S&P Global
Market Intelligence

James River Group Holdings, Ltd. NasdaqGS:JRVR

FQ1 2022 Earnings Call Transcripts

Tuesday, May 10, 2022 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.26	0.37	42.31	0.51	1.97	NA
Revenue (mm)	199.95	201.95	1.00	196.20	790.00	NA

Currency: USD
Consensus as of May-10-2022 6:02 PM GMT

- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	0.51	0.54	1 5.88 %
FQ3 2021	(0.64)	(0.72)	NM
FQ4 2021	0.09	(1.81)	NM
FQ1 2022	0.26	0.37	2 42.31 %

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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

Brian Robert Meredith
UBS Investment Bank, Research Division

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

Mark Douglas Hughes
Truist Securities, Inc., Research Division

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

Presentation

Operator

Welcome to the James River Group Q1 2022 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to Brett Sheriff, Head of Investor Relations. Please go ahead.

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

Thank you. Good morning, everyone, and welcome to the James River Group First Quarter 2022 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 in our most recent Form 10-K, Form 10-Qs and other reports and filings we've made 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 Frank D’Orazio, Chief Executive Officer of James River Group.

Frank N. D’Orazio
CEO & Director

Thank you for that introduction, Brett. Good morning, and welcome to everyone on the call. I'm pleased to be back with all of you today to provide some additional color on our first quarter as I believe the group's earnings potential is beginning to show through in these results, and we only expect this dynamic to accelerate and become more apparent in the coming quarters.

We also remain encouraged by both our continued ability to execute on our business initiatives as well as the positive trends we're seeing in the market and believe they should both continue throughout 2022. One hallmark of our franchise has remained consistent despite some of the strategic actions that we've announced over the last few quarters is that our core E&S business has continued to produce extremely attractive margins and premium growth.

And our first quarter this year was no different in that respect. We also continue to make progress in delivering on our business plans for our Specialty Admitted and Casualty Reinsurance segment, focusing our capital on our U.S. businesses while acting as nimble and opportunistic underwriters.

Before turning to Sarah, I'd like to provide some commentary on the performance and outlook for each segment. In our E&S segment, we experienced compelling results from a top and bottom line perspective. Gross premium growth was 12.6% compared to the first quarter of 2021, with 10 of our 13 underwriting units experiencing double-digit growth, demonstrating significant broad-based expansion across the segment.

Renewal rates increased 8.4% across our E&S unit, marking the 21st consecutive quarter of rate increases, totaling 52% over that period. In many instances, this is the fourth or fifth renewal cycle of positive rate increase on our renewal business as accounts are remaining in the E&S marketplace longer and for multiple renewal cycles.

We believe this is a key indicator to support our belief that the favorable market conditions that the sector has enjoyed for several years should last throughout 2022 and likely beyond.

Turning to profitability. The E&S segment reported a combined ratio of 83.7% and produced underwriting income of $21.5 million. The accident year loss ratio in the first quarter was 64.7%, roughly consistent with a 64.3% in the prior year quarter. While rate increases have moderated from the mid-teens level of a year ago that, they continue to be above -- they had continued to be above both our own view of loss costs and our own rate expectations for the year. As previously stated, we intend to remain patient in recognizing these favorable trends in our loss picks.

In Specialty Admitted, we decreased our writings and workers' compensation by 12.6% while growing the rest of our fronting program book. Gross written premiums across the segment declined 1% in the quarter, driven by the declines in both our individual risk workers' compensation business and our largest program relationship that is also workers' comp focused.

Excluding workers' compensation, gross written premiums in the balance of the segment grew 6.5% despite the loss of a fronting partner that was acquired in the fourth quarter of 2021. Just as importantly, we added new fronted programs in the quarter that will diversify our exposure base prospectively as we continue to have an attractive pipeline of new opportunities in various stage of diligence.

Fee income in the segment increased 8.4% during the quarter to $5.6 million. Turning to casualty reinsurance. As discussed last quarter, we expect to reduce the top line of this segment by approximately $100 million during 2022 as we continue to focus our business and capital on what we believe to be the best opportunities throughout the group. We now renewed several treaties during the first quarter that drove the segment's premium decline of approximately 54% versus the prior year period.

Of the business that did renew in the quarter, we achieved significant rate increases as we focus on margin enhancement and portfolio optimization in the Reinsurance segment. As initially disclosed with our fourth quarter earnings release, our Q1 underwriting results in Casualty Reinsurance included $11.5 million of loss associated with the legacy portfolio transaction, which closed on March 31.

Overall, we are pleased with the underlying performance of the group, remain thankful for the tremendous relationships we share with our distribution partners and firmly believe that the strategic actions we've taken over the last 18 months to derisk the balance sheet will continue to allow the earnings power of our franchise to shine through. We believe the outlook for James River is very strong. Lastly, you may have noticed we filed an 8-K on April 28, announcing the retirement of Jerry Masters from our Board of Directors. Jerry had served on the James River Board since 2014 and was the Chair of our Audit Committee and our Lead Independent Director. We have benefited greatly from his service, thank him for his much valued counsel over the last 8 years and certainly wish Jerry the best in his retirement.

And with that, let me turn the call over to Sarah Doran.

Sarah Casey Doran
Chief Financial Officer

Thanks, Frank, and good morning, everyone. For the first quarter of 2022, we delivered $13.9 million of operating income. This included $5 million of underwriting profit and $16.3 million of net investment income. The loss portfolio transfer agreement we executed in the first quarter, which now reinsures most of our casualty reinsurance segment reserves, elevated the group combined ratio by 6.1 percentage points and reduced underwriting income by $11.5 million for the quarter, as we previously announced.

Excluding the impact of the transaction, the segment would have generated an accident year loss ratio of 60.6%. Our annualized net operating return on average tangible common equity was 11.8% for the quarter. Again, this was made lower by the discrete impact of the transaction. Our expectation for 2022 continues to be that we would earn a low double-digit return on tangible common equity across the group with strong underwriting profits in both of our U.S. segments and also grow our tangible book value per share, excluding AOCI.

Moving on to our profitability ratios. Both our loss and expense ratios were down considerably from the first quarter of last year. James River continues to have a very competitive expense ratio. It was 26% for the quarter, down almost 3 points from the same quarter last year. This is due both to our focus on expense management as well as to the scale we continue to build in the insurance businesses, while revenue growth continues to outpace operating expense growth. We continue to believe that a 26% to 28% expense ratio is extremely attractive for our franchise and business mix this year.

Frank largely covered the results of the U.S. segments, but it's worth spending a moment on Specialty Admitted. As we've mentioned, we reduced workers' compensation writing given the market conditions, but continue to grow the other risks in our fronting business. While claims counts have decreased in workers' comp, rates continue to be less compelling than those in other parts of our businesses.

This quarter, the segment produced a 98.9% combined ratio and 79.6% accident year loss ratio. The accident year loss ratio is broadly consistent with that of the second half of last year, when we increased our then current year workers' compensation loss ratio.

I would also point out that we had a few one-off impacts that influenced the segment expense ratio at different quarters last year, none of which were a factor in the current quarter.

Moving on. Investment income grew about 8% this quarter as we benefited from increased returns from our portfolio of renewable energy private investments. Realized losses were $5 million this quarter, almost evenly attributed to a decrease in the fair value of each of our small dividend-paying common equity portfolio and our floating rate bank loan portfolio.

In addition to the strong operating cash flow we generated this quarter of $65.4 million between the floating rate exposure that characterizes our bank loan portfolio and near-term maturities and the rest of our portfolio, we expect that over 20% of our current portfolio will have the opportunity for reinvestment or reset over the coming year. During the month of April, our reinvestment rate was about 100 basis points above our current portfolio yield of 2.75%.

Net unrealized investment gains decreased $86 million for the first quarter of the year, reflecting a decline in the fair value of our fixed income portfolio. As a reminder, we tend to hold substantially all of our fixed maturities and an unrealized loss position until they recover their fair value or mature and the average credit quality of the fixed income portfolio remains A+.

And finally, on taxes. Our effective tax rate this quarter was 24.6%. It was elevated by discrete tax items, primarily related to the excess tax expenses associated with vested restricted stock units. While there are many points of impact to our tax rate, we continue to believe that the full year rate will be closer to 21%.

In conclusion, James River ended the first quarter in an excellent financial and strategic position. We have ample capital to operate in the current environment and continue to see very attractive opportunities to invest and continue to scale our company.

We ended the quarter with tangible common equity of $429.9 million and tangible equity of $574.8 million, which includes the Series A preferred we issued last quarter.
And with that, I will turn it back to the moderator to open the line for questions.

Question and Answer

Operator

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

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. Thank you. Frank, when you think about the progression of the cycle, let's say, through 2022, you expressed optimism and it suggests that it might extend into 2023. What -- when you look at the market, what gives you more positive signals around that? .

Frank N. D'Orazio
CEO & Director

I think the broader macro factors driving rate increases have not really shown any signs of slowing momentum in the first few months of the year. So underlying economic fundamentals and growth thus far remain very strong, and inflation has obviously emerged as a factor. So I expect carriers are going to be successful and continue to push for rate throughout the year. In terms of our home production, we saw strong growth across almost all E&S underwriting units in the first quarter, and we're seeing a good flow of new opportunities in our fronting and program business. So everything that we're seeing in the marketplace just suggests the continuation of the recent trends.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Sarah, you described, I think, 11.8% return on tangible this quarter, which included the 6 points of losses in Casualty Re. Your guidance is for low double digit for the full year. Is that conservatism. If we add back those 6 points, should the returns be a little bit higher?

Sarah Casey Doran
Chief Financial Officer

Yes. Thanks for the question, Mark. If we added back to the 6.7 combined ratio to the return on tangible common equity, the ROE would be considerably higher, I think, in the high teens. For the quarter. We do feel like we had a wonderful contribution from our renewable energy portfolio this quarter. And that's kind of pushed, I think, NII up versus our expectations, for sure. But I do think there is a little bit of conservatism in our low double-digit ROTE expectation there. And we feel -- we certainly feel good about achieving that over the course of this year.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And you've mentioned that the turnover in the portfolio likely to be about 20% this year. Would it be similar next year as well?

Sarah Casey Doran
Chief Financial Officer

So the 20% is a combination of what is the portfolio as floating rate and what's maturing over the year, and it's about half and half to each. And I would think that next year would be pretty similar in terms of that in terms of that turnover, if I would say that.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. Understood. The -- in Specialty Admitted, the underlying program, the underlying workers' comp program, was that just a change in their appetite? Was there any change in your allocation or the nature of the relationship with that large account?

Frank N. D'Orazio

CEO & Director

No, Mark, we've seeing some pressure on rates for the last couple of years and workers' comp that large program happens to be California workers' comp focused. And so we've been bringing down our retention in terms of what we assume on that program over the last couple of years. But it's really the rate environment. Now we're not a 50-state writer. We have, as you know, an individual risk orders comp unit that focuses on the Southeast and then this large program. Broadly, I would say the rates that we're seeing in the Southeast and the individual risk workers' comp unit are behaving a bit better, closer to leveling off, but we're still seeing double-digit decreased pressure in terms of rates in a large program. And so I wouldn't say if that has any change in appetite. It's kind of responding to the market conditions rationally.

Operator

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

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of quick ones here for you. First, Sorry, you're still guiding to a 26% to 28% expense ratio. I know you had a 26% here in the first quarter. And typically, if I look back historically, the first quarter is your highest expense ratio. So why is it still going to be 26% to 28%?

Sarah Casey Doran
Chief Financial Officer

Sure. You're right. It is typically the highest, Mark -- excuse me, Brian, apologies, but one of the things that I'd point out is in the fourth quarter, we've had significant reductions in our expense ratios. We've reduced our compensation throughout the organization just given the performance that the company had achieved in recent periods. We are obviously not anticipating that anything like that would happen in this year. We feel very comfortable with our balance sheet and our earnings forecast there.

So part of that is that expectation. I think that's important to point out because that fourth quarter has probably been artificially low as we look at the organization and the turning power is going forward.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. But if I'm looking at the second and third quarter, though.

Sarah Casey Doran
Chief Financial Officer

Yes. Look, it can fluctuate in any given quarter, just given our scale, but I think the biggest piece of the annual expense ratio has really been, for example, last year, that it was down at, I think, 14% in the fourth quarter, which would have pushed it down to the 23% for the year.

Brian Robert Meredith
UBS Investment Bank, Research Division

And then a second question, I'm just curious, given that rate continues to be in excess of trend and then it looks quite good. If I look in your E&S, the underlying loss ratio was actually up on a year-over-year basis. Any reason for that?

Frank N. D'Orazio
CEO & Director

Well, I would say two things. One, I mean, it's just about right on the number, right? So fairly consistent with the last year, and that's going to change just based on changes in the business mix from year-to-year. But overall, don't forget the theme that we've been stressing is just that we're going to be patient just relative to -- and conservative relative to both the loss ratios that we set and how we let those loss ratios kind of season over time.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And Frank, any significant changes in business mix that you're looking at in the first quarter or in 2022 versus '21? Any areas or lines of business that we'll see in your 10-Q that you're popping up more?

Frank N. D'Orazio
CEO & Director

No, I'd say that the appetite is fairly consistent with the past. I mean we've been taking risk primarily in the E&S segment and being more of a fronting carrier in our Specialty Admitted segment. In terms of the growth, it's really been kind of consistent throughout most of our E&S segment. I referenced before the 10 out of 13, I believe, segments that are showing double-digit growth in the quarter. So very strong and pricing is really holding up very well. So we're now 21 quarters of consecutive renewal rate increases.

At this point, rate on rate is extremely meaningful. And we're seeing it throughout the book. And we're seeing it back to double-digit rate increases in some lines that kind of started off this market change a few years ago in terms of being leaders relative to rates. So that's great to see. And the other point I would mention is -- and we mentioned it in the prepared comments as well. Business is just staying in the E&S market and with us for much longer. And that's extremely positive. We see it in our submission stats renewal submissions grew over 20% this quarter.

So that's a faster clip than last quarter and in line with quarters earlier in this hard market. So extremely beneficial to us. We quote roughly 90% of our renewals and bind a very high percentage of them, call it, high 70s, low 80 percentages. -- just given our familiarity with the risk. So those are multiples of our quote and buying ratios on new business. So it's a very -- having the increase in terms of the renewal ratios going up is just a very efficient use of our underwriters' time in terms of quoting renewals and, of course, an efficient use of our capital.

Operator

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

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

Two related questions. The ratio of net growth in excess and surplus went up on a year-over-year basis. So I was hoping you could talk about, I guess, what we're seeing now underlying trends in ceding commissions and maybe long-term thoughts on where net growth to trend?

Sarah Casey Doran
Chief Financial Officer

I'll start with that. Maybe Frank can jump in. I think it went up a point or two, Meyer, if I'm looking at that correctly. So not a big jump. And this is really just the sensitivity on where we're going to grow in any given quarter. I think in past quarters, for example, I think about our excess casualty line, that's about 1/3 of E&S. 2, 3 years ago, it was a much smaller percentage. So as that line has grown, it's pushed the ceding ratio up because that line is heavily reinsured. So if that doesn't -- that was really kind of outpacing everything. We're still seeing great growth and great rate in that line. But I think some other lines grew a little bit faster overall in the quarter. And with 13 underwriting divisions, different lines are going to grow at different paces in any given quarter. So that's just going to be mixed as to how we ended the quarter.

I would just kind of add, though, as well, those treaties are renewing in now kind of in the summer time frame. Those treaties and partners and structures have really been very much unchanged for many, many years at James River. So we are not expecting: A, big changes to any of those structures, or B, big changes to the cost necessarily. Clearly, it's a lifetime that we're working through that, but that's how we think about it. So on the ceded piece and on the cost of ceded, not expecting much, but it will depend on where we see the growth and where we see the rate to continue to grow the different divisions that, that will impact through the P&L, if that helps.

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

It does. Second question is the mix of earned premium -- sorry, I should say, net earned premium in Specialty Admitted, is the contribution to orders compensation changing appreciably?

Sarah Casey Doran
Chief Financial Officer

The contribution of net earned specifically that's your question. It was a little bit lower this quarter, just given that we've grown the fronting business, other parts of the fronting business around it, but I wouldn't say it's an appreciable change, and I'm not I'm not confident that, that's going to be the case as we look at a year from now or a couple of quarters from now. I think we want to remain pretty nimble in our ability to write that business as things change and as you know, most importantly, the growth in the fronting business can be pretty lumpy because it's so kind of-deal dependent, for lack of a better way to describe it. I think that's going to consistent.

Operator

We have a question from the line of Casey Alexander with Compass Point.

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

Just a quick question. How the Casualty Re was gross written of about $30 million versus $64 million last year. So obviously, you're bringing it down, as you said. How would you look at that gross written compared to how you expect it to play out during the year. Is that a fairly reasonable level of gross written for the balance of the year for Casualty Re?

Sarah Casey Doran
Chief Financial Officer

So for the quarter, it was about $30 million, as you pointed out there, Casey. That -- the first quarter is almost always our largest quarter for that segment, and it's the largest by a fair amount. So I would expect that to trend down pretty significantly over the course of the year because we are -- we've already said we're going to take $100 million out of the book on a full year basis. And the first quarter is the largest. So I think from here on out, you'll see smaller GWP quarters in that segment.

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

All right. Great. That's very helpful. Just one for Brett, what would you -- do you have what you would call sort of a normalized level for net investment income going forward? Obviously, a large contribution from renewable energy, what would you call a normalized level going forward? .

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

Yes. Casey, I think we break out the detail of net investment income in the earnings release there, our more stable part of the portfolio, reported a little over $13 million for the quarter. As Sarah mentioned, the renewable energy portfolio does bounce around quite a bit quarter-to-quarter. And she also provided some details in terms of reinvestment rates being higher than the existing portfolio yield. So the more stable part of the portfolio, the $13 million and change should trend a bit higher as we continue to reinvest the portfolio.

Operator

I'm showing no further questions at this time. I would now like to turn the conference back to Frank D’Orazio.

Frank N. D’Orazio
CEO & Director

Okay. Thank you. I want to thank everyone listening on the call for their time today and for their questions that we received this morning. To the employees of James River, thank you for your hard work and dedication in delivering our Q1 results, as I suggested earlier, it is certainly a very solid start to the year. I look forward to speaking with all of you again in a few months to discuss our Q2 results. Thank you, and enjoy your day.

Operator
This concludes today's conference call. Thank you for participating. You may now disconnect.