating Officer and Sarah Doran, who recently joined us as our Chief Financial Officer and I are all here together. And I want to welcome Sarah and to say how glad we are to have her take a prominent role in directing our company. And welcome also to everyone who's on this call live or taking time to listen to the recorded version.

December marked the end of our second year as a publicly traded company, and we really do appreciate your continued interest in our results. As a direct result of the efforts of people all around our company, we enjoyed a very profitable fourth quarter and the full year for 2016. I think the headlines in our press release, which many of you may have seen, provide a good summary of the value our company delivered to shareholders this quarter and for the year.

We had record annual net income. We enjoyed a 24.7% growth in the fourth quarter from our very profitable E&S segment and 20.1% for the full year. We doubled gross fee income from the prior year, and we think that affirms our strategy of growing fee income is working. We enjoyed a 2.3% reduction in our group-wide expense ratio, demonstrating the increasing expense advantage we have when compared to many of our excellent competitors. We earned a 14.6% operating return on tangible equity for the full year and if we add it back to dividends that we pay, we calculate it at 17.2% growth in tangible book value for the year. We paid $66.3 million in regular and special dividends to shareholders and this represented a 6.5% yield on the weighted average trading price of our stock over the year.

As always, the metric we pay most attention to is our underwriting profitability. And you may already have noticed that we have reported a group-wide combined ratio of 94.3% for 2016 and 92% for the fourth quarter. This may be an appropriate moment to confirm our guidance. We expect to earn a 12%, or better, return on tangible equity, and to write to a combined ratio of between 92% and 95%. The value proposition we're working to deliver for our shareholders is this, we're highly experienced underwriters who seek to deliver consistent underwriting profits.

We grow by seeking opportunities, and we shrink when necessary to preserve underwriting profitability. We underwrite accounts we understand at market prices we believe provide a margin appropriate for the risk we take when we promise coverage to policyholders. We're actively exploring new risks to broaden our opportunities for growth, and we eschew lines of business or risk structures we believe introduce substantial volatility in our book. We are a low-volatility underwriters.

And the capital markets underpinning the insurance and reinsurance world have changed substantially over the past many years, and alternative capital sources play a larger role than ever in addressing risk in the United States where we're focused and around the world. We're actively working to develop strong and mutually beneficial relationships with these new capital sources and to deliver value to them in return for earning fees that benefit our shareholders by boosting our return on shareholder equity. And in part, our growth in fee income reflects that emphasis on our part.

Turning for a second to market conditions, before we get to your questions. Our E&S segment continues to see record number of submissions. We were up 12.8% for the year and we continue, as I mentioned before, to grow very nicely in this profitable area. Rates for the year and for the fourth quarter in the E&S segment were essentially flat. They were down 0.3% of 1% for the year. But that's a perfectly satisfactory state of affairs for a segment that continues to produce very good underwriting ratios.

During the fourth quarter, we were able to grow in Commercial Auto, in Environmental, in Excess Casualty, in Excess Property and Sports and Entertainment within the E&S segment. And in keeping with our focus on underwriting profitability, we wrote less premiums in manufacturers and contractors, energy, medical professionals and professional liability. I just like to salute the leadership and the entire team of our E&S division for their terrific underwriting in 2016.

In our specialty admitted segment, we managed to double gross written premiums for the year from $91 million in 2015 to $182 million in 2016. However, in keeping with our focus on building partnerships with other capital providers, the Specialty Admitted segment retained only 30% of the written premium. Fee income in this segment almost tripled in the fourth quarter compared to a year ago and more than doubled for the year.

This has been an area of focus for us in our Specialty Admitted segment and the management and team there is absolutely delivering on this goal and we salute them too. It's worth noting that the directly written Workers' Compensation book we have in this division also grew and achieved some of the best risk-adjusted rates we've seen in a long time in that segment during the fourth quarter of 2016.

Our Casualty Reinsurance segment, essentially, broke even on an underwriting basis for the year and for the quarter, reporting 100.1% combined ratio for the year and 101.8% combined ratio for the quarter. I suspect many listeners on this call are aware that the environment for Casualty Reinsurance is tough, but we think these are reasonable results in this environment. Our book continues to be insulated from volatility because we write no property.

The book is overwhelmingly pro rata casualty, 94% pro rata casualty, and we take modest participations on accounts where the underlying policy limits are generally $1 million per recurrence risks. The existence of our reinsurance segment underpins our corporate structure, and you may have already noticed that our estimated group-wide tax rate for 2016 is 6.1%. We believe the book that the management team has put together here is a very solid, low volatility book of Casualty Reinsurance, well underwritten.

Turning quickly to investments. We were pleased with the performance of our investment portfolio for the quarter and the year. Our strategy is to invest the vast majority of our portfolio in traditional high-quality government and corporate bonds and then to supplement returns by investing a small amount of our total corporates in alternative assets where we expect to earn outsized returns and add meaningfully to our overall investment returns. Our strategy worked well this quarter, and we saw high returns and profits from renewable energy investments and all the other alternatives also made a meaningful contribution to our overall investment returns.

So we entered 2017 with confidence about our underwriting, bolstered by the knowledge that we began with a solid balance sheet, appreciative of our shareholders for support and support of all of you on this phone. Grateful for the excellence and thoughtful work that all of our colleagues throughout the company do. And we're looking forward to another good year together.
With that, let me open the floor to questions.

Question and Answer

Operator

[Operator Instructions] And I am showing our first question comes from the line of Charles Sebaski with BMO Capital Markets.

Charles Sebaski

So I guess the first question I have is on -- any update on your share in economy, new economy business, not any particular lines, just if there's been growth? Or how much is that contributing to E&S growth? Has there been any expansion on the client base?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Well, I think in general, we all know, everybody knows that the new economy or capital goods sharing part of the economy continues to grow. We now have, I think, 49 or 50 total accounts that fall under this category, most of them in commercial auto and, yes, we see good growth among many of those clients. For us, we think that's really a very, very interesting business. It's profitable business. To the extent that it's Commercial Auto business, it tends to have a higher current year -- we posted at a higher accident year loss ratio, and you may see some escalation in the estimated or forecast or booked current accident year loss ratio on the E&S division where most of that business is written. It's just reflective of the higher loss ratios, typically, in that Commercial Auto business. That's offset by lower expense ratios associated with that business. And by the way, across those lines and for all those accounts, we reserve them with, essentially, the same discipline that we use for our entire book of business and try to post it in a cautious and current accident year and then develop. We've also developed an awful lot of expertise in the claims handling side of this business. And I think that's been a key for us being able to develop some of these accounts. But it's a growing area of the economy and it grows for us, and we are very interested in that business, we think it's fascinating.

Charles Sebaski

Excellent. I guess then any announcement in general, have you seen -- how's the competition? Or I mean, obviously it's a competitive market. I'm just curious if there's been any changes over the last quarter, the back half of the year, either with standard markets or new competitors or how does the overall competitive environment across the lines is looking?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Yes. Well, I would characterize it's competitive, but highly rational. Absolutely, there are number of carriers. There is good, healthy competition in that business for the year. I think I said that the rates were down for the year 0.3%. Actually, in the fourth quarter, rates were slightly up. We see lots of opportunities. We have never ever had more submissions in our E&S division than we have today. This is the period of highest submission activity we've ever seen. So we think there's plenty of opportunity there. There is competition. Remember that we're in the smaller end of this market, small account market, and we think there's really good opportunity there. And we think the margins are holding up quite nicely. Bob, if you want to add to that?

Robert P. Myron
President, Chief Operating Officer and Director

Just let me add that similar to what we've said in the past, there continues to be -- there's more competition in the larger accounts space. And for us, that's six figure accounts and up. That's definitely more competitive space than where our average premium is. But I would just echo that in the excess and surplus lines space and also in the Specialty Admitted small accounts space, the competition is definitely rational, and we're putting business on the books at what we think are perfectly acceptable margins. And the last piece of that is we continue to see benign underlying loss trends.

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

One final thought about that is, if there is a stimulus program, a meaningful stimulus program in the United States, that will almost certainly benefit the E&S business and particularly the small to medium size account sector where we write. That will do very well in the context of economic stimulus.

Charles Sebaski

Excellent, I guess then just one final kind of numbers based question. Looking out over this year, just trying to get a sense on the fee income and how that ramps up over this year and the kind of benefit we could think that would have on the expense offset? I know that some of that gets booked through expense offsets. So thinking about your expense ratio through -- going through 2017, is the fee income a couple hundred basis point benefit to the expense ratio in 2017? Is that a reasonable way to think about it? I am just trying to...

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Yes. I don't think we want to give specific guidance on where we think fee income will grow or exactly how much of the input active would have on the expense ratio. I think that we do, however, I think generally, expect it to grow as we continue to -- we're getting fee income from a couple of places as you know, from funding of programs in the Specialty Admitted segment. And clearly the gross written premium there is growing quite a bit. And as the gross written turns into earned, our earned fee income will continue to go up. And then in the servicing of claims, in particular in the Commercial Auto area, as we continue to get growth there in terms of underlying exposures and miles driven and the like, we would continue to expect fee income to grow in that space as well. We just -- we're just not going to give specific guidance on dollar amounts or necessarily the expense ratio impact.

Charles Sebaski

Fair enough. Please.

Sarah C. Doran
Chief Financial Officer

Sorry, Chuck. I would just point out that for this quarter in particular, it was a 2.2% reduction to the expense ratio to fee income.

Operator

And our next question comes from the line of Randy Binner with FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

So I guess I kind of wanted to push a little bit on the guidance and it's good, first, in this environment, as you've laid out. But there's a 12% tangible ROE and a 92% to 95% in the combined. You did deliver a higher ROE than that in 2016. And so I think of James River as being conservative historically, but I just want to kind of flesh out, how we should think about the accident year loss pick? You mentioned in your previous comments that there is a relationship with a higher loss ratio and a lower expense ratio in a lot of the new economy Commercial Auto business you're writing. But that still doesn't quite get us as low as we thought that, that underlying combined might be. And so, I guess the gist of the question is, is this a business -- is this new economy Commercial Auto, where I'm thinking a lot of this growth is coming from -- is it going to be like a lower margin higher, but you make up for it in volume kind of business? Or is this a function of a higher accident year loss pick you're putting up, because you're growing faster and it's kind of your typical profile conservatism on your initial loss pick?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Well, let me just start with guidance. And let me go back to the -- to where you started with the question, which was about our guidance. We thought long and hard and we recognize that in 2016 our results exceeded the guidance that we offered. But really, if you think about a 12% return on tangible equity and 92% to 95% combined ratio, I think that captures two really important signals that we're trying to send to our shareholders. One is a lack of volatility and a real focus on underwriting. And two, 12% is roughly 1,000 basis points above the risk-free rate. And we think that's a signal that we think that our process and our method is going to deliver really good consistent returns. And I think we approach providing guidance in the same way we approach taking other risks. And we are careful to try to articulate goals that we think are ambitious. But we are also careful not to set up a situation where we would disappoint. So that's the beginning part. Then the second part you asked was, is the new economy business more or less profitable than the rest of our E&S business? We have targets for profitability in that E&S business. I think the new economy business meets our general targets for that profitability and return on tangible equity. This is -- we don't seek an overall -- if you take the entire book of our business, E&S, Specialty Admitted and Casualty Reinsurance, I don't think we are anticipating in 2017 a contraction in our underwriting total margins. But the number we're comfortable putting out there is a 12% or better return on tangible equity and a 92% to 95% combined, which we think is, in the context of the world, an ambitious target. We'd love to beat it again. But I think that's an ambitious target and a good signal. It's meant to be a strong signal. But not without getting over our skis or ahead of ourselves.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, that's fair. And then on -- I guess just a follow-up question because this can indicate -- this can affect the E, is the -- I just want to confirm there's no signal here on any sort of change in the tolerance, the payout of the special dividend to the extent that your capital levels remain good and remain well supported by the reserve redundancies?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Our capital -- well, our capital levels are -- our reserved redundancies and our capital levels are two different issues. But to be fair about it, we're very comfortable with our balance sheet and our reserving methodology relative to the information and good insights we get from independent actuaries who look at our book remain -- our methodology remains consistent and our position relative to the independent look remains consistent. So that's one. Two, we are careful to announce dividends one at a time. But we do think we are a well-capitalized company. And we -- I am not today, as I sit here, concerned about our ability to handle the growth we anticipate or the business we anticipate and our balance sheet is in good shape. And if you looked at our BCAR scores or other, you would see that we are well-capitalized company.

Anything else, Bob or Sarah on that?

Robert P. Myron
President, Chief Operating Officer and Director

I would just reiterate that I wouldn't take that guidance to signal anything with respect to changes in capital management, but would reiterate that we look at dividends a quarter at a time. In particular, a special dividend, which we will assess at the end of the year, if anything, to be paid in that respect.

Operator

And our next question comes from the line of Mark Hughes of SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Anything in the manufacturers and contractors segment that got your attention this quarter? I think you said you wrote less business there. Is that a pricing issue? Are there just less premium to be had there?

Robert P. Myron
President, Chief Operating Officer and Director

Well, the first thing that I would say about it, Mark, this is Bob Myron, is that we did grow that division for the year. There was a little bit of a reduction in the quarter. I don't think we make up -- take a lot from that. It's a -- it's always been one of our largest divisions. And so I think it's probably just a little bit of a quarterly adjustment, so to speak. But we did have about 6% growth in that division with it for the course of 2016. So we feel great about where it is and what the prospects are for it going forward. And I think, as Adam said, that's certainly one of the divisions that could benefit significantly from economic stimulus and the pricing in that division continues to be perfectly reasonable.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Great. In the reinsurance, your top line was up in the gross written premium, high-single-digits. Is the model still to hold that steady? Or is it growing a little bit here?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

In general, the model is to hold it steady. We had growth, a large percentage growth in the quarter in that segment. But on a dollar basis, I think it was, like, $12 million or something. So it wasn't a lot. I think it was opportunistically just a couple of more treaties than what we were expecting and relative to last year a couple of additional small deals. And I think the team down here is going to just continue to be opportunistic. In this environment, there is certainly not a charge to grow. But to the extent that small additions that are profitable cross their desk and it fits within our underwriting parameters, it's something that they would certainly do and can do.

Sarah C. Doran
Chief Financial Officer

I think the other thing I'd add on that is, there was significant growth over the quarter, but not on a yearly basis. It was really just the timing difference quarter-over-quarter. So I don't think that signals anything.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Adam, you had mentioned the new capital sources and how you are developing relationships there, helping out, presumably, your fee business, Specialty Admitted. What's the pipeline look like? Are we going to see another big contract, potentially emerge in 2017?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

We don't preannounce any of this. But we are -- we're very interested in that business, and we're talking to a number of, really, we think very solid, very thoughtful players in that industry. We hope to develop relationships. We can't predict timing or how it would work out. But certainly, we think it's an important opportunity for us to fully explore and our management team is really engaged, I think, in productive ways in those conversations. We'll see what emerges from it.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then, finally, you wrote less medical professional. I think that has been the trend. You pointed out fewer doctors are getting kicked out of their coverage these days. Did you see any particular transition at year-end? Or is it just more of the same?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Just -- I think it's a continuation of the trend, and it's just a smaller pool to choose from.

Operator

[Operator Instructions] And our next question comes from the line of Meyer Shields with KBW.

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

So one, I guess, small question and one big one. Most Commercial Auto insurers are reporting unanticipated high frequency and severity trends and recognize that your reserving has proven to be consistently conservative, but how are you reflecting that particular dynamic in the sort of newer economy product lines?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Well, we're spending an awful lot of time analyzing the results in granular detail. You are correct to point out that this is a tricky line of business. And this is not like taxis or some of the other more traditional commercial lines of business. This is -- tends to be new economy ride share where people are using their own vehicles part of the time and then driving for commercial purposes part of the time. There is a fair amount of technology associated in this. And there's no -- the other thing I would point out to you that, much of the noise in the Commercial Auto business is associated with trucking. And this is passenger auto-related business. So it's different in that regard. There's a very big distinction between a midsize car going down the street and a several thousand ton truck barreling down a crowded highway in terms of the consequences of those accidents. So we look at it very carefully. It's a very prescribed book. We've got a lot of information on it. We spend a lot of time analyzing it. It does have a higher loss ratio, as I mentioned, than the other parts of our liability book in the E&S sector. And you could see that's in the rising current period pick in the E&S is that that higher pick influences, the overall loss ratio there. It also enjoys somewhat lower expense ratio, which is an offset because we're really focused on the pretax bottom line there. I hope that answers your question.

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

It does. No, it's very helpful. And then sort of a speculative question. Obviously there's a lot of chatter about lower domestic tax rates in the U.S. So I guess the two areas that I would ask you to comment on are, one whether that lower tax rate could imply more price competition from, let's say, domestic carriers that don't have the same sort of internal quota share arrangements that James River does? And second, whether it's likely to affect the demand for casualty reinsurance to the extent that there is sort of an arbitrage opportunity with a Bermuda-based reinsurer?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

The first thing I'm tempted to say is that we consulted with General Flynn during the campaign and he assured us that there will be no tax changes. But well that's not, that was meant as a joke, probably not a very funny one. The -- look, we view underwriting and every single underwriter in our company at every single level of our company are judging pricing and loss costs on a pretax basis. We don't -- we're not sitting there making calculations or ascribing cost to capital at the underwriting level on an after-tax basis. This is a pretax business from our point of view. And when we say, we're going to make an underwriting profit, we mean we are going make an underwriting profit pre-tax. If the tax rates go down, that's fine, and that will play out where it is. I think we're -- we've done a lot of work on this. I think it's very confusing for anybody to try to predict where the Congress may or may not come out on this. But I just don't see a tax rate decrease spurring competition because I think most people who are measured on combined ratios are thinking about that as a pretax measure.

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

Okay. Does that flow through in terms of your perception of the demand for reinsurance that you meet?

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Yes. I think so. Look, much of our reinsurance, if you look at that book, remember that is 94% pro rata or quota share. Many, many, in fact, I would say probably the majority of our partners in the reinsurance side of the business are seeking surplus relief. And so we're supporting them in lines of business where they need additional capital, and we have respect for their underwriting. So I don't think a reduction in tax rates will dramatically affect that.

Operator

And at this time, I'm showing no further questions. So with that said, I'd like to turn the conference back over to Chairman and CEO, Mr. Adam Abram, for closing remarks.

J. Adam Abram
Chairman, Chief Executive Officer and Chairman of James River Group, Inc

Thank you, Andrew, and thank you, everybody, who joined us and a very, very loud and -- thank you to all of the colleagues and associates all around James River for a wonderful 2016 year and a great set up for 2017. And we look forward to joining our shareholders and others on this call at the end of the first quarter. Thank you.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.