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James River Group Holdings, Ltd. NasdaqGS:JRVR

Earnings Call

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Call Participants

EXECUTIVES

Brett Shirreffs
Senior VP of Finance, Investments & Head of Investor Relations

Frank N. D'Orazio
CEO & Director

Sarah Casey Doran
Chief Financial Officer

ANALYSTS

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 Benjamin, and I will be your conference operator today. At this time, I'd like to welcome everyone to James River Group Q1 2024 Earnings Call. [Operator Instructions] I would like to turn the call over to Brett Shirreffs, Investor Relations.

Brett Shirreffs
Senior VP of Finance, Investments & Head of Investor Relations

Good morning, everyone, and welcome to the James River Group First 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 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, Brett. Good morning, everyone, and welcome to our first quarter 2024 earnings call. I'm pleased to be joining you today to provide additional color on our first quarter results in addition to providing some commentary on market conditions and the future outlook for James River. Before we get into the results for the quarter, I'd like to take a moment to briefly acknowledge the closing of the previously announced sale of JRG Re. As we have discussed, this was a critical strategic transaction for James River that we believe creates a more focused and profitable organization moving forward. We are pleased to have closed the transaction on the original terms of the stock purchase agreement, and our focus remains on consistently producing profitable results within our E&S and Specialty Admitted segments, areas where we have meaningful scale and credibility with distribution partners to take advantage of market opportunities.

I should also note that the strategic review process that we began at the end of last year remains ongoing. The Board continues to consider a wide range of options, and there is no set time line for the completion of this process. As you might imagine, the delay in the closing of the sale of JRG Re created some downstream impacts with regard to the status and overall timing of the strategic process. Now turning to our results for the quarter. We have started the year on a strong note, reporting net income from continuing operations of $0.53 per share, adjusted net operating income of $0.39 per share, a combined ratio of 95.3% and a 17.4% adjusted operating return on tangible common equity, which is in line with the guidance we have provided for 2024.

In terms of our E&S business, we continue to benefit from strong and accelerating rate and submission growth, creating numerous opportunities to profitably grow our heavily weighted SME business. Submission growth continued at a strong pace during the first quarter, increasing 9% with meaningful growth in both new and renewal submissions. This is an increase from the 6% submission growth of the first quarter of last year. In total, we saw over 90,000 submissions during the first quarter, the largest quarterly total in our company's history. I would highlight general casualty submission growth of 45% in the first quarter, while excess casualty submissions increased 8%, and Allied Health and Environmental division saw submission growth of 6%. As I will discuss further momentarily, both our general casualty and excess casualty divisions also experienced the strongest pricing acceleration and had the highest renewal rate increases within core E&S.

Alongside strong submission growth, pricing conditions remain broadly attractive in our core E&S business. And having both of these dynamics in sync enables us to be selective about the risks we put on our balance sheet. Our focus remains on delivering consistent earnings and returns for shareholders. This quarter, we saw several larger accounts come up for renewal, many with a meaningful commercial auto component that did not meet our profitability rate hurdles, and we made the decision to not renew the accounts. As we have previously discussed over the last few years, we have implemented additional process and rigor around our performance monitoring and underwriting oversight, and we believe actions like these will produce better margins over the long run.

As previewed, our E&S business continues to experience broadly favorable pricing conditions. Renewal rates for the quarter were up 10.7% across the segment and have accelerated to be meaningfully higher than the first quarter of last year as well as higher than the full year 2023, with the majority of our underwriting divisions recording pricing increases in the high single or low double-digit range. We saw particular strength in some of our larger underwriting divisions with rates in excess casualty get more than 20%, general casualty and energy divisions up nearly 9% and excess property rates increased 16%. In our view, rate change continues to exceed loss trends as well as the pricing assumptions in our 2024 plan, and we remain confident that we are continuing to generate attractive margins on this portfolio. We have long maintained that smaller accounts where we have a steady submission flow of new opportunities and premium growth, have been more profitable for us.

This quarter, we made the active decision to non-renew several larger accounts, primarily in the Excess Casualty division as a result of some of the underwriting actions I spoke about earlier. Other competitors in the market were offering more aggressive pricing than we were willing to offer. And while we may see these accounts again in the future, we thought it was prudent to let them go for this renewal term. These actions had a direct impact on the decline in E&S gross written premiums of 6.6% during the first quarter. Offsetting the large account non-renewals in excess casualty, we did see continued growth in other divisions with general casualty premiums up 16% from the prior year and growth of more than 40% from environmental and sports and entertainment.

We believe our strong submission flow demonstrates the meaningful opportunity set our underwriters take advantage of each day. And while it's clearly still very early in the second quarter, in April, we have seen strong premium growth over the prior year and an increasingly attractive rate environment, with the segment now showing premium growth over prior year through the first 4 months.

The E&S segment combined ratio was strong at 87.3%, producing $18.5 million of underwriting income. The accident year loss ratio was 64.3% for the first quarter, which was an improvement of 140 basis points from the prior year. Reserve development for the E&S segment was de minimis during the quarter, and we did not have any reported losses related to catastrophes or the Baltimore Bridge tragedy.

Turning to Specialty Admitted. Gross written premiums in our fronting and programs business increased 23% compared to the prior year quarter, excluding the impact of workers' compensation. Many of our existing programs showed substantial growth and continue to benefit from the positive renewal rate changes available in the market. The segment produced a combined ratio of 97% and an underwriting profit of $800,000 for the first quarter. We are pleased with this performance and the segment's continued execution of our objectives to start the year. Overall, the E&S market continues to be characterized by strong rate increases in excess of expected loss trend and meaningful new and renewal submission opportunities. We continue to believe that 2024 will provide ample opportunities for growth as we focus on profitable underwriting to generate consistent and attractive returns for shareholders.

Before I turn the call over to Sarah, I do want to take a moment to acknowledge and commend the hard-working and resilient employee base of our company who continue to progress against our stated goal of making James River an even better company in the markets we serve. Our overall voluntary employee turnover for the first quarter was 3 percentage points better than the same period in 2022 and exactly the same as our group turnover rate for the first quarter of 2023. Clearly, our people continue to be the greatest advantage we have in this market, and we are both pleased and grateful to have such strong employee retention. 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 you've seen, we started out 2024 on a strong note with net income available to common shareholders of $20.9 million or $0.53 per diluted share compared to $5.3 million or $0.14 per diluted share for the same period a year ago. On an adjusted net operating basis, we are reporting $14.8 million or $0.39 of income per share as compared to $14.97 million or $0.40 per diluted share for the same period a year ago. Turning to our underwriting results. The first quarter combined ratio of 95.3% compared to 94% a year ago. Our loss ratio improved slightly, 66.4% from 66.7% a year ago.

And as Frank mentioned, we did not experience any catastrophe losses. There was really no net impact from prior year development. At 28.9%, our expense ratio ticked up slightly from 27.3% a year ago. And as mentioned previously, upon renewal last summer, we changed the key E&S reinsurance treaty to cover more of the portfolio, limit volatility and maximize underwriting income while more efficiently managing reinstatement premiums. This has had the impact of pushing our net to gross retention to 55% this quarter, down from 64% in the prior year period, but consistent with the second half of last year. We've also continued to make investments in people and technology.

And finally, it's worth mentioning that our operating expense ratios are elevated in the first quarter of the year due to compensation expenses, including equity-based grants for retirement eligible employees that were made in March, which reside in our corporate and other expense line. For the first quarter, we recorded net investment income of $22.6 million from continuing operations, an increase of 23% or $4.2 million from the prior year quarter. Our embedded book yield was 4.6% compared to 3.9% at this time last year.

We've been holding a fair amount of our portfolio in our short-term our cash strategies, which are returning in excess of 5% as we work through the close of our M&A transaction. Going forward, as we begin to allocate some of this to our core fixed income portfolio, reinvestment rates remain attractive in the mid- to low 5% range. We experienced $4.6 million of net realized gains on investments, the majority of which were related to changes in fair values of our common and preferred stock portfolios. Overall, our portfolio remains well positioned to take advantage of the strong market dynamics and attractive yields. And with that, I'll turn the call back to the operator to open the line for questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Casey Alexander with Compass Point.

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

Congrats on the speedy resolution of the casualty REIT sale, and it's great to see no additional adverse development in E&S. It's really great to see. I appreciate the discipline in the non-renewals of the larger accounts. I'd like to dig into it a little bit more, Frank. Is -- are you developing a strategy of working towards smaller policies, lower limits and trying to get away from types of issues that could lead to larger claims and potentially nuclear verdicts?

Frank N. D'Orazio
CEO & Director

Yes, Casey, thanks for the question. And let me first kind of speak about the underwriting actions that we took because I think it will provide some additional context on what we're trying to accomplish here and answer your questions. So as we've spoken about it in the past, portfolio management is an ongoing process for us. And at times, it's caused our writings to decrease in specific quarters, and this is exactly what you're seeing in our results for the first quarter. We took specific underwriting actions to preserve rate and maintain underwriting profitability in a very specific area of the portfolio. So as a result, we nonrenewed several large accounts that didn't meet our profitability hurdles and these were primarily excess casualty accounts with a heavy commercial auto component. So in some instances, we may not have agreed with the proposed underlying attachment or specific account could have had significant loss emergence. But really, in all instances, we just have a very specific view on our 2024 loss trend assumptions associated with excess commercial auto and it's in the high teens.

I believe it's our highest view of loss trend of any line we currently write. And so, in essence, we held our ground on pricing, and we saw it impact several of our larger accounts that included a $5 million account, a $2 million account a number of larger accounts in our excess casualty division alone. And so, you'll know this. I mean, we have over 32,000 policies in force, but we only have a few dozen accounts that are greater than $1 million. So, if you non-renew a few of these for underwriting reasons, you can't have to write a lot of 24,000 accounts to replace them. You'll see the impact pretty directly in the quarter.

So, we're comfortable we made the right decision in prioritizing profitability of production. And we have found, I think, to your point, that smaller accounts have just been more profitable for us over time for a number of reasons. And so, we made those underwriting calls and have moved on certainly to the next quarter. But in terms of the impact kind of going forward and how to think about how it will impact us in future quarters, we actually started taking a hard look at large commercial auto across our E&S segment in the middle of last year. And so much of this review has already been done. By and large, we had this quarter and maybe the second quarter to complete -- and I want to be clear on this. Not every outcome is binary. We aren't automatically nonrenewing these accounts by any means.

We underwrite, we loss rate down. We get input from our actuaries and our COO. And in some instances, we get the terms and pricing that we need. In other instances, we may choose to cut back our limit or raise our attachment or explore additional reinsurance. So, in discussing this issue that we're talking about now with our E&S segment President, there was a higher concentration of larger dollar heavy auto-driven excess casualty accounts in the quarter, but we don't have much more than maybe another 1/4 of these accounts to review with this same lens. And he had identified a handful of excess casualty accounts that were 7-figure premium items, heavy auto component that we're going to take a hard look at. Some of them we may have already looked at last year, quite frankly. But irrespective, we don't expect the same concentration that we just experienced in January and March. So, a long way of kind of explaining the underwriting actions that we took in the quarter, kind of where it was focused. But yes, I think it still spells out our real comfort with the S in SME because it makes up the vast majority of the portfolio.

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

Look, that's great color. My second question is you had a great -- excellent combined ratio in excess and surplus, but in specialty admit, it's still 97%. It's profitable, but it's -- I think how do you drive better margins through specialty admitted. I think people are not unhappy to see workers' comp exposure go? And also, how do you get fee income from specialty admitted running at a growth rate as opposed to just sideways?

Frank N. D'Orazio
CEO & Director

Yes. So listen, I think that some of the metrics and the numbers coming out, especially mid are going to be a little bit noisy right now because of the actions that we took over the last couple of quarters in terms of the non-renewal of the California workers' comp program and then the sale of the individual risk comp unit, the renewal rights transaction that certainly impacted the top line especially at it through 2024. But in essence, what we've done is we've refocused the segment to make it a pure fronting and programs business. And it has been historically profitable for us. We expect to continue to generate attractive returns going forward. We need to continue to scale it now that we are solely focused. So we saw great growth, 23% in the first quarter.

Again, that's ex-comp -- we continue to experience solid growth from our existing programs, and they have gained scale and benefit from the positive rating environment. But I think the answer to your question is continuing to get additional scale in the space, particularly in this kind of awkward period where we've just made some pretty strategic moves relative to what makes specialty admitted. So the good news there is we do have a pipeline. We have some large programs that we're looking at right now. They're in various stages of diligence. So, we'll continue to diligence them, work with the reinsurance market and hopefully have more to kind of speak about relative to new production there in future quarters.

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

All right. And my last question and then I'll step out is could you just kind of review where the remaining estate of James River sits with the rating agencies?

Sarah Casey Doran
Chief Financial Officer

I'm not sure exactly what you mean by the remaining you mean by our company as it sits now, Casey, I'm happy to take that...

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

The company as it sits now with Casualty Re finally out of the way and where do you sit and what are your conversations with the rating agency?

Sarah Casey Doran
Chief Financial Officer

Sure. No, I appreciate that. So, we have regular quarterly conversations with the rating agencies. So, we've done that by now. It's just typically part of our quarterly process, and we do that at a minimum. And I would say it's a very healthy dynamic. And they're well apprised of kind of where we sit, both on a capital and go forward and certainly current performance perspective, and we feel very good about that dialogue. That's probably how I'd leave it, if that makes sense.

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

Okay. All right. And appreciate the underwriting discipline that you're showing on those accounts.

Operator

Your next question comes from the line of Mark Hughes with Truist Securities.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Kind of the few remaining larger accounts that you're taking a closer look at, is that appears, -- is that a 2Q issue? Or is that going to be spread through the year?

Frank N. D’Orazio
CEO & Director

Well, yes. So again, we started the process in the middle of last year. So there may be a 1/4 of these accounts that maybe have not kind of gone through the same type of level of scrutiny. But accounts that we started the process with last year will be up for renewal again. But I think the answer to your question is there's maybe one more quarter of reviewing these accounts. But the point maybe I need to kind of reemphasize is it's not necessarily a binary outcome. We had some binary outcomes this quarter where we actually just non-renewed the business. But there are other outcomes like cutting back limit, raising attachment point, buying additional reinsurance where you still retain the account. We just had a concentration of non-renewals in the first quarter.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Right. And it sounds like April is pretty strong. So, the quarter starting off with a good momentum. The...

Frank N. D’Orazio
CEO & Director

Yes. I mean... Let me just touch on that for a second. I mean, because it's not the first time, certainly since I've been with James River that we've taken portfolio management actions that have impacted top line. I think the most recent quarter where we had a similar dynamic was in the third quarter of 2022 and E&S segment premiums declined, I believe, it was 6%. So directly related to underwriting actions impacting a few divisions, but we reported healthy growth for the full year in '22 and then again in 2023. And as I said in the prepared comments, we continue to see a robust set of new and renewal business opportunities. So, submission activity up 9%. We saw 8,000 more submissions than the prior year quarter, so we're continuing to receive strong support from our wholesale distribution partners, which is very encouraging and speaks well to the opportunities set for the year.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. On that point, did I hear you properly? I think you said general casualty submissions were up -- was it 45%?

Frank N. D’Orazio
CEO & Director

That's right.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Did you kind of increase your appetite? Did you let distribution know that you were interested in a wider range of business? Or is that just the organic, that's what's coming out of the -- or that's the opportunity set these days?

Frank N. D’Orazio
CEO & Director

No, I think it's probably more the latter, just in terms of broader market dynamics. I think the combination of real concerns around social inflation with the reality of the overhang from the last years of the soft market are still playing out reserve balances as well as well as a tighter reinsurance market environment for casualty real risk. So, I would say it's not only keeping opportunities maybe with the exception of like D&O, so third-party opportunities. in the E&S market, we're just -- we're benefiting from seeing more growth in the submission opportunity. So, you're not seeing the admitted market tempted to come back in. We're seeing more kind of come into the E&S sector.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Okay. And then the current accident year loss ratio in E&S was down year-over-year. Would you say that was mix? Was that better pricing? How would you characterize that?

Frank N. D’Orazio
CEO & Director

Yes. So, the year-over-year for the quarter you're talking about, is it 140 basis points primarily a mix issue, right? So, we talked about the growth in General Casualty, which has a higher loss ratio and then some movement in -- excuse me, in excess casualty as well. And of course, a refreshed view of both expected loss as well as trend assumptions that are baked into the plan for '24.

Operator

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

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

I apologize. I missed some of the earlier comments. But Sarah, when you said that there is higher compensation in the first quarter, is that something new because you don't see a higher expense ratio in the past couple of years in the first quarter.

Sarah Casey Doran
Chief Financial Officer

Yes. That's a good question, Meyer. We did our -- you may remember about 1.5 years plus ago. We -- the company adopted a compensation plan that had a number of changes. And specifically, it had directed targets as to how compensation would be earned in the short-term plan versus a high degree of variability and the lack of target. And I think that was designed to better align us with investors, and certainly, the market as it stands. So, we made that change with regard to our STI. At the same time, we made a change to institute a retirement function, where it's based on age and years of service. And we have a number of folks who theoretically are eligible for that. So that changes the way that the LTI is expensed through the year. Basically, more of it's expensed in the first quarter rather than ratably for those eligible. So that's what's causing that dynamic, and that is a more recent phenomenon.

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

The press release also talks about higher professional fees. Is that something that we should expect to continue over the course of the year?

Sarah Casey Doran
Chief Financial Officer

Yes. Another great question. That's going to be a little bit lumpy. Some of that is obviously related to a little bit of what we experienced in the first quarter with regard to some of the back and forth in the close of JRG Re, so I would expect for that to come down. Just to spend a moment on that. If you look at --

where that's flowing through in PNLS and the corporate and other operating expenses, and you see that this quarter being about $11 million as compared to $9.3 million in the first quarter of last year. I would expect -- and that number is encompassing both the equity comp for the whole company as well as all those professional fees, et cetera. So that number is a little bit elevated. I think it's more than elevated -- it's 20% elevated over the last -- first same quarter of last year. i.e., the 11.1% versus the 9.3%. And I would expect for the rest of this year, Meyer that number to be down closer to where it was in the first quarter of last year.

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

And then one last question, and I don't know if this is answerable at this point in time, but I'm guessing there's a little bit of discontinued operations in the second quarter for the period before the casualty deal closed. Is there any quantifying that yet?

Sarah Casey Doran
Chief Financial Officer

Not yet because that would not be public. But I would imagine that to be pretty small for the 16 days that we own the business, Meyer.

Operator

That concludes our Q&A session. I will now turn the conference back over to Frank D'Orazio for closing remarks.

Frank N. D’Orazio
CEO & Director

Thank you, Benjamin. Before we end today's call, I want to acknowledge and thank Patricia Roberts, who's been a Director of the Board of James River since 2019, serving on multiple committees and sharing our compensation committee for the last few years. The company has benefited greatly from her leadership and knowledge of the E&S sector. And while we will miss her insight and wisdom, we certainly wish her all the best in our upcoming retirement. Okay. I want to thank everyone for their time today and for the questions we received this morning. We look forward to speaking with you all again in a few months to discuss our second quarter results. Thank you and enjoy the rest of your day.

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