S&P Global
Market Intelligence

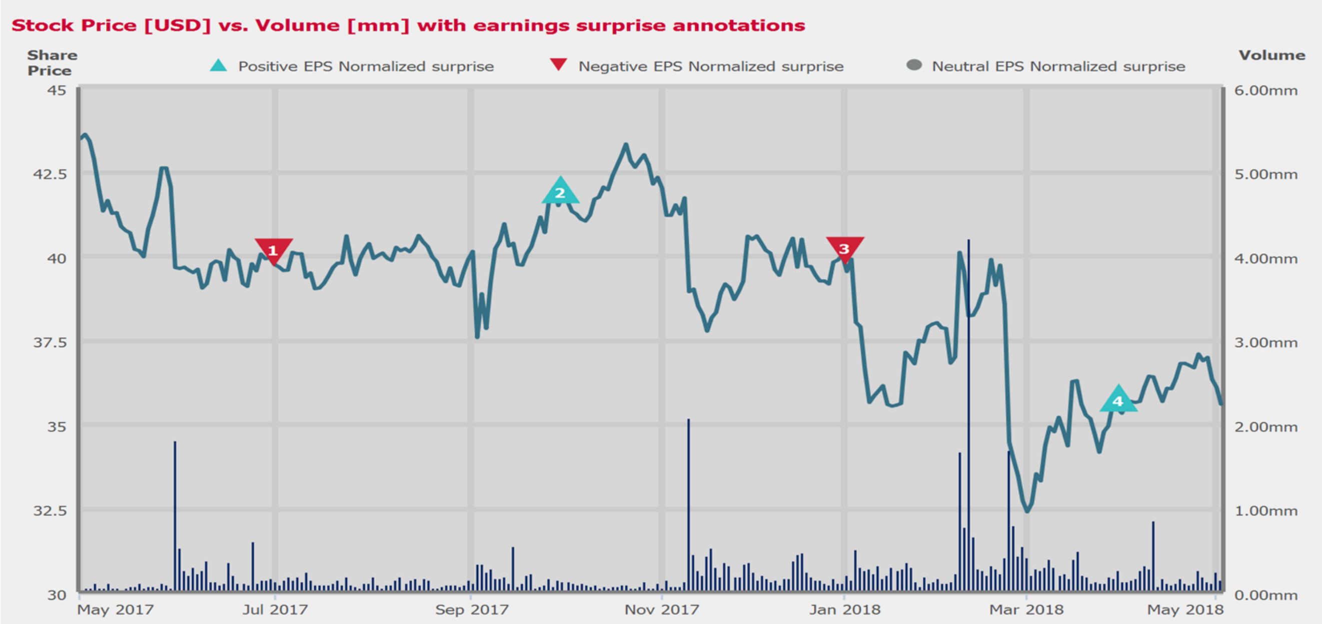
James River Group Holdings, Ltd. NasdaqGS:JRVR
FQ2 2018 Earnings Call Transcripts

Thursday, August 02, 2018 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.54	0.58	7.41	0.63	2.41	2.69
Revenue (mm)	228.31	228.04	(0.12 %)	222.82	891.79	917.11

Currency: USD
Consensus as of Aug-02-2018 2:54 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	0.50	0.49	(2.00 %)
FQ3 2017	0.33	0.36	9.09 %
FQ4 2017	0.71	0.13	(81.69 %)
FQ1 2018	0.54	0.55	1.85 %

Table of Contents

Call Participants

EXECUTIVES

Kevin B. Copeland
Senior VP of Finance & Chief Investment Officer

Robert Patrick Myron
CEO & Director

Sarah C. Doran
Chief Financial Officer

ANALYSTS

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

Matthew John Carletti
JMP Securities LLC, Research Division

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

Randolph Binner
B. Riley FBR, Inc., Research Division

Presentation

Operator

Good day ladies and gentlemen. Thank you for standing by and welcome to Q2 2018 James River Group Holdings, Ltd. Earnings Conference Call. [Operator Instructions]

As a reminder, this conference may be recorded.

At this time, I would like turn the conference call over to Mr. Kevin Copeland, Head of Investor Relations. You may begin.

Kevin B. Copeland
Senior VP of Finance & Chief Investment Officer

Thank you, Olivia. Good morning, everyone, and welcome to the James River Group Second Quarter 2018 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 Bob Myron, Chief Executive Officer of James River Group.

Robert Patrick Myron
CEO & Director

Thanks, Kevin, and good morning, everyone. This is Bob Myron, President and CEO; and with me today are Sarah Doran, our CFO; and Kevin Copeland, our Chief Investment Officer who also leads IR for us.

We have a few prepared remarks and then we look forward to taking your questions. We've posted another solid quarter generating an annualized return on tangible equity of 15%. We had good top and bottom line performance in each of our 3 segments with underwriting results showing an overall improvement from a year ago as highlighted in our press release. Our combined ratio for the group came in at 97.3 and we had good combined ratios at all 3 segments. We had a small amount of net adverse loss reserve development but it didn't have a significant impact on our underwriting results, in part because our expense ratio continues to decrease and is at a great absolute level in the quarter at 23.1.

Pricing continues to be attractive in our E&S book. And I expect market conditions will continue to move in the right direction. Our investment performance was very strong.

Let me talk about a few of these things in some more detail and then I'll ask Sarah to do the same.

Regarding growth, in our E&S segment, we had strong growth overall growing in 9 of 13 underlying division.

The Commercial Auto division grew 25%, substantially assisted by the rate increases we previously obtained on our largest account back in March.

In our core E&S book, we grew 15.3%.

The growth in Commercial Auto is moderating as in the current contract period for our largest account we're insuring 40 states down from 49 states in the previous contract. We mentioned this in our call with you last quarter. We still expect Commercial Auto to grow, just at a more modest pace than it did last year.

In core E&S, we saw strong growth in general casualty which was up 60%, and excess casualty which was up 43% and in environmental, which was up 20%. Submissions for the E&S segment overall were up 10% in the quarter over a year ago.

In the Specialty Admitted segment, we grew gross written premiums by 31% in individual risk workers' comp and 26% in the Fronting division. This growth is due to increased submission flow, a continued strong economy and the increased growth of our largest fronted deal.

Over the last few months we have added 3 new fronted deals which should generate additional gross written premium growth and more importantly attractive fee income in the coming quarters.

New business submissions for our individual risk workers' comp segment were up 47% in the quarter. This was due to the addition of several new underwriters and marketing staff in the recent past. In the casualty reinsurance segment, we shrunk by 54% which was in line with our expectations as we refine the book and focus on more profitable accounts.

Now with respect to pricing. In core E&S which is all business in the segment excluding Commercial Auto, renewal pricing was up 2% in the quarter. While this is a drop off from the amount we reported in Q1, some of the decline was driven by the pricing of large renewals with favorable loss histories. Excluding 2 large renewals that we booked at material price declines in our Environmental and Energy divisions, core E&S rates were up 4%.

Another reason for the decline versus the 13% we achieved in Q1 was a much larger dollar amount of Allied Health accounts renewing in the first quarter. We only had about $3 million of Allied Health renewals this quarter.

As always, going forward we will seek the best rate increases we can achieve in the current marketplace while not materially impacting retention rates.

In our Specialty Admitted segment, rates were down for the -- for workers' compensation 1% but net of underlying index loss cost changes, we believe margins held steady or improved.

In the casualty reinsurance segment, there was an approximate 5% rate increase on the underlying primary contracts and an approximate 1% increase in reinsurance treaty pricing in the quarter.

Let me speak a bit about accident year loss picks and loss reserves as well as loss emergence.

In our E&S segment, our accident year loss pick increased approximately 0.5 point on a sequential quarter basis. This was due to both increased weighting of our Commercial Auto division earned premium as well as our ongoing approach of making prudent and conservative accident year loss picks in the core E&S book.

On a group-wide basis, our accident year loss ratio was 73.2% up about 3 points from a year ago for the same reasons.

With respect to loss reserve development in our casualty-re segment, we had some adverse loss reserve development from business written several years ago and nearly all of it was from excess of loss reinsurance. For proportional reinsurance of excess of loss business, the amount of business that we put on the books now of this type in this segment is negligible. Also I'd like to highlight that even with the adverse prior year loss reserve development in this segment we were able to deliver a 96.8% combined ratio which was a slight improvement from the first quarter of this year.

This is because the more recent business we have put on the books in this segment is running well and while the quarter did show loss emergence above expectations, the first quarter of the year showed loss emergence of less than expected, so on a year-to-date basis, we are in line in that segment.

Within the specialty admitted segment, looking at reported loss ratios. Loss emergence has been materially lower than it was a year ago on a year-to-date basis.

Within the E&S segment and Specialty admitted segments, we were basically flat on loss reserve development.

In E&S, we had $2 million to $3 million of favorable development in core lines offset by $2 million to $3 million of adverse development in Commercial Auto.

Like in the casualty-re segment, in core E&S we had loss emergence that was a bit less than expected in Q1 this year and in Q2 it was a little more than expected but a on year-to-date basis, we are basically flat.

In the Commercial Auto division, while we did book a small amount of adverse development in the quarter, on a year-to-date basis, the reported loss ratio is materially lower than it was 1 year ago.

It is worth mentioning again that we have had substantial price increases in our largest account in Commercial Auto over the last 2 years. We are booking a prudent and conservative accident year loss pick in the Commercial Auto division and thus we are highly confident in our overall level of reserves for both the division and the segment as a whole. The 2018 accident year in particular is off to a positive start from a loss emergence perspective.

With that, let me turn the call over to Sarah Doran, our CFO.

Sarah C. Doran
Chief Financial Officer

Thanks, Bob, good morning, everyone.

For the second quarter of 2018, we made underwriting profits of $5.5 million, generated an operating profit of $17.6 million and are reporting net income of $17 million.

As Bob mentioned, our combined ratio has modestly improved as compared to the prior quarter, in part given our low expense ratio.

While our expense ratio improved as compared to both the second quarter of last year and the first quarter of this year, we continue to believe that a mid-20s expense ratio is extremely attractive for our franchise and mix of business.

Complementing our underwriting performance, investment income was 18%, as compared to the second quarter of 2017. This was principally due to our larger investment portfolio, rising yields and strong performance from our alternatives portfolio as has been the case through our history.

We continue to enjoy strong cash flow from our businesses as operating cash flow this quarter was $115.6 million, as compared to $49 million in the second quarter of last year.

In line with this, cash and investments have continued to grow and are up about 7% year-to-date.

While we would not expect this growth to continue at current levels, our portfolio has been the beneficiary of the strong growth in our business these last few quarters.

A brief note on our external reinsurance renewals many of which occurred during the second quarter. We were pleased to renew our significant coverage at little to no change in pricing and to be able to expand coverage to match our growth in certain lines of business. We continue to use our reinsurance strategy as a key capital management tool.

And finally on taxes. Our effective tax rate this quarter was 8.2%. While there are many points of impact to our tax rate, we continue to believe that the full year rate will be similar to historical averages and therefore likely a few points higher than it was this quarter.

We ended the quarter with tangible shareholders' equity of $469.4 million, an increase over the $465.8 million at the end of the first quarter of 2018. Operating leverage or trailing 12 months net premiums written to tangible equity was 1.7x:1. With that let me turn it back to Bob.

Robert Patrick Myron

CEO & Director

Thank you, Sarah. In closing, I feel great about our prospects going forward. Pricing is up, submissions are up. Loss costs are reasonable. We're getting strong growth where we are targeting it and the continued economic expansion of the U.S. economy will continue to drive positive exposure growth. This concludes our prepared remarks.
Operator, we are now ready to open the call up for questions.

Question and Answer

Operator

[Operator Instructions]

Our first question is coming from the line of Randy Binner with B. Riley FBR.

Randolph Binner
B. Riley FBR, Inc., Research Division

Good morning. Thank you, I just had a couple of questions about the Commercial Auto activity on the reserve side in the quarter. Bob, I think you mentioned in the call that it was -- it was relatively modest and then that the 2018 accident year is off to positive start. So the 2 questions, is kind of, one is there a way to kind of size what that move in Commercial Auto was versus the offset from other E&S because that's a dynamic we've seen in years past and then if '18 is looking good, just curious where the adverse came from accident year wise for Commercial Auto.

Robert Patrick Myron
CEO & Director

Yes. So I think I think we said this in the -- if I understand your first part of your question frankly we said, I said, this is -- that the -- there was about $2 million to $3 million of adverse development in Commercial Auto offset by about $2 million to $3 million of positive development in other core E&S lines. So that's how we ended up flat. And in terms of where it came from, it was mostly from 2016 but overall a very, a very small number and I would just reiterate that we're seeing the reported underlying loss ratio in this division be substantially lower than it was 1 year ago. And as you pointed out we are booking a -- what we think is a very good current accident year loss pick as we are earning premium on the current contract.

Randolph Binner
B. Riley FBR, Inc., Research Division

Okay, that's the same thing.

Robert Patrick Myron
CEO & Director

We feel good about the overall level of reserves in that division.

Randolph Binner
B. Riley FBR, Inc., Research Division

What -- so that would be a pretty dramatic improvement in how reserves are developing. I think that move in the '16 accident year and '17 was a number that's maybe like $35 million roughly. So this is obviously much smaller. This is just a quarter but still it seems small and your comments are positive. So what -- you have pricing that's better but you mentioned loss activity is better so just thinking about that, that category of risk. What has kind of supported such a significant improvement in that, that exposure?

Robert Patrick Myron
CEO & Director

Well, I think it's a number of things. I think it's as we've highlighted substantial price increases over the last 2 years both in terms of the '17 and the '18 renewal, there has been some re-underwriting actions that aren't specifically related to rate, with respect to share that we may take up a risk, what we're getting paid for fees from a claim handling perspective, that ends up getting booked as premium. The states that we're actually insuring and how those states perform. Some states have a -- there's some relatively state-specific performance that we've talked about before and so there's a number of different factors.

Randolph Binner

B. Riley FBR, Inc., Research Division

And I think you're -- there is a lot of geographies you're covering in that book. Is it, would you expect to continue to shed certain geographies as you lock in on the more profitable aspect of that block?

Robert Patrick Myron
CEO & Director

I wouldn't say that we would Randy. I mean at this point in time, we're just 4 months into the new contract. And so as of right now we don't have any expectation of any changes. Obviously there, as we get into the winter when we start renewal discussions we'll see about that. But we're -- we're still the largest insurer of these guys in terms of their U.S. risks and 40 states is a significant number, and obviously a majority of the mileage that they have driven across the United States. So we don't expect any changes right now. I mean there could be some paring down but I don't see it right now.

Operator

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

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

Thank you, good morning. Bob, when you talk about reported underlying losses are good, are there you referring to frequency and severity as opposed to kind of the financially reported or book losses? I think you're making the distinction between what your experience is versus what you're actually putting up for loss reserves. Could you clarify that a bit?

Robert Patrick Myron
CEO & Director

Yes. Well, I think you're exactly right. We're talking -- obviously we booked what we did in the quarter when you sort of -- when you look across casualty-re, specialty admitted, core E&S and then the Commercial Auto division. So I was just adding some color around what the underlying reported loss activity, really looking at reported loss ratios which would be paid plus change in case incurred outstanding, that ratio relative to a year ago and those were year-to-date statistics that I was quoting. So specialty admitted is running very well relative to 1 year ago. Core is basically flat. Commercial auto is down and casualty-re is basically flat as well. And I think that, that answers another question that we were anticipating getting because other people have gotten this well is, in particular in core E&S which is maybe the best measurement and we're not really seeing a big change in underlying loss cost trend. Now we're trying to book a prudent and conservative accident year pick in case that happens but on a year-to-date basis, we're not really seeing that.

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

Right, that's helpful. How about loss emergence on the 2017 accident year for the Commercial Auto. Can you comment about that?

Robert Patrick Myron
CEO & Director

It -- de minimis, negligible, not a big number at all.

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

Okay so coming in line with expectations?

Robert Patrick Myron
CEO & Director

Yes.

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

You said in workers' comp your pricing is down 1%. Now is that on an absolute basis it's down 1%? Or is that taking into account the loss costs as well, if you follow me? Is it loss cost plus 1% or is it 1% on absolute terms?

Robert Patrick Myron
CEO & Director

No, it's on absolute terms. So we're sort of looking at that on a pure premium basis and then -- but what we also look at, as we should, is what do we think the underlying loss cost trend is there. And I -- it's basically down so I think we think that there the margins are holding or perhaps even expanding in comp. So even with a price decline, I think there's positive margin there.

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

Is there some particular niche that you're finding that kind of good pricing? Or is that your -- I think you mentioned some expansion in staff and marketing folks, that sort of thing?

Robert Patrick Myron
CEO & Director

No, I don't think we -- I don't think there's anything that we would point to in particular. The book is a lot more diverse than it was certainly when I came here several years ago. It was very focused on one state and 90% contractors business and now contractors is one of the larger classes but there's a number of other classes there. I'd say in general it was pretty -- it was pretty broad, that we're getting -- that rates are holding up for us.

Sarah C. Doran
Chief Financial Officer

But we still don't have exposure to a state like California, for example, still are regionally focused, largely 4 states for the most part book.

Robert Patrick Myron
CEO & Director

For that individual risk workers' comp book, yes.

Sarah C. Doran
Chief Financial Officer

Yes, for that book.

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

And then finally in specialty admitted, sounds like activity is picking up in terms of some new agreements. How is the pipeline behind that looking?

Robert Patrick Myron
CEO & Director

I think it's good. Nothing is booked until it's bound, I guess I would say, right, and as Sarah has always pointed out that this definitely is lumpy but I think we're -- you don't do anything for 1 quarter or 2 and then you get a new $40 million deal. So I think the pipeline is pretty robust. It's always been a little difficult to forecast but I think we're -- we made mention of 3 that we've put on that we think are going to continue to drive some year-over-year gross rate premium growth and fee income growth in the coming quarters relative to a year ago.

Operator

And our next question coming from the line of Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Bob, I wanted to go back to the commentary you had on the core E&S rates and it sounds like mix shift, just changes in mix of business impacted the kind of the aggregate number. Can you kind of -- just looking at the individual lines, I think that there's about 12 of them. I mean forgetting mix, just kind of looking at each line and what pricing did, how would you characterize that? Did it did it largely hold and at kind of the levels it was at and therefore we're just kind of seeing say a 4% number because of where the business is written this quarter? Or did you see a little bit of slowdown in the absolute levels of increase in those lines, a little cooling off?

Robert Patrick Myron
CEO & Director

Yes so that's a good question and I think let's try and look at this on a little bit more of a normalized basis. We got 6% in Q4, 13% in Q1 but we tried to normalize that ex Allied Health, which has gotten, which we had seen a lot of new but also renewals and of course pricing changes that we've been talking about are always based upon renewals, right. And ex that, ex Allied Health, it was 8% and then we're trying to normalize again and basically say 4%. And I would say one of the -- while many of the divisions had pricing increases that were compelling, I would say one of the ones, Allied Healthcare did not have a lot of renewals. It was only about $3 million and I would say that, that -- that division is in -- that market is in a little bit of flux right now and trying to figure out what it's going to be. There was substantial price increases that you know about. Some of the insured response here has been "Well, perhaps let's take our retentions up materially, right, and try and have this more of an excess coverage and do like a self-insured retention type of thing." And that is not business that we love from a credit risk perspective because oftentimes we want to get collateral for the, whatever that large SIR is because the way it works [indiscernible] standpoint you got to pay the claim first and then recover the SIR from the insured. So we haven't -- we're not in love with doing that. So we did get rate on what we renewed in that Allied Healthcare division but the overall level of renewals was low and the rate increase was a lot smaller. So I think we're going to -- we're going to have to see where that goes. I think more broadly the other divisions were up sort of mid-single-digits in general. So we're pleased with that and we're going to continue to seek that.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. And have you seen that kind of hold and I know July is just a few days in the past but has that generally kind of -- have we kind of reached a little bit of equilibrium of rate increase in a number of those markets, maybe ex Allied Health, that -- do you see it as sustainable in the near term.

Robert Patrick Myron
CEO & Director

I think it's sustainable but we did get asked this question on the call last quarter as well. And we don't really -- the rate information that we get we usually get several business days, at least, after the end of the month, right. And so I think it's more anecdotal, that we are still I think we're still out there getting that. But I actually don't have anything concrete in that respect.

Matthew John Carletti
JMP Securities LLC, Research Division

And then just my only -- my other question. I just want to talk about capital management expectations and kind of as we get in the back half of the year how you're thinking about it. Obviously casualty re is shrinking so the overall kind of top line growth is muted while there's still good growth in E&S and specialty admitted. How should we think about that and balancing, I think you guys have shown that you're putting your capital to work, the specials have shrunk. How should we think about your capital position as we kind of approach year end?

Sarah C. Doran
Chief Financial Officer

So I think, Matt, it's Sarah. I think the way that we -- we're thinking about that is to -- just looking at our ordinary dividend, we feel that, that yield is decently in excess of where many of the peers and many of the other folks in this space are. So that's a helpful balancing point but I think more importantly you'll see us grow in both of our insurance businesses and obviously shrink in the reinsurance business for the balance of the year but we want to keep that capital for the opportunities that we've seen in both of the insurance businesses. I mean to get the rate that we've been getting in different pockets of E&S and to look at some of these fronting opportunities and even in the individual risk workers' comp book, just given our comments on that earlier, we feel like we're in a better spot to make a return on that. So I think this is probably a year where we think more heavily about our ordinary dividend and less about the special, which has been episodic. I mean a special is by definition a special and that's kind of an if and when decision but just given the pipeline that we have we'd like to -- we're at 1.7x surplus now, we're up over a half a churn from this point last year. So I guess that's how I would think about it and how we're thinking about it.

Matthew John Carletti
JMP Securities LLC, Research Division

That makes sense. Great, thanks for the color and best of luck.

Sarah C. Doran
Chief Financial Officer

Thank you.

Operator

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

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

So 2 quick questions on investment income. One, can you give us the new money rates? And two, is there a timeline for deploying the, I'm calling it, excess cash that's been built up on the balance sheet?

Kevin B. Copeland
Senior VP of Finance & Chief Investment Officer

Meyer, it's Kevin here. So to answer your first question. We are reinvesting at rates roughly 20 basis points higher than maturing levels, and then as for the timing of reinvesting the funding in Carolina Re, our new reinsurance vehicle, that'll happen during this quarter. So over the next month or 2, it'll be fully invested.

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

Okay, that's very helpful. Casualty Re, I guess sequentially the expense ratio went down. Can you give us a sense as to maybe like a sustainable level for the rest of the year as topline shrinks?

Sarah C. Doran
Chief Financial Officer

Yes, you know I think the -- where the expense ratio was this quarter is not unreasonable to stretch that through the rest of the year. It's kind of 30% to 32-ish% and there are a lot of things -- I'd caution that there are a fair amount of things that can move around. We have -- your profit commission's attached to a fair amount of net business and should that particular book or contract do well that would push up the expense ratio. But certainly with the rationalization of the book and the way that we're looking at things I think that's a fairly reasonable generic assumption.

So was your second question Meyer, was it on top line?

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

No, it was the expense ratio in light of the direction of the top line.

Sarah C. Doran
Chief Financial Officer

Yes, I would think about the expense ratio kind of where it was this quarter going forward.

Operator

[Operator Instructions]

At this time I'm showing no further questions. I would like to turn the call back over to Mr. Bob Myron.

Robert Patrick Myron
CEO & Director

Thank you, everyone, for your time today, and we look forward to speaking with you next quarter.

Operator
Thank you. Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.