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James River Group Holdings, Ltd. NasdaqGS:JRVR

Earnings Call

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Call Participants

EXECUTIVES

Frank N. D'Orazio
CEO & Director

Sarah Casey Doran
Chief Financial Officer

Zachary Shytle
Senior Analyst of Investor Relations and Investments

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Mark Douglas Hughes
Truist Securities, Inc., Research Division

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

Presentation

Operator

Thank you for standing by. My name is Kate, and I will be your conference operator today. At this time, I would like to welcome everyone to the James River Group Q3 2024 Earnings Call.

[Operator Instructions]

I would now like to turn the call over to Zachary Shytle, Investor Relations. Please go ahead.

Zachary Shytle
Senior Analyst of Investor Relations and Investments

Good morning, everyone, and welcome to the James River Group Third Quarter 2024 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 of our most recent Form 10-K and 10-Q 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.

In addition, during this presentation, we may reference non-GAAP financial measures such as adjusted net operating income, underwriting profit, tangible equity, tangible common equity, and adjusted net operating return on tangible common equity. Please refer to our earnings press release for a reconciliation of these numbers to GAAP, a copy of which can be found on our website at www.jrvrgroup.com.

Lastly, unless otherwise specified, for the reasons described in our earnings press release, all underwriting performance ratios referred to are for our continuing operations and business that is not subject to retroactive reinsurance accounting for loss portfolio transfers.

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, Zach. Good morning, everyone, and welcome to our third quarter 2024 earnings call. We're excited to be joining you this morning to discuss what has been a very active quarter for James River. And by that, specifically, I'm referring to the meaningful strategic actions that we announced with our earnings last night and our corresponding investor presentation or FAQ document.

In addition to providing detailed commentary specific to our announcements, I also plan to speak to market conditions and the future outlook for James River. Last night's release announced significant validating investments from 2 of the most sophisticated investors in the insurance sector, one being amongst the P&C industry's most respected voices on claims and reserving and the other, an existing investor who has witnessed the refocused transformation of the company over the last few years.

These and other actions, including a meaningful reduction to our fixed charges, position our balance sheet favorably as we focus on putting capital to work across the attractive opportunities that we're seeing in our well-regarded E&S franchise. First, on capital. Enstar Group has agreed to invest an additional $12.5 million in newly issued common equity at a share price of $6.40 over and above the shares it had previously purchased in the open market. Through this transaction, we expect that Enstar, one of the industry's foremost voices on reserves, will be among our top 5 shareholders.

We have also amended the Series A convertible preferred shares held by Gallatin Point Capital and converted $37.5 million or 25% of the security outstanding to common equity, also at a share price of $6.40. In doing so, we strengthened our common equity base, but also reduced the preferred dividend, both in total quantum as well as by pushing it out to stay at 7% for 5 years and then capping it upon reset. Finally, we've also reduced our quarterly common dividend to $0.01 per share.

Next, in our efforts to continue to reduce reserve volatility, we have entered into a $75 million limit top-up adverse development cover also with Enstar on our E&S reserves from accident years 2010 to 2023, attaching directly above the legacy cover we bound and announced with State National in July. Upon closing of this new layer following regulatory approval, the company will have $150 million of gross legacy coverage remaining to protect our E&S reserve portfolio. Since I joined the company in late 2020, we've worked diligently to address legacy balance sheet issues and derisk the organization to allow it to focus on its strength. With these actions, we believe we've walled off reserve development from the past business and have positioned James River extremely well to move forward and take advantage of the robust underwriting environment still benefiting our E&S franchise.

With the company now simplified and refocused on our flagship E&S insurance operations and with our balance sheet now bolstered and further validated by leading industry investors, the James River Board of Directors has concluded that the company is well poised to provide significant future value to shareholders beyond what would be available in the sale of the company today, and as a result, has concluded the strategic review process. Fully aware of their responsibilities to shareholders, the Board will continue to be responsive to compelling future proposals to create shareholder value, but feels bringing the strategic review to a conclusion at this time is appropriate.

Now turning to our results for the quarter. We reported a net loss from continuing operations of $1.07 per share and adjusted net operating loss of $0.74 per share. The vast majority of the loss was driven by the impact of the State National ADC, which we announced in July and accounted for this quarter as well as the results of our third quarter actuarial detailed valuation review. I'll come back to both of those items in a moment, and Sarah will also provide additional details on those topics as well.

However, to briefly frame the impact of the State National ADC and the third quarter reserve charge, we are reporting a combined ratio for the E&S segment of 136.1%, but the current accident year combined ratio for the segment is 92.6%. Our flagship E&S business continues to benefit from strong submission growth and significant rate increases. Underwriting conditions for our heavily weighted SME platform remain very attractive. We see meaningful opportunities to write profitable business across our portfolio and continue to benefit from strong employee retention and unwavering support from our distribution partners.

Submission growth continued to be robust during the third quarter with new submissions increasing 10%, while renewal submissions increased 12%. We again saw over 80,000 submissions during the third quarter, a continuation of the strong trends we have experienced this year. I would highlight our Environmental and General Casualty divisions, which saw submission growth of 29% and 24%, respectively, while manufacturers and contractors saw submission growth of 13%. In addition to submission growth, our E&S business continues to experience favorable pricing additions across our 14 underwriting divisions. Renewal rates for the quarter were up 8.6% across the segment and 9.4% year-to-date. The majority of our underwriting divisions saw pricing increases in the high single-digit range for the quarter, while Excess Casualty saw renewal rate increases slightly in excess of 20%. Rates in Environmental and General Casualty were each up 8%, while energy was up 7%. We remain confident that rate increases are continuing to exceed loss trends, allowing us to generate what we believe will be attractive margins on the portfolio.

Our E&S segment grew gross premiums by 6% during the quarter, led by growth of 12% in Excess Casualty and 10% in manufacturers and contractors. Our excess property underwriting unit continued to see market pressure on pricing and terms during the quarter. And as a result, gross written premiums declined 8% compared to the prior year quarter. Comparatively, our overall casualty portfolio grew by 6.7% compared to the third quarter of 2023. As previewed moments ago, our E&S segment results were really influenced by 2 substantial dynamics during the quarter, the impact of our previously disclosed E&S legacy reinsurance transaction with State National and our detailed internal valuation review of E&S reserves. These 2 dynamics pushed our E&S combined ratio to 136.1% as the segment produced an underwriting loss of $50.2 million for the quarter, while the accident year loss ratio was 64.7% also for the third quarter.

Over the past several years, we have continued to enhance and improve our capabilities around enterprise risk management, including a more in-depth third quarter internal reserve review process, our annual detailed valuation review, or DVR, which is a review of our entire E&S reserve balance. Over the last 2 years, we've taken steps to make this parameter review even more thorough and granular than it had been in the past. Enhancements to this process include the introduction of new methods, more refined segmentation, and a more detailed analysis of both gross and [AO] reserves.

Before moving on, I'd like to spend a few additional minutes discussing the findings of the DVR process. While overall frequency was down for most lines of business, in response to observed increases in severity, most acute in our other liability occurrence and to a lesser extent, our product liability lines, we have materially increased our view of loss trend and have made selected adjustments to our loss development tail factors. These actions put pressure on our carried reserves, and we have reacted and responded accordingly. This process resulted in a $76 million reserve charge prior to sessions to the State National ADC.

The majority of the reserve additions are in the 2021 and prior accident years and are more concentrated in the 2019 to 2021 years than our other liability occurrence and product liability lines of business with some smaller offsetting movements in the other segments. On a net basis, when applying the cover provided by the State National ADC, the reserve charge for the quarter is $57 million, which includes the previously announced $52.2 million of premium paid to State National in conjunction with the transaction we announced in July. As I've said over the last few quarters, we have made numerous underwriting changes across the portfolio over the last few years at the expense of nonrenewed premiums, especially in our commercial auto, general casualty, energy, and excess casualty underwriting divisions.

Whether through several years of compounding positive rate change, exiting challenging classes or adding exclusionary language or sublimits to restrict coverage, our underwriters have taken ample proactive actions to better position the future profitability of the portfolio while further establishing the underwriting culture of the segment. We are remaining cautious toward recognizing any of these underwriting improvements to date in our actuarial analysis despite promising early indications. Our DVR process reaffirmed our belief in the profitability of the 2023 and 2024 accident years, although we expect to be patient in recognizing it.

Turning to Specialty Admitted. Gross written premiums in our fronting and programs business increased 9% compared to the prior year's quarter and 14% year-to-date, excluding the impact of workers' compensation business that is now in runoff. The segment produced a combined ratio of 91.3% and an underwriting profit of $1.8 million for the third quarter. Specialty Admitted continues to execute on its objectives and overall performs very well. Finally, I should mention that the company experienced no net cat losses for either our E&S or Specialty Admitted segments for the third quarter.

In summary, we are excited about the strategic actions that we are announcing this quarter because we firmly believe they help us to move past the legacy issues of James River's past, particularly with the benefit of the validating investments of Enstar and Gallatin Point. We look forward to exiting the strategic review process and providing additional certainty to our employees, stakeholders, and distribution partners. We are bullish about the company's prospects after taking significant actions to derisk the balance sheet and are looking ahead to the fourth quarter as well as 2025 to continue to take advantage of underwriting opportunities while creating value for shareholders.

And with that, I'll ask Sarah to provide some additional color on the quarter.

Sarah Casey Doran
Chief Financial Officer

Thank you very much, Frank. Good morning, everyone, and thanks for joining us today. As we are announcing a number of things today, I thought I would focus my comments on certain key dynamics as well as some of the data points from the loss portfolio transfer we executed in July 2024 as that's now flowed through the financials. To start from the top, as Frank mentioned, we reported a net loss from continuing operations of $1.07 per share and adjusted net operating loss of $0.74 per share. The loss was generated in the E&S segment and was driven by the previously disclosed impact of the State National 4 July reinsurance transaction, which closed at the beginning of the quarter as well as by the additional reserve development we recognized as part of our third quarter detailed valuation review.

Coming out of that review, we increased loss and loss adjustment expense in the E&S segment by $76.3 million this quarter. This included the previously announced $52.2 million of excess consideration over reserves ceded in connection with the July reinsurance transaction as well as a $19.2 million deferred gain and a $4.8 million charge, which we effectively retained. So the unfavorable reserve development in the E&S segment, not subject to retroactive accounting is $57 million, i.e., the $52.2 million plus the $4.8 million and of course, the $165,000 of favorable development from our Specialty Admitted segment. This $57 million is close to the $52.2 million we effectively preannounced upon execution of the July reinsurance transaction.

The reinsurance contract we closed in July, like the one we signed yesterday, covers the majority of our casualty E&S reserves from 2010 to 2023 inclusive and incepts on January 1 of this year. This means it covers the majority of the first quarter and second quarter E&S reserve development we previously announced. Year-to-date, we have added $84 million of pure reserves to our balance sheet, which are subject to the reinsurance transactions. We retain 15% of the July reinsurance transaction, so that leaves $71 million, which has been ceded to the July reinsurance transaction. Once the transaction we signed yesterday closes, as of October 1, we would have $150 million of gross additional reserve cover available to us in the aggregate for the years 2010 to 2023, inclusive or $140 million net because as we mentioned, the July contract has a 15% corridor, which we retain.

The pretax cost of the new cover from Enstar is $52.8 million, and that will flow through our financials in the quarter in which the transaction closes. As for the financing, we expect to ultimately issue 7.8 million additional common shares as a result of the conversion and sale of $50 million of common equity. But we also expect to reduce our fixed charge outflows for dividend payments by about 45%, which is very valuable to us given the robust set of opportunities to put capital to work. The addition of the reserve development cover, reduction in fixed charge outflows, underwriting changes made over the last few years, and what we currently see as well-performing reserves, especially for the last 2 years, makes us very focused on turning the page and continuing to take advantage of a franchise and opportunity set with a robust set of opportunities in the wholesale E&S market.

Turning back to our quarter and specifically the profitability ratios. There were 2 dynamics this quarter aside from our reserve addition, which impacted the profitability ratios. These were reinstatement premiums and elevated G&A expenses, both at E&S. These increased the group combined ratio by about 6.5 points and the E&S combined ratio by about 8 points. For a moment on the expense ratio. At this quarter, our expense ratio was 31.4%, which has increased from the 26.4% a year ago. Absent these 2 dynamics, which I just mentioned, our group's 31.4% expense ratio would have been about 1 point below the 9-month result of 28.8%, which is closer to where we expect it to be. And the E&S expense ratio would have been around 24% rather than the 27.9% we reported. For the third quarter, we recorded net investment income of $23.6 million from continuing operations, an increase of 8.1% or $1.8 million from the prior year quarter. Included in net investment income is a final payment of about $800,000 associated with one of our renewable energy investments, which was previously sold.

Our embedded book yield remained constant compared to the prior year's quarter at 4.4%. We were able to invest a sizable portion of our cash position into high-quality assets with yields in excess of our embedded portfolio book yield during the quarter. As we look forward, we continue to see attractive yields averaging in the low 5% range. We experienced $4.2 million of net realized and unrealized gains on investments, the majority of which were related to changes in fair values of our common stock portfolio, offset by realized losses on sales in our bank loan and fixed income portfolios. But overall, our investment portfolio remains very well positioned to take advantage of market opportunities and attractive yields.
So with that, I'll turn the call back over to the operator to open the line for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Mark Hughes with Truist Securities.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Sarah, you had mentioned that the group expense would have been 27.8% as opposed to the 28.8%. Is the -- and then you suggested your expectations. Was that for the 27.8% or the 28.8% would be a good number on a go-forward basis?

Sarah Casey Doran
Chief Financial Officer

I would say the 27.8%, Mark. So let's round that to 28%. But we've never been super specific on that dollar amount, but I would say that's the right area to think about.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. And then with the kind of extended tail, you've seen issues in the other liability occurrence product liability. What gives you confidence that, that is kind of not going to be devil the 2023 or 2024 accident years? And then is your pricing, the pricing you've been taking, is that sufficient to account for that tail impact?

Frank N. D’Orazio
CEO & Director

Yes, Mark, thanks for the question. Let me try to provide a little bit of detail here relative to the DVR process and what we saw and what our actuaries responded to. So as I suggested, we did a full review of all the underlying assumptions and the methods and our actuaries drew conclusions as to the total reserve need for all lines and accident years. And what was driving our change in assumptions really was severity and reported losses were the biggest driver, which led us to increase both loss development and loss trend assumptions.

So we meaningfully increased our assumptions on loss trend, increasing at approximately 25% across the major segments. So other liability occurrence, GL, product liability occurrence, and excess liability occurrence. And to be clear, as I said, these changes are driven by severity trends. Frequency has not been the issue. I think broadly, frequency was down across the portfolio with maybe one exception. In fact, other liability occurrence, which is a large product line for us, which includes our habitational business in particular, actually shows very promising frequency trends as we believe our underwriting actions over the last few years are taking hold.

So to your point about the more recent years, because it's a full parameter review, we also apply the same process to our current year by definition, and we see meaningful redundancy in the '24 year and intend to be patient with it. So as I noted in my script, during the DVR process, we've not taken any credit for all the underwriting actions in addition to the rate that we've taken across the book in the past few years. And so in other words, we didn't lower reserves for what we believe are going to be better-performing businesses as those reserves mature in the more recent years.

Operator

Your next question comes from the line of Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Frank, just quickly, as a follow-on to that one, you said you increased your trend assumptions by about 25%. Can you give us a perspective on what you're assuming casualty trend is right now on your reserves and when you're pricing for?

Frank N. D’Orazio
CEO & Director

Yes. So it's a good question, Brian. So I think we've said over the course of past quarters this year that we've got a high single-digit view of loss trend for '24. We're actually in the process of finalizing our budget for 2025. So I'll be able to refresh that view for you when we talk again in another couple of months. But as of the '24 view was high single digit.

And within that, of course, certain lines are going to be higher, certain lines are going to be lower, particularly in the excess casualty space, you'll be higher.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. Got you. And it sounds like just to be clear here that the reserve development you had in the quarter, nothing came from '23. Any perspective on where it was coming from?

Frank N. D’Orazio
CEO & Director

Yes. Again, it would primarily -- sure, Brian. So primarily '21 and prior, heavier concentration in '19 to '21 and the product lines or lines of business specifically, the primary other liability occurrence, product liability occurrence, some excess liability occurrence. I would say, though, that the driver was the other liability occurrence.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then next question, I'm just curious on the Specialty Admitted business front. Has what's been going on had any effect on that business, like getting into an agreement with State National, those types of things? How are we thinking about that business going forward?

Frank N. D’Orazio
CEO & Director

So we've had pretty steady premium growth there, 9% premium growth in the fronting business in the third quarter and 14% year-to-date. We continue to experience solid growth from our existing programs. We have a pipeline of a number of different new opportunities that we're looking at. It is an area that I think we will continue to be cautious and careful relative to security and unrated reinsurance and making sure our contracts are very tight and also stay fairly tight relative to our participations, particularly in lines of business like commercial auto. So it's a nice complementary business, and it's doing very well over the course of '24.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then just last question here. Enstar is actually itself involved in a merger or anything. Any contingencies in your agreement with what's going on with the Enstar situation?

Frank N. D’Orazio
CEO & Director

No, it's not a concern. Our deal should close here, we expect fairly shortly.

Sarah Casey Doran
Chief Financial Officer

But there are no specific contingencies in the deal for what Enstar is executing, Brian. It's just regulatory approval for Enstar for the transaction. That's it.

Operator

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

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

I guess first question, going back to the recent accident year reserves. I'm hoping you could sort of clarify, is it the frequency or the severity of the current loss picks that makes the higher trends applied to earlier years less relevant?

Frank N. D’Orazio
CEO & Director

So I just want to make sure, Meyer, thank you for the question. I just want to make sure I'm answering it for you. The issue was not about frequency, and these were prior years. We're very comfortable with the current accident year. So in fact, just relative to frequency, I think the trends were down for just about all product lines, except for maybe one. So more of a severity issue and really not a concern relative to the current accident year.

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

Is that because there are higher severity trends already embedded in the current accident year pick?

Frank N. D’Orazio
CEO & Director

Yes, I would say that's accurate. And also, again, I think the most recent years obviously have the benefit of all the underwriting actions that we've taken, the better performance monitoring, the 31 quarters of compounded rate that is about 93%, I believe. So yes, I would say all those factors kind of influence the current accident year.

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

Okay. Great. That's helpful. And then when we look at the pricing, was the dip down in the third quarter pricing compared to the first half of the year, is that just a function of property? Or are you seeing decelerating increases in other lines as well?

Frank N. D’Orazio
CEO & Director

No, I would say the rate action, we say it all the time, it could bump around a little bit, but 8.6% across E&S and 8.9% in casualty lines. So that's a little additional bump because of property. So we continue to see strong pricing trends. We've experienced this throughout the cycle. To your point, rate change varies by line of business, but we continue to see healthy increases in some of our larger lines. And in fact, this quarter, we saw an acceleration in excess casualty rates at over -- just over 20%.

So I think the pricing environment remains broadly attractive. And I do think the reserve pressures that the industry has shown in casualty lines over the next -- or over the last few quarters, I should say, should embolden underwriters to continue to take rate. That's kind of our view.

Operator

Your next question comes from Casey Alexander with Compass Point.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Several have been asked, but I have a few more here. Can you define for me exactly of the remaining Gallatin Point position, how much of it has 130% conversion premium versus how much of it has a 200% conversion premium?

Sarah Casey Doran
Chief Financial Officer

Casey, the entirety of it is 130% on a voluntary basis and the entirety of it is 200% on a mandatory basis.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

All right. Secondly, the $52.8 million cost of the Enstar that will be -- that closed yesterday, I believe. So that will run in the fourth quarter. And will that be run as a loss and LAE expense? Or will that be run as a reduction of net earned premiums?

Sarah Casey Doran
Chief Financial Officer

Good question, Casey. That transaction was executed yesterday. It will close when it receives regulatory approval. As I mentioned a second ago, Enstar needs regulatory approval with the BMA. This is the same situation that we had when we executed an LPT with Fortitude. They also needed the regulatory approval from the BMA. So when that comes, the transaction will close. We would expect it to be in the fourth quarter, but we don't know, and we're not in control of that. So that's when it will be booked. So that's the first question.

And the second question, we need to work through our accounting when we're closing the quarter and booking the transaction. I would say my initial steer is that it would be booked as an additional ceded premium, but we need to work through that in the quarter in which we're closing it. As you know, the economic effect is the same. It's just the geography.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Okay. How much was spent on the quarter relative to the adjudicating the Fleming dispute?

Sarah Casey Doran
Chief Financial Officer

I don't think we've broken out those numbers so much, Casey. It's -- our legal fees are fairly de minimis relative to the numbers that we've reported, but I would say it would be for this quarter, decently under $1 million.

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

Okay. And once again, fees on Specialty Admitted are down year-over-year. Is that strictly due to workers' comp? Is this an adequate run rate going forward? And what can you do to get the fees growing from specialty admitted?

Sarah Casey Doran
Chief Financial Officer

Yes. Those fees -- a portion of those fees are actually the ceding commissions that we take in from the reinsurance that we attribute to this segment, Casey. So because we have less workers' comp and Atlas, we'll have fewer fees as well running through. So the fees really -- the fronting fees and the fees through the segment move up and down with total GPW. That's probably the way to think about them.

And I'm sorry, I didn't write down the second part of your question. Would you mind repeating that?

Casey Jay Alexander
Compass Point Research & Trading, LLC, Research Division

What it was -- is this a good run rate going forward is one portion of it and what does the company need to do to get those fees growing? Obviously, that's the major profit driver from the Specialty Admitted business as far as I can tell.

Sarah Casey Doran
Chief Financial Officer

That's right. That's a key part of it. I would say the performance of the business has been very stable, but I would kind of go back to my first answer there in saying that the fees will grow as the business grows and the top line grows. And that business has always been fairly lumpy and fairly transactional for us, meaning deals come on and certainly, to some degree, deals go off, but they are bespoke in their cadence.

So we would certainly expect to see those increase over time, but they are bespoke and transaction focused.

Operator

I will now turn the call back over to Frank D'Orazio for closing remarks.

Frank N. D’Orazio
CEO & Director

Okay. Thank you. Before we end the call today, I'd like to take a moment to recognize the resolve of James River and its employees. This has been a prolonged process under trying circumstances. And despite those challenges, the company has remained resilient, staff retention remains high, and the company continues to be recognized regionally and nationally as a top employer as we continue to execute on our corporate objectives. I am both proud of the company's accomplishments and very confident in our future.

Okay. I'd like to thank you all for your time today and for the questions we received this morning. We'll speak to you again in a few months. Enjoy the rest of your day.

Operator
Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.