CONTENTS



# James River Group Holdings, Ltd.

NasdaqGS:JRVR

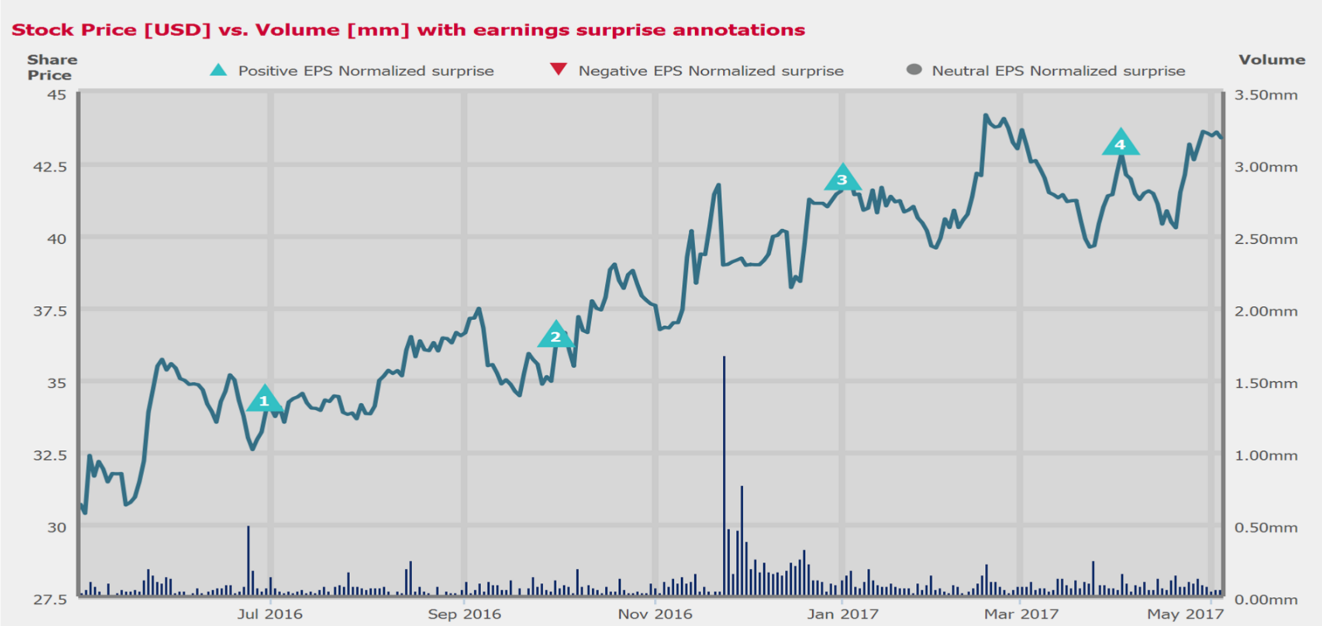
*FQ2 2017 Earnings Call Transcripts*

Wednesday, August 02, 2017 12:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ2 2017- | | | -FQ3 2017- | -FY 2017- | -FY 2018- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.50 | 0.49 | ▼(2.00 %) | 0.70 | 2.61 | 2.70 |
| **Revenue (mm)** | 169.83 | 202.39 | ▲19.17 | 175.05 | 702.05 | 734.45 |

Currency: USD
Consensus as of Aug-02-2017 2:06 AM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ2 2016** | 0.43 | 0.46 | ▲1 6.98 % |
| **FQ3 2016** | 0.71 | 0.72 | ▲2 1.41 % |
| **FQ4 2016** | 0.65 | 0.77 | ▲3 18.46 % |
| **FQ1 2017** | 0.55 | 0.58 | ▲4 5.45 % |

# Call Participants

## EXECUTIVES

**J. Adam Abram**
*Chairman & CEO*

**Kevin Copeland**

**Robert P. Myron**
*President, COO & Director*

**Sarah C. Doran**
*Chief Financial Officer*

## ANALYSTS

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

**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 the James River Group Holdings Second Quarter 2017 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Kevin Copeland, Head of Investor Relations. Sir, you may begin.

**Kevin Copeland**

Thank you, Kaylee. Good morning, everyone and welcome to the James River Group Second Quarter 2017 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 Factors 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 CEO of James River Group.

**J. Adam Abram**
*Chairman & CEO*

Thank you, Kevin. Good morning everyone. This is Adam Abram, and I'm joined today by Bob Myron, our President and Chief Operating Officer; and Sarah Doran, our Chief Financial Officer. And we appreciate your interest in our company.

We have a few observations to make, and then we'll get to your questions. Our company showed a lot of strength this quarter compared to the same period last year. Our rate of return is higher. We earned an annualized 13.4% return on tangible equity as compared to 10.9% in the first half of last year. We earned $0.03 more of operating income per diluted share this quarter than 1 year ago, and EPS through 6 months is up by $0.18.

Year-to-date, we've generated over 8% growth in tangible book value per share before the dividend. We are reporting a 4.9 percentage point reduction to our expense ratio, a 99% increase in fee income and 55% growth in net earned premiums, all compared to the same quarter last year.

Investment income grew 19% quarter-over-quarter and over 33% year-to-date. We benefited from another exceptional contribution this quarter from our renewable energy investment portfolio and an additional amount from our floating-rate [ bank ] loan portfolio.

Coming back to first principles. Profitable underwriting is and always will be at our foundation. This was the 17th consecutive quarter where we have reported an underwriting profit. We believe we've also delivered strong profits to our reinsurers for a long time. Our sharp reduction in expense ratio is very helpful as it permits us to be more competitive in our risk-bearing business. As the cost of acquiring and processing business is reduced, we have more flexibility in pricing risk profitably should the market tighten.

I am especially pleased by the rapid growth in our fee income. This is the result of a deliberate effort to deploy our skills, experience and infrastructure developed over years to benefit customers where we bear little or no risk. As this part of our business grows, we believe it will be valued differently than our risk-bearing business, which requires much more capital to generate income.

I attribute our long-term success in underwriting to being clear eyed in our assessment when we make mistakes and taking swift action to correct them. We want to describe 2 corrective actions we have taken recently. We reported $949,000 of adverse development at our Specialty Admitted business. Over the past few years, we've attempted to build out a program business in that segment. The fronting business has been profitable and has produced significant fee income.

On the program side, our efforts have not met our return threshold. While we've been quick to shut down unattractive programs to protect our balance sheet and our reinsurers who support those programs, this relatively small portion of our business has cost us money. The adverse development in this segment comes from these programs. We are moving away from the program business. I'll talk more about that in just a minute.

We also reported a loss in our reinsurance company. Ironically, a significant part of the loss was the result of catching up on several quarters of profit commissions on 3 accounts that remain profitable to us. Had we recorded the profit commissions in the previous quarters, they would have hardly moved the needle. As it was, since we identified and corrected the under-accrual this quarter, the aggregate amount was $2.0 million, which was enough to create a loss within the segment. Without this adjustment, the reinsurance segment would have reported a 100% combined ratio.

We caught the mistake during an internal review. To be clear, the accounting catch-ups are not acceptable to me or our team, and we've taken measures to prevent a recurrence.

The profit commission catch-up, however, was not the only reason we had a loss in the reinsurance segment. We reported a $2.2 million in adverse loss reserve development, mostly from the 2010 and 2012 contracts, which we no longer write -- a couple of contracts we no longer write. We expect every underwriting unit to make consistent underwriting profits.

The reinsurance business is currently in a tight market. Because of our corporate structure, the reinsurance business continues to contribute to overall returns, even when it produces modest losses. Through the first 6 months of this year, the Casualty Reinsurance segment reported a 101% combined ratio.

I feel good about our prospects for continuing to deliver attractive returns. And I'm going to make a few comments here that I think Kevin would regard as forward-looking.

We continue to see strong profitable growth in our E&S segment. This quarter, we quoted on more submissions than ever. Submissions were up across almost all lines and about 8% in total.

Year-to-date, the core E&S business has grown about 4%. We've been making concerted efforts to drive our expense ratio down, while maintaining high levels of service. Growth in our fronting business has also helped towards this. If you sum our risk-bearing businesses, we think margins are very slightly down as compared to a year ago. However, our lower expense ratio gives us flexibility in a competitive market. We think this is a material advantage today and going forward.

I will anticipate a probable question. We are reporting less favorable development in our E&S segment than we have in prior periods. I wouldn't make too much of that. Given our rapid growth in E&S within the last few years, we're inclined to let reserves develop before declaring victory, especially regarding the performance of that new business. Having said that, we like what we see. Those of you who follow us closely know that we conduct our deep dives into our reserves in the third and fourth quarters of the year.

I mentioned our struggle with the relatively small program business within the Specialty Admitted segment. We're doing much better with fronting within Specialty Admitted, and we will be redoubling our efforts in this area, focusing on larger transactions with less retained risk.

Fronting was the source of meaningful top line growth in this segment for the quarter. And as we begin to write -- and we began to write our largest fronting contract in June of last year. It also had a meaningful impact on the lower expense ratio and accident year loss ratio posted this quarter as compared to the comparable quarter in 2016. Fee income in this segment is an offset to expenses. We see attractive opportunities in the market to build this business.

Also on the positive side of the ledger, our niche book of Workers' Compensation business continues to perform well. While rates have fallen, reported loss costs have also declined. The math suggests that our margins in this line are holding. We'll keep a close eye on the line to see if actual results reflect the publicly reported trends. Right now our book is stable and continues to meet our return thresholds.

With regard to guidance, we expect to earn a 12% or greater return on tangible equity and a 94% to 97% combined ratio. The increase in our guidance for the combined ratio is the result of changing premium mix as our Commercial Auto division grows.

In conclusion, I'd say we're growing. That growth is leading to our generating greater profits than ever before. Our progress isn't always straightforward, but we're attempting to identify and correct errors quickly. We'll continue to build our balance sheet with an eye toward protecting the future of our company. And I'd like to conclude this good quarter by thanking every member of our company for their contributions to our joint effort.
And with that, let's go to your questions.

# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from the line of Randy Binner with FBR.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

So I'll try one on reserves, and I think, Adam, what I heard you say in the commentary there was that there's kind of tremendous growth in the E&S business, mostly in Commercial Auto. That would be the category I think it would fall into from a reserve perspective. And that tremendous growth is leading to some conservatism in how you're looking at reserves overall, so in Commercial Auto and outside of it. And that led, in part, to the lower development -- favorable development there in the second quarter, understanding that most of it also happens later in the year. But is that the right way to think of it, that there's caution around reserving practices, given the tremendous growth in the share ride business?

**J. Adam Abram**
*Chairman & CEO*

Yes. Randy, look, the thing we don't want to ever do is declare victory early or get ahead of ourselves in interpreting our results. We want to let them emerge and to be confident. And so, look, we're producing really sensational returns on tangible equity, I think. I guess I shouldn't say sensational but really good returns on tangible equity. And I think the smart thing to do is to let business age, and let's understand exactly what the development patterns are over time for this new and growing line of business. It's also an evolving line of business in terms of the economy. And so we want to make sure that we understand the patterns that are specific to this kind of business. And so yes, we're being -- we're taking a wait and see attitude. But as I said, we like the business. We like what we see. But we're not going to call this early.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

So 2 follow-up questions. One, I guess in the non-commercial Auto segment reserves. Is there anything that's changed with development there as it relates to claim emergence, legal outcomes, et cetera?

**J. Adam Abram**
*Chairman & CEO*

No. No. I mean that [indiscernible]

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

If you think Commercial Auto, and then so with this -- with the rideshare, is it -- are there more accidents? Are more -- is there more accidents than we're seeing with other Commercial Auto lines, and they're more likely to be litigated? Is that a trend you're seeing?

**J. Adam Abram**
*Chairman & CEO*

No. Each -- look, we've got over 50 accounts in this area. And there are variations between the accounts, so I'm not going to make some big wide statement. But the business is performing. We're just waiting to see, and -- but there's nothing that's alarming me right now. It's just that we are -- it's early. And we should wait and see how it develops. And this is the way we've approached our business for 30 years. And so we're using the same general philosophy, probably a lot more technology, and -- but the same general philosophy to analyze our reserves on this business as we've used in other businesses for 30 years. The difference is we have a segment that's growing very quickly, and so we're being careful.

**Operator**

Our next question comes from the line of Mark Hughes with SunTrust.

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

In the E&S segment, your net earned premium grew a lot faster than the written premium. And that's been the pattern but more so this quarter. What drives that?

**J. Adam Abram**
*Chairman & CEO*

It's really Commercial Auto.

**Sarah C. Doran**
*Chief Financial Officer*

Yes, I'll answer that, Mark. It's really just Commercial Auto. We're really earning it as we're writing it, so when you see the growth of that, that's kind of providing the variation there from what you've seen historically.

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

Okay, the core E&S, Adam, did you say it was up 4% for the 6 months? Was I -- do I remember correctly that it was up 11% in the first quarter? What did you see in the second quarter there?

**J. Adam Abram**
*Chairman & CEO*

Still up but up less.

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

Yes. Any particular reason for that, as you look at it?

**J. Adam Abram**
*Chairman & CEO*

I'm flipping a page to give you the answer. No, I wouldn't say there's any particular reason. What's going on is we're having the usual fluctuations in competition by division within the E&S segment. Things come and go. Sometimes you'll have a large policy or 2 that can affect the division in a quarter. You know that we write mostly smaller policies. So I think it's -- what I would say to you is I think it's episodic, really. I would not try to draw a trend from that.

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

Okay. How much of program business are you doing now? And I assume that's all sitting in Specialty Admitted. How much of that, as you make that transition, should go away?

**J. Adam Abram**
*Chairman & CEO*

Sarah, do you want to speak to that?

**Sarah C. Doran**
*Chief Financial Officer*

Yes. It's not very much. A lot of our program business and we took the development this quarter is actually business that we've canceled, as I think Adam referenced in his prepared remarks. So I've been saying -- I can get -- I just don't have the number at my fingertips. I can look at it and come back to you by the end of the call to give you a precise number. But it is pretty small. And the other frame of reference that I use is we've got about $840 million of net reserves up for the entire group right now. And the reserve program in the fronting business, which is included in that, are about $22 million of net reserves there. So it's less than 2.5%, 2.6% of the overall net reserves.

**J. Adam Abram**
*Chairman & CEO*

And so I just -- I wanted to add to that. So Sarah has made the point of how small the program reserves are with regard to the overall reserves in the company, I just want to give a tip of the hat here. Even though we're disappointed with the results, I did want to commend the leadership of our Specialty Admitted division for swift action -- the swift action they took, with regard to poorly performing programs. And they -- sometimes companies hope and wish that things will get better without a reason. I think that our team there was very clear eyed and decisive in canceling programs that weren't performing to ours or their expectations. And I -- well, I know we all, everybody at the company, would like to have only profitable programs. I think part of the success of our company is being really direct with ourselves about what results are and taking actions that are appropriate. And the leadership of the Specialty Admitted segment did that very swiftly and a good job on their part.

**Robert P. Myron**
*President, COO & Director*

Mark, this is Bob Myron. I just would layer in for reference here. Generally, we call fronting anything where we take less than 10% of the risk, and programs have generally been a 25% to 50% net line. I would say the majority of the in-force and noncanceled fronting and programs book are in less than 10% net risk line. And it's what we're going to be pursuing going forward. So most of what we're seeing here are small canceled programs, where our net risk line was, as I said, 25% to 50%, but the overall reserve level for all of that is pretty small. And so we think containable.

**Sarah C. Doran**
*Chief Financial Officer*

I'll just come back, [indiscernible] for year-to-date for programs premium, net written premium was about $4 million. So pretty small compared to the other one if we try to categorize it.

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

Final question on the -- in the E&S, on current accident year, it looks like you were flat in terms of combined ratio year-over-year. The increase in current accident year is offset by the improvement in underwriting. Is that the way we should think about the book going forward if you have more mix shift in favor of the Commercial Auto? Could -- have we hit a point of equilibrium here? Or might you see improvement or deterioration if the mix continues to shift?

**Sarah C. Doran**
*Chief Financial Officer*

So overall accident year? I missed the beginning part of the question.

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

The first part of the question was the current accident year.

**Robert P. Myron**
*President, COO & Director*

[indiscernible] the combined ratio is about the same.

**Mark Douglas Hughes**

*SunTrust Robinson Humphrey, Inc., Research Division*

Is that on a -- have we hit equilibrium?

**Robert P. Myron**
*President, COO & Director*

I wouldn't say that we are expecting a deterioration in that accident year combined ratio as the mix weighs in, but...

**Sarah C. Doran**
*Chief Financial Officer*

I think that's right. I mean, there could be a little bit more of an increase, I think on the fringe, but not much, if anything. I wouldn't expect -- I would expect to be kind of right around where we are right now with the gross [indiscernible]

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

At this point any improvement -- any movement in current accident year would be presumably offset by underwriting improvements. And so relatively stable at this point. And then the favorable development kind of swings the net number, is that fair?

**Robert P. Myron**
*President, COO & Director*

Yes. And I would say the last thing is as we continue to get the growth there, the expense ratio is going to continue to come down, in particular, driven by the fee income, right? So even if we do have accident year loss increases, you're going to have continued declines in the expense ratio, and that's why it doesn't feel like that's going to deteriorate.

**Operator**

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

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

Adam, one quick question. You talked about the full year combined ratio, and I can't read my handwriting. Is the expectation 94% to 95%?

**J. Adam Abram**
*Chairman & CEO*

No. The expectation is 94% to 97%.

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

Okay. So recently, I guess we saw, State National, which is one of the competitors in the fronting business, get acquired. When that happens, is that -- does any business shake loose? Is there reason to be optimistic because of that?

**J. Adam Abram**
*Chairman & CEO*

I wouldn't expect that to happen. State National has good relations with their customers, just as we have very good relations with our customers in the fronting business. Markel and State National both affirmed when they announced this purchase that the model that State National has used for a long time, which is to allow the MGAs, who are producing most of this business to select their reinsurers, will continue. And that makes a lot of sense because that's a very important element for the -- the ability to select their own reinsurers is a very important element of that business to the MGAs, who really, in essence, own that business. And so I wouldn't expect MGAs, who are happy right now on State National paper to move from State National paper. Having said that, Meyer, let me make a point, a great deal of the -- a significant -- let me state it this way. We do business with State National. The MGAs who choose State National also come and choose JRG Re as reinsurers with some frequency. So we've always regarded and continue to regard State National as a good partner with us. And I'd like to congratulate them on a great sale. I think that Markel's purchase of that State National business at a great price for Markel and a great price for State National is an affirmation of our plan to build fronting business as well. And so I think that's -- it's -- there's no bad news there. There is validation there for our business plan, and there's every reason to think it will be business as usual as we go forward.

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

Yes. No, it's clearly an affirmation of the value of this business. I absolutely agree. Two other quick ones. If we look at the Casualty Reinsurance accident year loss ratio, it improved from the first quarter. Was there something unusual in the quarter? Or is this kind of a midyear true-up?

**Sarah C. Doran**
*Chief Financial Officer*

No. That's really a mix issue, Meyer, in that we have been redeploying or kind of moving the book around into business that's more attractive from a loss ratio perspective. So that's all that is.

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

Any impact on the expense ratio from that?

**Sarah C. Doran**
*Chief Financial Officer*

Not that we see, no. That's a fairly stable expense ratio business, just given that we're -- it's all entirely casualty book.

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

Okay. And final question. Adam, you talked about more flexibility in pricing because of the phenomenal improvement in the expense ratio. Is that theoretical at this point? Or are you starting to incorporate [indiscernible]?

**J. Adam Abram**
*Chairman & CEO*

No, it's theoretical. I just think it puts us in a really good, competitive position. But as I said, while you'd be silly not to look out and wonder about slight changes in margin, in fact in the quarter, in the core E&S book, in the quarter, rates were up. And theoretically, rates are also up in our workers' comp book. But that's a little bit more complicated because for you to measure rates in the workers' comp book, you also have to measure the loss cost. They're down more than the rates are down. But rates are down. So theoretically, our margin is higher. That's -- I made a little comment about that without going into detail, that we believe those rates, when compared to loss cost, are very attractive. But we're keeping an eye on that, because it involves testing the loss cost measurement over time. I hope that's articulate enough for you to understand. I hope that wasn't too garbled.

**Robert P. Myron**
*President, COO & Director*

And I'll just add in the last piece of it. The rates, in the underlying reinsurance business, the primary business, are up low single-digits as well in the quarter.

**J. Adam Abram**
*Chairman & CEO*

So going back to your original question, this is -- this is an advantage which we have not had to deploy yet.

**Operator**

[Operator Instructions] Our next question comes from the line of Brian Meredith with UBS.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

A couple of questions here for you. The first one, Adam, a couple of the other conference calls so far this quarter, some companies have talked about this, the standard market trying to impede a little bit more in the E&S market. I know in the past you've said that that's really not happening with you guys, particularly given the smaller premium dollars that your business has. But have you seen any of that yet?

**J. Adam Abram**
*Chairman & CEO*

Look, I think that it will be -- this business is competitive. There's no question about it. Competition is strong and probably increasing a little bit. We're able -- we've been able to maintain our margins in the E&S business, and if you take the explanation I made before, also in our core workers' comp book. And Sarah mentioned that if you look through the quota share treaties in our reinsurance book, we think rates are up modestly there too. But Brian, there is a world of competition out there, and it's one of the reasons I'm really glad that we've been able to manage our expense ratio down in that we probably have more flexibility if we need it -- if we should need it going forward than many companies with higher expense ratios.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Got you. And then just curious, is your workers' comp business still growing, your core workers' comp?

**J. Adam Abram**
*Chairman & CEO*

It is. But I think it's really, I mean, basically flat.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Got you. And is most of that more exposure growth?

**J. Adam Abram**
*Chairman & CEO*

Very modestly. Yes, it's growing very modestly. [indiscernible]

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

And then my last question, just back on the program business, sorry to beat on this one a little bit. But what type of business was it? And I'm just -- and the reason for my question, I'm trying to understand kind of what the tail on that business could be and the risk that we could see some further development coming out of those programs.

**J. Adam Abram**
*Chairman & CEO*

There were 2 parts to it. The biggest part was Commercial Auto, and the second part of it was some workers' comp.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Okay. And is there any kind of aggregate stop-loss caps or anything on those programs? Or there is possibility for more development.

**J. Adam Abram**
*Chairman & CEO*

We had low retentions per policy on all of that business.

**Brian Robert Meredith**
*UBS Investment Bank, Research Division*

Got you.

**Robert P. Myron**
*President, COO & Director*

Generally, no, we don't have any aggregate stop loss. There generally was, as mentioned before, significant quota share reinsurance. And then, to the extent the underlying limits written were more than $1 million, there would be an inuring excess program, so it really should limit any significant severity there. But there isn't anything that's going to cap it out completely.

**Operator**

And I'm showing no further questions at this time. I'd like to turn the call back to Mr. Abram for closing remarks.

**J. Adam Abram**
*Chairman & CEO*

Thank you, operator. And thanks to everybody who participated on the call today. And again, thank you to all of our colleagues across the company and all of our many partners out there. We're building together a great business, and we appreciate everybody's support and interest. And thank you and have a great day.

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