S&P Global
Market Intelligence

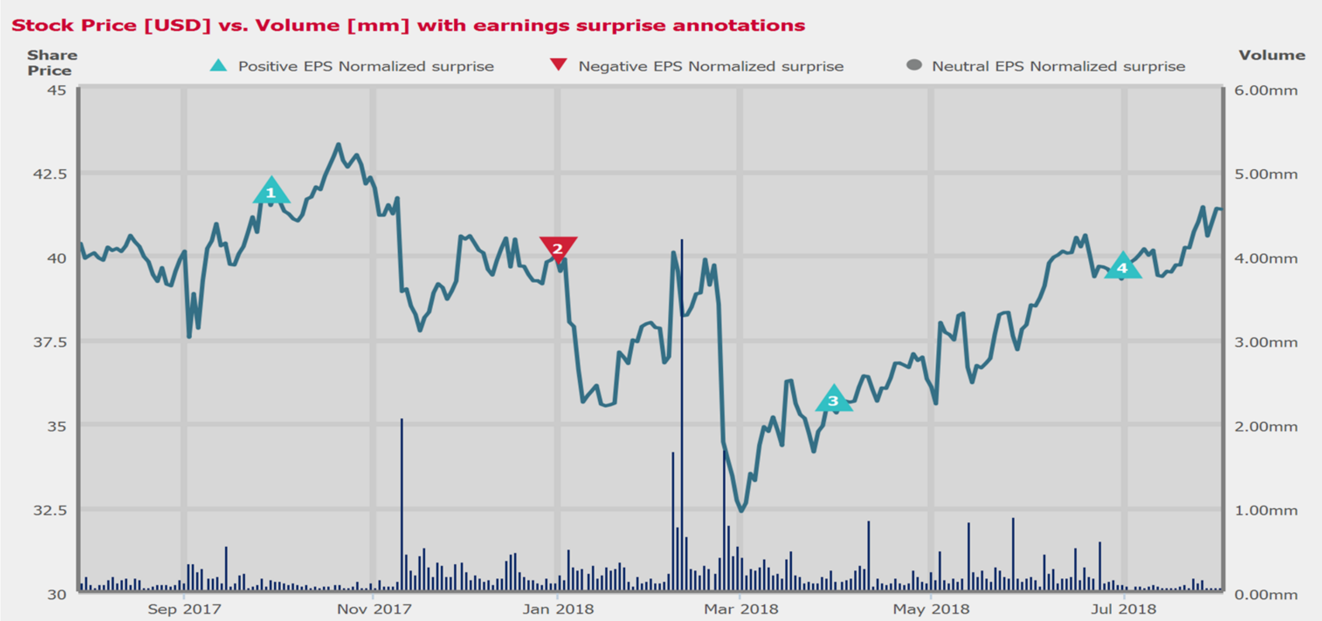
James River Group Holdings, Ltd.
NasdaqGS:JRVR
FQ3 2018 Earnings Call Transcripts

Thursday, November 08, 2018 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2018-			-FQ4 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.60	0.64	6.67	0.65	2.43	2.69
Revenue (mm)	226.65	224.69	(0.86 %)	222.99	892.21	907.72

Currency: USD
Consensus as of Nov-08-2018 7:54 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2017	0.33	0.36	9.09 %
FQ4 2017	0.71	0.13	(81.69 %)
FQ1 2018	0.54	0.55	1.85 %
FQ2 2018	0.54	0.58	7.41 %

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Call Participants

EXECUTIVES

Kevin B. Copeland
SVP Finance & Chief Investment Officer

Robert Patrick Myron
President, CEO & 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
B. Riley FBR, Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Third Quarter 2018 James River Group Ltd., Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Kevin Copeland, Head of Investor Relations. You may begin, sir.

Kevin B. Copeland
SVP Finance & Chief Investment Officer

Thank you, Nicole. Good morning, everyone, and welcome to the James River Group Third 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 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'll now turn the call over to Bob Myron, President and Chief Executive Officer of James River Group.

Robert Patrick Myron
President, CEO & Director

Thank you, 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 you just heard from us and who also leads Investor Relations.

We have a few prepared remarks and then we look forward to taking your questions. We have posted another solid quarter and we've generated an annualized return on tangible equity of 15.1% for the year-to-date, well above our guidance of 12% or greater. 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 96.0 and we had good combined ratios at all 3 segments. We didn't have any material property losses in the quarter from any of the noteworthy catastrophic events or otherwise, nor do we currently anticipate any material losses from events in the fourth quarter to date. We had net adverse loss reserve development in 2 of our segments but it didn't have a significant impact on our underwriting results. Pricing continues to be attractive in our E&S book, and I expect market conditions will continue to be positive going forward. Our Specialty Admitted segment continued to see favorable loss emergence as it has year to date and this quarter generated a combined ratio of 87.3%, its lowest in recent memory, as our fronting business is now a meaningful contributor to the segment.

Our investment performance was again very strong. Let me talk about a few of these things in some more detail and then I'll hand it over to Sarah.

Regarding growth. In our E&S segment, we had strong growth overall, growing in 8 of our 13 underlying divisions.

The Commercial Auto division grew 17%, substantially assisted by the significant rate increases we previously obtained on our largest account back in March.

In our core E&S book, we grew 7.4%.

This was substantially driven by strong growth in Excess Casualty, which was up 28%; in General Casualty, which was up 16%; and in Environmental, which was up 126% but on a small premium base.

Growth across all 3 was characterized by both the addition of new accounts and meaningful rate increases on renewals. Submissions for the E&S segment overall were up 7% in the quarter over a year ago, which is right in line with where we've been in the last 2 years, 7% to 10% per quarter. Our average premium per account in the quarter was about $17,800, which is the lowest it has been in a few years. That's fine with us. It just means that the larger accounts are becoming more competitive and we're happy to walk away from them if we don't think we can get good pricing.

In the Specialty Admitted segment, we grew gross written premiums by 31% in individual risk workers' comp and 14% in the fronting division. This growth is due to increased submission flow, the continued strong economy and the inception of the new fronting deals we also discussed last quarter.

Submissions for our individual risk workers' comp segment were up 60% in the quarter. This was due to the addition of several new underwriters and marketing staff over the last year or so. In the Casualty Reinsurance segment, while we did shrink the book in line with expectations, the renewal data of above $50 million of premium was pushed out from the third quarter of this year to the fourth creating a lumpy comparison.

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. When looking only at accounts under $100,000 in premium, renewal pricing was up 3% in the quarter. And our Specialty Admitted segment, rates were down for Workers' Compensation 1.2%, but net of underlying index loss cost changes we believe margins held steady.

In the Casualty Reinsurance segment, there was an approximate 3.3% rate increase on the underlying primary contracts, and then approximate 1.4% increase in the reinsurance treaty pricing this quarter. Let me now speak a bit about loss reserves and our accident year loss picks.

In our E&S segment, we had adverse loss reserve development of approximately $10.4 million, which was basically all from the 2016 accident year on our Commercial Auto division and principally from 1 large account and 1 state.

In 2017, we separately priced this state and also had a lower share of the risk that we did in 2016. In 2018, we no longer write this state. Now, overall, the 2018 accident year in our Commercial Auto division is developing well, which is a result of very significant increases in pricing as well as other underwriting actions we have taken in this account in the last 2 years.

The 2018 contract is approximately 3x the size of the 2016 contract. A reduction in the current accident last year loss pick of a few loss ratio points resulted in an IBNR takedown in the quarter that substantially offset the adverse loss reserve development from the 2016 year.

We're comfortable the current year accident year loss pick is still conservative and prudent and are very comfortable with our overall level of reserves in the division and the segment.

On a group-wide basis, our case reserves are strong and our IBNR as a percentage of total reserves is at 63%, which is notable given that we have been waiting in shorter tail casualty business in the last few years.

On a group-wide basis, our accident year loss ratio was 67.5%, down from 78.2% a year ago, principally from this reduction in the Commercial Auto current year loss pick.

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

Sarah C. Doran
Chief Financial Officer

Thanks, Bob. Good morning, everyone. For the fourth quarter of 2018, we made strong underwriting profits of $8.1 million, generated operating profit of $19.4 million and are reporting net income of $19.6 million.

Our combined ratio is improved as compared to the prior quarter as book-to-loss and expense ratios have declined.

And while our expense ratio improved as compared to both the third quarter of last year and the second quarter of this year, we continue to believe that a mid-26 expense ratio is very attractive for our franchise and our mix of business.

This quarter, the ratio has benefited from the continued growth of our Specialty Admitted business as well as certain lines within core E&S that entail attractive ceding commissions.

Complementing our underwriting performance, investment income grew about 10% as compared to the prior quarter and even about 3% as compared to the sequential quarter. This was principally due to our larger investment portfolio and rising rates on a floating rate loan portfolio, which more than offset a decline in our Renewable Energy portfolio.

We continue to enjoy the strong cash flow from our businesses as operating cash flow this quarter was $87.8 million as compared to $55.7 million in the third quarter of last year.

In line with this, cash and investments have continued to grow and are up about 10% year-to-date -- 12% year-to-date. While we would not expect this growth to continue at current levels, given we have actively reduced our third-party reinsurance business, our portfolio has been the beneficiary of the strong growth in our business these last few quarters.

And finally, our taxes. Our effective tax rate this quarter was 11.5%. While there are many points of impact on our tax rate, we continue to believe that the full year rate will be similar to historical averages. We ended the quarter with tangible shareholders' equity of $477.7 million, an increase over the $469.4 million at the end of the second quarter of this year.

Operating leverage for the trailing 12 months net premiums written to tangible equity was 1.5:1. As we mentioned in prior quarters, we have elected not to pay a special dividend this year given the attractive opportunities we continue to see and putting our capital to work in our growing insurance businesses. And with that, I'll turn it back to Bob. Bob?

Robert Patrick Myron
President, CEO & Director

Thank you, Sarah. In closing, I feel great about our performance year-to-date and for our guidance for the year, so there is no change to that. Pricing continues to be up, submissions continue to be up. We're getting strong growth where we are targeting at and we feel great about the performance of the most recent years in our Commercial Auto book.
This concludes our prepared remarks. Operator, we're now ready to open up the call for questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Mark Hughes from SunTrust.

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

I wonder if you could talk about the adverse development in the quarter. You've given some very good detail. I'm sort of curious on maybe a little more practical level, what you're seeing on severity? Are these cases just lingering on in the whatever settlements or payouts higher than expected? How many claims are still just going through some sort of adjudication process or they could still continue to develop? Just a little more detail would be helpful.

Robert Patrick Myron
President, CEO & Director

Sure. And Mark, you're talking about the 2016 year specifically and the underlying cause of that?

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

Yes, exactly.

Robert Patrick Myron
President, CEO & Director

Yes, I would say that it's obviously, as mentioned in the prepared remarks, it's concentrated in Florida and it's really a severity issue there and it's really around UM, UIM and that's underinsured or uninsured motorist-related claims. And it's not really necessarily related to litigation. It's really more of just settlements on what the absolute value of those claims are. So it's really a severity thing based upon the regulatory environment in Florida and not really frequency-driven.

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

Anything you can say about how many open claims are there? Or at least just some sense of the magnitude of the risk that you could have potentially more adverse?

Robert Patrick Myron
President, CEO & Director

Yes, sure. So I don't have the statistics specifically for Florida but I can tell you for the accident year on aggregate, 98% of the claims for the accident year have been closed. So it's a pretty substantial number. I think we've said a number of times that this book of business, given what it is and also given our proactive claims handling here, it's meaningfully shorter tail and shorter duration than the rest of our casualty business.

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

And then final question, your underwriting leverage, is that influencing your growth outlook at all? Are you being a little more selective in the business you will take in light of our capital situation?

Sarah C. Doran
Chief Financial Officer

No. I wouldn't say that we are. Only that we are focused on the insurance businesses rather than the reinsurance business. So that's where the growth is showing up year-to-date and we will continue for it to be so, Mark. And that's in line with some of the tax changes that came down at the end of last year and the structural changes that we made that we've been discussing throughout the year but I wouldn't say that all of the capital is influencing the growth in our insurance businesses.

Operator

And our next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions for you. Just curious, Bob and Sarah, 2016 year developed diversely. Why aren't the loss trends that you're seeing in '16 also impacting your '17? Because I understand it's a different rate on that business is much higher but wouldn't the loss trends have an impact on the '17 year also if that's kind of getting elevated?

Robert Patrick Myron
President, CEO & Director

Yes. So I mean, a couple of things. First of all, we took significant underwriting and pricing action in '17 and then, of course, '18 as well and so that was -- we've had pricing increases on top of pricing increases and the reunderwriting actions were principally around the shares of the risks we might take by state, for example, and some other smaller things. But given that the thing that has made 2017 so -- 2016, so problematic has really been Florida, whereby we had a materially reduced share of that risk in '17 along with a separate pricing for that state. That is the reason why we haven't seen it leak into 2017. And 2017 has held. And I think that another important thing that -- in this regard is for the group as a whole, we -- in the past, we generally had third-party actuarial work done in the latter half of the year in the fourth quarter but in this year, some of the third-party actuarial work that's done by outsiders that was done in the fourth quarter of last year, was done in the third quarter of this year, specifically around worker -- commercial auto and workers' comp and some other lines of business. So the results of that work is reflected in this quarter's results.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then second question, on workers' compensation insurance, one very, very large workers' compensation insurance writer out there noted rising frequency as a result of this very low employment environment. Just curious what your thoughts are on that? Doesn't sound like you're seeing it in your book but is it something that you're keeping a watchful eye on?

Robert Patrick Myron
President, CEO & Director

And this is in workers' compensation?

Brian Robert Meredith
UBS Investment Bank, Research Division

Correct. Workers' compensation, individual comp in your Specialty Admitted business?

Robert Patrick Myron
President, CEO & Director

Yes, I don't think we've seen a real increase in frequency. There is actually -- there's -- maybe I'll weave this into the change in the accident year loss pick. We saw some elevated reported loss ratios in the first 9 months of last year. And it started to appear as though -- it started to appear as though we were in particular getting some severity increases and then just number of policies enforced and there are a number of people in the workforce, some frequency activity as well. And that's the reason why on a year-to-date through last September 30, 2017, we ended up having a materially higher current accident year loss pick. We put in place the 50% quota share effective October 1 of last year. And since that point in time, we've seen nothing but low reported loss ratios again. And they've been meaningfully low, right back to the level that they were at in the several prior years prior to 2017. So we're not really seeing frequency and severity issues in the workers' compensation book in the last 4 quarters.

Sarah C. Doran
Chief Financial Officer

And we're absolutely keeping an eye on that as you would expect us to.

Robert Patrick Myron
President, CEO & Director

Yes.

Sarah C. Doran
Chief Financial Officer

And the increased submission count of 60% that Bob mentioned in his prepared remarks, is nice and powerful but our growth has been pretty moderate, certainly as compared to that as we want to keep a close eye and be selective around that. Comp is cyclical.

Robert Patrick Myron
President, CEO & Director

Right. Comp is cyclical. We obviously are off a peak from a pricing perspective. And so I think it's -- we got to watch it really carefully as Sarah says, just that what we will start to see, lost cost inflation at some point but we're not seeing it yet. And I think to the extent we do, we're well protected with a 50% quota share and then a meaningful excess of loss tower as well that sits on top of that workers' comp book we're buying 29.4 million excess of $600,000 I think, so that should take any severity issues out of the equation as well. And we like ceding commission that we're getting the quota share treaty there. So I think, we're in good shape to weather what might be coming. We just haven't seen it yet.

Operator

And our next question comes from Meyer Shields from KBW.

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

I was wondering whether it's possible to quantify, I guess, by accident year, we look outside of Florida in Commercial Auto, the average incurred loss per, I don't know, 1,000 miles, how accident year '18 compares to accident year '16 and '17?

Robert Patrick Myron
President, CEO & Director

The average incurred loss, I guess, you're talking about that from a perspective -- excluding rates right, you're just talking about absolute dollars?

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

Exactly.

Robert Patrick Myron
President, CEO & Director

Yes, I think given our mix and the fact that with the 40 states that we have and there are some less volatile states in there and some less higher but it's down a little bit in there. And then, of course, on top of that, we've gotten very significant price increases. And then I would also say that there has been some modest frequency declines. And that's been because of the driver actions that our client has taken in terms of improving the driver pool. The folks that we deal with there they are normally the heads of insurance but also what they call safety division as well. And they've done a lot of good work on better screening for drivers in terms of culling drivers who have had negative reviews and/or accidents and/or complaints and things like that. And so that has manifested itself in the frequency numbers that we've seen as well.

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

Okay. That's very helpful. Second question, as Casualty Reinsurance, I guess, setting aside the $50 million timing shift. Should the shrinkage in Casualty Reinsurance premiums translate to or have any impact on the investment portfolio duration?

Sarah C. Doran
Chief Financial Officer

No. I don't think so, Meyer. I mean, it's -- the duration of our E&S business and even of the little that we retain in the Specialty Admitted business is not dissimilar to what we write in the Casualty Re business. So I wouldn't think that the investment duration will be that different either. If I think about the dynamics of answering your question if that's -- that's the way I think about it at least. Obviously we are not absolutely asset liability matching just given it's a P&C business but yes.

Operator

[Operator Instructions] And our next question comes from Randy Binner from B. Riley.

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

I came in late, so I apologize if this has been asked but can you share what the statutory or Schedule P developed loss ratio is for your Commercial Auto line in 2016 and 2017, including this quarter?

Robert Patrick Myron
President, CEO & Director

Well, I want to be careful about providing information that's too specific to an individual client. But I think it's -- the 2016 year obviously is in a significant loss position from a ratio perspective. And then I think that the '17 year is not materially different than where it would have been at the end of last year. And then we feel very good about a conservative accident year pick that we are still booking on the '18 year, given all the magnitude of the pricing and underwriting changes. And so '17 and '18 are still booked at levels that are resulting in underwriting profits. And we feel good about those years.

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

And then on operating leverage. I guess -- I think this may have been covered before but it seems like it's around 0.8x, so -- the way we measure it is last 12 months net written premiums over total GAAP capital, I understand that there's different ways of measure but because it's an offshore company, that's what we use. So just, in general, that would be pretty conservative from an operating leverage perspective, I think, it would be closer to 1. What -- without the special here but kind of a good operating outlook for the business, what's the right operating leverage? Is this the right operating leverage we should expect in 2019, 2020 and beyond?

Sarah C. Doran
Chief Financial Officer

I think that there is room, we measure it a little bit differently, we get to 1.5:1x and that's down a little bit from last quarter, it was 1.7:1x. I think that we have room likely above the 1.7:1. So we have room from an operating leverage. We have a safe room from a financial leverage perspective as well. So there is a fair amount of room to run as we look at the growth opportunities in our insurance businesses over the next year or so. We just felt like that was a better use of capital. And we've been saying that this whole year than paying the special that we don't feel like we get, quite candidly, a lot of credit for given that we've only been paying it for a couple of years. So we wanted to get the 15% operating return on capital that we've gotten on our business kind of year-to-date and kind of blow that out over the next couple of quarters with that capital as well rather than running the same special this year.

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

How does your calculation work?

Sarah C. Doran
Chief Financial Officer

Yes, we get to 1.5:1x Randy, which is what I said in my prepared remarks, which is just 12 months net written to capital -- tangible capital.

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

Tangible capital, got it.

Sarah C. Doran
Chief Financial Officer

Yes. And might be the delta.

Operator

And I'm showing no further questions at this time. I would now like to turn the call back to Bob Myron, President and CEO for any further remarks.

Robert Patrick Myron
President, CEO & Director

Thank you, everyone, for your time this quarter and we look forward to talking to you again in 3 months.

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