S&P Global
Market Intelligence

# James River Group Holdings, Ltd. NasdaqGS:JRVR

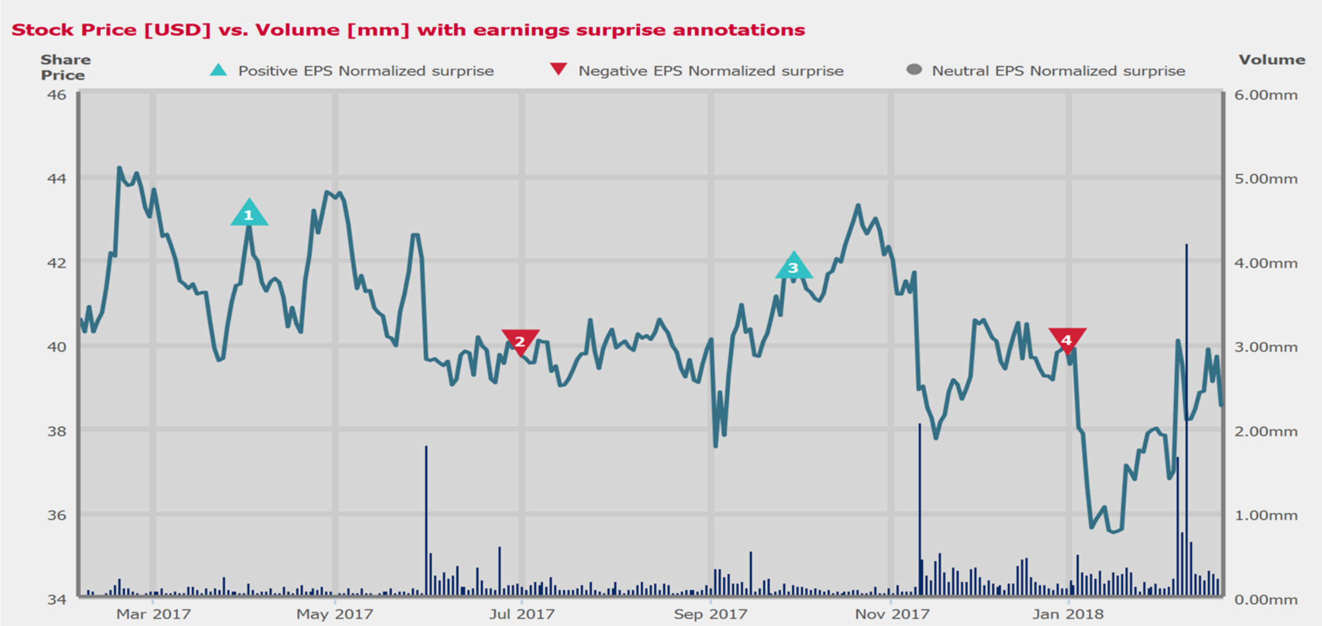
# FQ1 2018 Earnings Call Transcripts

## Thursday, May 03, 2018 1:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ1 2018- | | | -FQ2 2018- | -FY 2018- | -FY 2019- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.54 | 0.55 | 1.85 | 0.58 | 2.41 | 2.73 |
| **Revenue** | - | - | 3.11 | - | - | - |
| **Revenue (mm)** | 211.75 | 218.34 | - | 218.23 | 866.77 | 888.70 |

Currency: USD
Consensus as of May-03-2018 6:45 AM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ1 2017** | 0.55 | 0.58 | 5.45 % |
| **FQ2 2017** | 0.50 | 0.49 | (2.00 %) |
| **FQ3 2017** | 0.33 | 0.36 | 9.09 % |
| **FQ4 2017** | 0.71 | 0.13 | (81.69 %) |

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# 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, and welcome to the Q1 2018 James River Group Holdings Earnings Conference Call. [Operator Instructions] As a reminder, this conference may be recorded.

I would now like to turn the conference over to our host of today's call, Mr. Kevin Copeland. You may begin.

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

Thank you, Tanya. Good morning, everyone, and welcome to the James River Group First 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 will now turn the call over to Bob Myron, Chief Executive Officer of James River Group.

**Robert Patrick Myron**
*CEO & Director*

Thank you, Kevin, and good morning, everyone. This is Bob Myron, and with me today are Sarah Doran, our CFO; and Kevin Copeland, who you just heard from, our Chief Investment Officer who also leads Investor Relations for us. We have a few prepared remarks, and then we look forward to taking your questions.

The year is off to a great start. We had strong top and bottom line performance in each of our 3 segments, with underwriting results showing a substantial improvement from a year ago, as highlighted in our press release. Our combined ratio for the group came in at a 96.4% and we had compelling combined ratios in all 3 segments, with favorable reserve development in each of them.

I am thrilled by the pricing increases we received in our core E&S book and very pleased with renewal pricing overall. While relative to a year ago our investment performance was down, in absolute terms investments performed well, roughly in line with our expectations. 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 and strong growth in most of the underlying divisions. The commercial auto division grew 84%, substantially assisted by the rate increases we have obtained on our largest account. In our core E&S book, we had growth in 9 of 12 divisions.

In particular, we saw strong growth in allied healthcare, which was up 208%; and energy, which is up 97%; and in general casualty, which was up 70%. Part of this growth was from rate increases, which I will discuss more in a minute, and part of it was from increased submission activity and opportunities in some larger accounts.

As mentioned last quarter, the nursing home space in the allied healthcare division is very hard right now, with substantial price increases on renewals and strong flow of new submissions that are coming out of the admitted market. In divisions like energy and general casualty, there were a variety of underlying causes for growth, from select large single accounts written for energy contractors to the growth in the restaurant space, which I mentioned last quarter. Submissions for the E&S segment overall were up 8%.

In the specialty admitted segment, we grew gross written premiums by 7% in individual risk workers' comp, and 23% in the fronting division. This growth is due to increased submission flow, the continued strong economy, and some smaller new fronted deals that have been put on the books in the last year.

In the casualty reinsurance segment, we did grow in the quarter. But as we said last year, by the end of the year we expect gross written premium to decrease by approximately 50% from what it was in 2017 as we refine the book and focus on more profitable accounts.

From a bottom line perspective, the E&S segment had good results, but I'd like in particular to note the improved underwriting results of the specialty admitted segment and the casualty reinsurance segment. Those 2 segments had some of the lowest combined ratios they have had of late.

Now with respect to pricing, in core E&S, which we define as all business in the segment excluding commercial auto, renewal pricing was up 13% in the quarter. This was driven by the allied healthcare division. Excluding the allied healthcare division, our core E&S rates were up 8% in the quarter, which is still very compelling. 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 workers' compensation but net of underlying index loss cost changes, we believe margins held steady. In the casualty reinsurance segment, overall price increases were up approximately 7%. This was due to an approximate 5% increase on the underlying primary contracts and a 2% increase in reinsurance treaty pricing.

Let me speak a bit about accident year loss picks and reserves. In our E&S segment, our accident year loss pick increased approximately 4 points 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 loss picks in the core E&S book. On a group-wide basis, our accident year loss ratio was 72.8%, up 2.5 points from a year ago.

Overall, I am pleased that we were able to deliver a compelling combined ratio in the quarter for the group, while at the same time booking a higher accident year pick, having favorable reserve development for the group as a whole and in all 3 segments, and lastly, to increase our IBNR percentage of total net reserves from 65% at Q4 2017 to 65.6% at the end of this quarter. Lastly, commercial auto loss emergence was in line with our expectations this quarter.

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

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

Thank you, Bob. Good morning, everyone. We are very excited about our start to the year, the prospects for our business, and our continued balance sheet strength. I'll go ahead and fill in some of the blanks on the moving pieces to the quarter and our outlook.

For the first quarter of 2018, we made underwriting profits of $7.2 million, generated an operating profit of $16.6 million, and are reporting net income of $15.6 million. Before I get too far into the results, I'll take a moment to highlight the accounting change effective in the first quarter which creates a further difference between non-GAAP operating income and GAAP net income and will likely have the effect of creating net income volatility going forward.

Effective January 1, 2018, all changes in the fair value of equity securities are reflected in net income rather than in other comprehensive income on the balance sheet, so there are now 2 components of net realized and unrealized gains and losses on investments in the P&L. The first are the pre-tax gains and losses from the sale of investments, which includes the valuation allowance on our bank loan portfolio. And the second is the change in unrealized gains or losses on equity securities resulting from the new accounting pronouncement.

This quarter, we recognized a pre-tax loss in the value of equity securities of $1.7 million within net income, which was partially offset by realized pre-tax gains of $900,000 on investment sales during the quarter. I'll stay on investment results for just a few more comments.

This quarter, our net investment income decreased about 21% as compared to the same quarter last year. The first quarter of last year included an exceptional performance from our renewable energy portfolio. While income in our core fixed income and other private investment portfolios was up meaningfully this quarter, results from our $40 million renewable energy portfolio can be volatile, as they are generally influenced by both interest rates and revaluations by the sponsor.

This quarter, the rising rate environment negatively influenced the market value of these assets, and this could continue to occur to the extent rates continue to rise. These assets have been outsized contributors to our investment income over time. Despite the lower contribution this quarter as compared to the first quarter of last year, they still produced an annualized return of 10.4%.

We continue to enjoy strong cash flow from our businesses, as operating cash flow this quarter was $48.5 million as compared to $16.1 million in the first quarter of last year. This is a benefit to our increased float and future earnings, as invested assets grew about 3% over the sequential quarter and almost 10% year-over-year.

Turning to the expense ratio, as we have said, we view this as a key competitive advantage of ours. This quarter, our group expense ratio decreased to 24.9% as compared to 29.1% in the first quarter of last year. This decrease has come through changes in business mix and increased scale. The 24.9% this quarter is equal to that of the third quarter of 2017. We believe a mid-20%'s expense ratio is very effective and attractive for our franchise and mix of business.

Finally, a moment on taxes. Our effective tax rate this quarter was 8.7%. As we've said before, the rate fluctuates from period to period based on the mix of income by country and tax jurisdiction as well as the timing of option exercises and the vesting of RSUs, which generally has been larger for us in the first quarter but can happen at any time. So there are a number of moving pieces to our tax rate, but 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 $465.8 million, down slightly from $474.5 million at the end of last year. Net income was generally offset by $9 million of dividends we paid and the $18.5 million of after-tax unrealized losses from the impact of rising rates on our fixed income portfolio. Operating leverage, or trailing 12 months net premiums written to tangible equity, was slightly higher than last quarter at about 1.75 times to 1.

Bob, I think that covers everything on my list. Let me turn it back to you.

**Robert Patrick Myron**
*CEO & Director*
Thank you, Sarah. Operator, can you please open the line for questions?

# Question and Answer

**Operator**

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

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

I just have

[Technical difficulty.]

**Robert Patrick Myron**
*CEO & Director*

All right. Maybe we should move on to the next.

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

The next question?

**Operator**

And our next question comes from Matt Carletti of JMP Securities.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

Bob, I was just hoping you could maybe expand on your comment about commercial auto a little bit, how you said that loss emergence was in line with expectations. Is there anything else you can point to? I know it's only been 3 months since kind of what happened last quarter, but is there anything else you can kind of point to in kind of the daily claims trends you're seeing or things like that that give you additional comfort that the actions you took at the time were more than appropriate?

**Robert Patrick Myron**
*CEO & Director*

Yes. Obviously, this is something that we look at pretty carefully, but I think there isn't a lot more to say. I mean I think we have an expectation in terms of what we think loss emergence might be, and then you're always comparing that to actual. And for the quarter, it was in line. And so that ended up with the result that we ended up having in the segment, which was a reasonable loss ratio, a reasonable combined ratio, and overall favorable development for that segment. So I think it was consistent with our expectations. And we're obviously pleased about that given that we are about 3 months beyond the results that we had there in Q4.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

Okay. And then my only other question relates to the pricing in core E&S. I think you quoted you have 13% in the press release, and I think I caught you saying 8% kind of ex allied health. How did April look? I know it might be too little to give a number, but did the acceleration that you saw in Q1 kind of persist in April, or did it inflect one way or the other?

**Robert Patrick Myron**
*CEO & Director*

Yes, we really don't have rate information for April yet, given how close we are to that month. And so let me just go back to the beginning. Yes, you heard correctly that we did get 8% ex allied health, which I would reemphasize that is a really good rate increase on renewals. And we are continuing to seek rate increases in this current environment. And in terms of April and Q2 activity, we'll have to give you an update on that when we release Q2 earnings. We just don't have a lot of data that right now.

**Operator**

And our next question comes from Mark Hughes of SunTrust.

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

Were there a -- can you give us a sense of the loss picks on the core E&S business when we think about last year, the prior year? Are those loss picks relatively steady? Have they come down given that the pricing has improved, or is there a little more conservatism in the loss picks?

**Robert Patrick Myron**
*CEO & Director*

Yes. Thanks, Mark. So I think just philosophically, always we seek to book, as I mentioned in my prepared remarks, a prudent and conservative pick in that respect. And we've basically said always before this is always sort of in the high 60%s or sort of low 70%s. And we're continuing to take a similar approach in that regard. And so it's really not different than what we've -- a lot different than we've done in the past. It may be up a little bit, and I think that that's just really, again, a philosophical approach, that we want to make sure that we start out of the box with earned premium and, even in the context of these pricing increases, booking something that we think is prudent and conservative.

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

In that commercial auto book, where is the sort of -- is there an inflection point somewhere where, once you get beyond that point, you've got much more confidence in the loss emergence? When do you know, so to speak?

**Robert Patrick Myron**
*CEO & Director*

It's a shorter tail book, clearly, than the average general liability type of business that we're writing in the rest of the segment. I think we have always, as time passes for any individual underwriting year -- as time passes, you sort of gain more and more confidence. But I think that really we think of 12 to 24 months beyond the end of the underlying underwriting year when you start to have increasing levels of certainty with respect to paid losses relative to ultimate and reported losses relative to ultimate, and you've got a significant amount of the claims closed. So it's sort of not a 4 to 5-year thing like it might be in general liability. It's a bit shorter than that. But it does take some time because, as you know, we're not covering any of the property or physical damage piece of these risks, so it's all liability.

Sarah, would you add anything to that?

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

No, that's pretty expansive. I think that covers everything. Thanks.

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

And then does '17 look like it's acting like '16 in that way? Is it following a similar pattern, I guess, i.e., more predictable?

**Robert Patrick Myron**
*CEO & Director*

Yes. So the '17 -- for the largest account, the '17 underwriting year just finished up on February 28, right, because this is a large first renewal, which I think we've said before. And I would just go back to the previous comment, that in general for that division within the segment, loss emergence was consistent with our expectations generally.

**Operator**

[Operator Instructions] And our next question comes from Meyer Shields of KBW.

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

Two quick questions. One, the tail on the allied health book where you're seeing all this growth, is that meaningfully different than the rest of non-core? I'm sorry, of core E&S?

**Robert Patrick Myron**
*CEO & Director*

I don't think it's a lot different, no. I think that if you think about the type of claims there, it might be like a slip and fall or a broken hip or something in a nursing home or something like that. And so it certainly is going to have a tail, but I don't think it's tremendously different than like a construction defect claim for a contractor's GL or something like that. And part of that is because we're principally writing primary there, right? It's not like it's an excess book.

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

When I look at investment income, if I add back the $1.7 million impact of the accounting standard change, it looks like net investment income on I'll call it the core portfolio is up 23%. Is that a good base run rate going forward based on new money yields?

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

I think so. I don't have a view that it's going to be different. And I'll ask our Chief Investment Officer, Kevin, if you want to chime in on that.

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

Yes, absolutely. This quarter would be a good run rate looking forward. But just to be clear, Meyer, the unrealized loss that went through income, that's actually booked as a realized loss. It wouldn't be in net investment income if you're modifying that line item.

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

Okay. So I guess I'm trying to get that clear. So the 11-4 is the right number?

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

The 11-4 after -- sorry, is 11-4 your number for the non-private investment portfolio?

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

Yes, it's the 11-436 excluding renewable energy and other private.

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

Yes.

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

Okay.

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

Yes, that would be -- exactly, yes. That would be a good run rate going forward.

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

Okay. No, that clarifies that. And one last question. Is there any change -- I know that there's a rate increase on the largest account within commercial auto. Any change to the fee structure?

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

Yes, we mentioned this a little bit last quarter, Meyer, in that the structure itself didn't change but the way that we account for it will change, in that, over the next couple quarters you will likely see -- and this is just geography, less fees coming through and increased premium. So we will account for more of that fee business as premium.

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

Okay. And should we assume that that premium carries 100% combined ratio?

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

I wouldn't.

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

Okay.

**Robert Patrick Myron**
*CEO & Director*

Yes, basically, claims handling fees -- some of the claims handling fees that previously we were booking as fee income are now -- there's now a requirement that we've got to book this as premium. And so it's got to flow through the P&L as written and then earned, and then have probably a loss ratio and sort of expense ratio applied to it. So optically it's going to -- for that segment, it's going to cause a decrease in how we -- what we show for fee income.

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

For fees, but the same level of profitability here.

**Robert Patrick Myron**
*CEO & Director*

But it's really not affecting the economics as significantly.

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

Yes.

**Meyer Shields**

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

Okay. Yes, that's what I meant to ask. The underwriting profit will look similar to -- expected underwriting profit will look similar to the current fee profitability.

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

I think that's fair. Remember the renewal was just March 1, so now going forward we'll have that as an indirect comparison from last year.

**Operator**

And I'm showing no further questions at this time. I would now like to turn the call back over to management.

**Robert Patrick Myron**
*CEO & Director*

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

**Operator**
And ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.