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JRVR - Q1 2017 James River Group Holdings Ltd Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Q1 2017 James River Group Holdings, 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, Mr. Kevin Copeland, Head of Investor Relations. You may begin your conference, sir.

Kevin Copeland

Thank you, Audey. Good morning, everyone, and welcome to the James River Group First Quarter 2017 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 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-Q and other reports and filings we make with the Securities and Exchange Commission. We do not undertake any duties to update any forward-looking statements.

With that, I will turn the call over to Adam Abram, Chairman and CEO of James River Group.

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

Thank you, Kevin. Good morning, everyone. Kevin and I are here with Bob Myron, our President and Chief Operating Officer; and Sarah Doran, our Chief Financial Officer. We're eager to get into our conversation prompted by your questions, but we thought I would start with a few preliminary comments. We enjoyed a very good quarter. Our combined ratio was 97.2%, with all 3 underwriting segments reporting profits from underwriting. And as many of you on this phone call know, profitable underwriting is the foundation stone of our company. And an accurate measure of combined ratio and strong returns from tangible equity are the 2 metrics, we think, most important in evaluating our results. Our annualized return on tangible equity for the quarter was 14.8% compared to 10.9% in the first quarter of last year. I'd like to thank all of our colleagues, for their attention to detail and hard work that allowed us to report these good results to you. Our combined ratio in the E&S segment is higher than it has been. Some time ago, we made a deliberate decision to grow the rideshare book within the E&S segment, knowing that it would cause the combined ratio in this segment to rise but believing it would help us drive return on tangible equity. We are, of course, aware of the general trends around Commercial Auto, and they're not good across the industry. However, the vast majority of our Commercial Auto business within E&S comes from approximately 50 transportation network company accounts, which are to be differentiated from traditional commercial auto, where trucks are the dominant risks. We have very little exposure to physical damage in this line. While this line is only a few years old for us, it is a relatively short tail business, and importantly, it fits our specialty focus. And our experience so far leads us to believe this is good business for us. An additional benefit of this new business is that it puts us -- permits us to put through work capital we've been holding in reserve for just such an opportunity, which is part of what is driving the strong returns on equity we're reporting this quarter.

Over the past 2 years, our operating leverage, meaning net written premiums to equity, have risen from 0.8:1 for 2015 to 1.0:1 for the 12 months ended March 31, 2017. While we take pride in our team's innovative approach to writing accounts in the new economy, our transportation network accounts are not the only area where our company is enjoying profitable growth. We continue to see more opportunities than ever in our core E&S book and submissions were up 10% this quarter in the E&S segment, core segment, compared to the first quarter of last year. These submissions are leading to new business. Our core E&S business grew by 11% compared to the first quarter of last year's. Rates in the core segment were 1.2% lower than in the first quarter a year ago, but we're satisfied these rates will generate our desired profit, and the combined ratio in this part of our business is consistent with our historical results in E&S. However, because of the large Commercial Auto premium book, our overall E&S combined ratio was 90.6%, up 4.7 points from last year.

In our Specialty Admitted business, our gross written premiums grew by 153%. Because much of this business came in our fronting division, net written premiums grew by a smaller but still impressive 38.4%. Regular participants on this call know of our emphasis on increasing fee income. We are reporting an 88% increase in fee income over the first quarter of 2016. Comparing this quarter to the first quarter of last year, the Specialty Admitted segment made a 1 percentage point improvement in combined ratio. Some of you will remember that we write a book of Workers' Compensation in this segment. We refer to this business as our direct Workers' Compensation business, and it continues to perform well. Rates are down, however, and we're watching this book carefully.

Our Casualty Reinsurance segment reported a 97.5% combined ratio, 1.7 points better than last year at the same point. Premiums in this division were higher than in the same period last year, and for the year, we anticipate only modest growth in Casualty Reinsurance.

So just summing up there, once again, all 3 of our segments made underwriting profits, and we're quite pleased by that news. A quick word about investments. Once again, our alternative investment portfolio has delivered solid returns for us. We allocated a small portion of our total portfolio -- roughly, it's about 5% of the total -- to alternatives. While these returns are lumpy, 3 of our past 4 quarters, returns from these investments have been significant contributors to our growth in tangible book value and income.

So in conclusion, we're growing on a number of fronts, some of which utilize more capital than others, all of which, we believe, are contributing to underwriting profits, and taken together, generating industry-leading returns on tangible equity. Any of our fellow shareholders, who purchased stock in our IPO in December of 2014, will likely have taken note that our dividends since the IPO equaled 1/3 of our tangible equity as of our initial public offering. This quarter, TBV, tangible book value, grew by 4.8% gross of our dividend. So we're off to a good start. We're very interested to know what's on your mind. Let's get started with your questions. Operator, who's up first?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Randy Binner with FBR.

Randy Binner - *FBR Capital Markets & Co., Research Division - MD, SVP and Senior Analyst of Insurance Research*

I do have a couple. So going back to the -- Adam's comments there on Uber being a combination of less property exposure and not being trucking, not seeing the Commercial Auto issues that are plaguing the Group overall, could you dig into a little bit more why we're not -- why you're not necessarily seeing higher loss activity at least versus your pricing? Because to me, intuitively, it seems that these are vehicles that are moving around a lot and have someone looking at an iPhone when they're driving. So can you just dig into that more so we can intuitively understand how that commercial class is different from a lot of other Commercial Auto classes out there?

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

Randy, first, I just want to make a point that it is 50 ridesharing transportation network accounts, and it's not a single account. You are correct, of course, that the Rasier account is the largest of all of those. The answer is, we're not absolutely certain why that's true. What we do know is that the reporting on this is very quick, that we've dedicated a really very substantial amount of resources, both human resources and intellectual capital, handling the claims in this area and to rapidly adjudicating and fairly adjudicating claims in this area. And the results have been good, but as to why these drivers do better than someone driving, say, a UPS truck, I can't tell you. I do think, if you just think about this kind of naturally, there are differences between your familiarity and the ease with which you can drive your personal vehicle in an urban setting and the ability to navigate a larger panel truck or a larger delivery vehicle through a crowded urban street, I suspect, while many people do work full days doing rideshare work, I also suspect that there are very large number of drivers who are doing this part-time, and perhaps, there are a little fresher when they do it. The bottom line is, we don't know. I can only speculate, and I can tell you what our results are to date. And we're happy, and we're satisfied with them.

Randy Binner - *FBR Capital Markets & Co., Research Division - MD, SVP and Senior Analyst of Insurance Research*

Great. And then just one more if I can. On the reserve release, it was a little bit lower than we expected in the quarter. But it tends to be lower in the front half of the year. Is there any color you can give us on kind of what accident years comprise and what [lines] comprise the release in the first quarter? And how we should think about the timing of reserve reviews we go through the year?

Sarah C. Doran - *James River Group Holdings, Ltd. - CFO*

Randy, it's Sarah. I think as is typical from what you've seen in this company, it is -- we are more heavily weighted to the third and the fourth quarter, because that's when we have our independent reserve reviews completed. So nothing atypical this quarter versus the first quarter last year. In keeping with our historical E&S business, those are older years, and we're not -- it's not been a routine of this company to release anything in the last few years and to kind of wait till the age is typical. So nothing different, difficult to keep the third and the fourth quarter.

Operator

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

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

Anything in the reinsurance book, any changes? I think earned premium is up this quarter. You've had some volatility on a quarterly basis in terms of written premiums. Should we still expect that, that's relatively steady? Or is that going to grow a little bit?

Robert P. Myron - *James River Group Holdings, Ltd. - President, COO and Director*

Yes, Mark, it's Bob Myron. So I think that, as I'm sure you know, reinsurance is a tough market right now and has been for some time. The space that we play in and what our guys are focused on is the proportional reinsurance market. The terms and conditions there seem to be holding pretty steady. And at least in the business that we write, which is really dominated by Excess and Surplus Lines type of business, the underlying rates continue to be pretty good. In fact, there was -- the underlying rates were up about 4% in that book of business during the course of the quarter -- this quarter over a quarter a year ago. So our guys down here on our small team is not charged with growth, but opportunistically, if they see a deal -- a small deal here and there, they have put it on. So we may see a little bit of growth in that segment once we get to the end of the year relative to a year ago. As you've pointed out, it obviously is lumpy. The team is really being charged with growth. It's more of just opportunistic of a small deal here and there that is -- that's causing what you're seeing.

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

On the E&S business, I don't know whether you've mentioned your submission flow, but kind of a sense on how that is looking. And then I think you've had initiative to try to refine your own internal processes to make sure you're getting it more of those high-quality submissions and making sure you're focusing on where the best prospects are. Give us updates there.

Robert P. Myron - *James River Group Holdings, Ltd. - President, COO and Director*

Yes. So submissions' flow, as it has been in the past, continues to be strong; measured Q1 versus Q1 a year ago, our submissions were up 10%. And it was pretty broad brush across the core E&S lines. We are getting a lot of looks from our broker partners. I think that, that is a combination of responsiveness, obviously, a low-rated company, good subject matter expertise, reasonable commission rates. And so we continue to see very good flow in that space, and so I think that's encouraging. And you can't make a perfect correlation between that submission flow and the numbers cited -- Adam cited. But as mentioned again, the core E&S written premium was up 11% in the quarter. So we're encouraged by continuing to see good business opportunities there.

Operator

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

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head, Global Insurance Strategist, and Senior Property Casualty Insurance Analyst*

A couple of questions here. Adam, I just want to follow up a little bit on this rideshare stuff. Just, I guess, a quick question would be, are you loss picks on your rideshare business up on a year-over-year basis? Or are they flat and simply this is just a mix-shift situation going on?

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

We don't break it down, Brian, by segment to that level of detail for our loss picks. The loss picks for Commercial Auto rideshare book are higher than our overall loss picks for the rest of our business. These numbers -- for the entirety of our business, these move around as we have both more experience in pricing changes. So Commercial Auto size of the account, consistency, profitability, competitive world that we live in has a certain pricing metric. We're very comfortable with where our pricing is. On this, it's an important new area of the economy to be involved in. And it's generating -- we believe it's generating acceptable underwriting profit to us.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head, Global Insurance Strategist, and Senior Property Casualty Insurance Analyst*

I don't doubt that. I'm sure it's incredibly attractive. Just trying to, like you said, dive into the increasing accident year loss ratios and the mix shift. How should I get that?

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

Well, remember, we have a long history of trying to be cautious in the early days of booking any policy in our system. And so if you were to look at us historically, you would see that current accident years for -- across our business, we try to put up at an estimate that is a good, solid, strong estimate. And we hope -- it's not a certainty by any means, but we hope that over time, with experience and good claims handling, we can bring that down. But we're approaching this business with the same methodology that we approach the rest of our business, knowing that it would take the entire E&S combined ratio up because of the nature of the business.

Robert P. Myron - *James River Group Holdings, Ltd. - President, COO and Director*

Brian, I -- just a layer into that. So the pick has always been higher. It's more dramatic now because of the waiting and how much more that has grown relative to the rest of the core E&S business, right? So it's obviously -- the accident year pick has been creeping up for some period of time for some number of quarters for that segment, and it's principally because it has been growing a lot more than that division has been in the rest of the segment.

Sarah C. Doran - *James River Group Holdings, Ltd. - CFO*

Right. And the only other thing I would add is, obviously, we go through annual renewals and pricing moves around as well. So it's not just the loss pick that's moving, it's pricing that's moving, too. So there are a number of different things you are feeding into that.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head, Global Insurance Strategist, and Senior Property Casualty Insurance Analyst*

Okay. All right. Great. And then second question, just curious, Workers' Compensation insurance, what's happening there within your Specialty Admitted segment?

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

So the direct book there, I think, if you just look at the public filing rates that we compare ourselves, I think, net pricing, you have to take the loss cost and you have to take the rates. So take those in combination. I think, overall, rates are down 10%, which is pretty substantial. We're watching it very carefully. I would say that our current experience in our book does not reflect in terms of -- we're watching claims very carefully, both arisings, frequency of arisings, severity, back to work, timing and percentages, medical cost, et cetera. And it does not reflect that numerical calculation, but that -- in other words, it's better than that numerical calculation. But our team is watching that in real time and with what I'll call a very experienced (inaudible). And we've got a lot of confidence in their skill set and their willingness to make appropriate adjustments very quickly if we see anything that gives us pause. Today, no pause.

Robert P. Myron - *James River Group Holdings, Ltd. - President, COO and Director*

So let me just add on to what Adam said. Remember that this is probably only going to be a $35 million to $40 million book for the full year. So it's a relatively small piece of our overall writings. And then just -- I totally agree we're seeing declining loss trends in terms of our own experience. The index loss costs -- sort of market index loss costs for the places that we are is actually down 5%. So while rates are down 10%, the index is down as well. So the margin compression is mid-single digits so to speak. And to us, that is still a healthy level of pricing relative to underlying loss costs. And so we think, overall, the margins remain good in that sense. So it's interesting, and I'm sure we're not the first person or group that has talked about that, that index is in many respects across the U.S., our pricing -- underlying loss costs are going down. And so we're seeing that as well.

Operator

(Operator Instructions) And your next question comes from the line of Meyer Shields with KBW.

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

On the (inaudible) companies, I guess, I want to ask you a question in a different direction. Are you seeing maybe the frequency of claims on a year-over-year basis level off, because all of the issues that sort of simulated higher-than-expected frequency over the past couple of years are either embedded in driving levels or starting to subside?

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

You're talking about in the Commercial Auto book?

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

Yes.

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

I don't think that we have seen -- look, the Commercial Auto book is growing, as you've noted, pretty considerably. So there are a lot more miles being driven, but I'm not seeing a trend of increase per mile driven that's causing us any concern. The book is a complex analyze though because there are big changes in states and territories simultaneously with this growth. You get different geographic concentrations that can make that a little confusing, Meyer. But, in general, claims per mile driven are fine and pretty consistent.

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

Okay. And then just briefly, when you have premium adjustments in Casualty Reinsurance, does that affect the segment loss ratio? I imagine it helps the expense ratio just because of volume. But I was wondering whether that matters to the loss ratio.

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

Well, we didn't comment on this, but the -- I don't think we've commented on this yet, but the underlying rates. And so this is another nice -- thank you for setting us up to say something nice about our Casualty Reinsurance business. The underlying rates that we're seeing from the (inaudible), and remember that, I don't know, 95%, 96% of that business is quota-share business, something like that. And the underlying rates on that business the (inaudible) are charging their customers are up this period. So that's very positive. I think they were up 3% or 4% this period. So that's a very positive thing, and it contributes to profitability and to -- it's not really contributing to growth, but is contributing to profitability.

Robert P. Myron - *James River Group Holdings, Ltd. - President, COO and Director*

To your question about premium adjustments, if we've got a premium adjustment through -- from 2 years ago with respect to a treaty that's fully earned, we would book a commission expense on that but not an increase to the loss ratio, right? The increase in the earned premium would not increase the losses so to speak. And you could have some benefit that could fall to the bottom line. So positive premium adjustments on fully earned contracts are definitely positive there.

Operator

I'm showing no further questions at this time. I would now like to turn the conference back to Mr. Adam Abram, Chairman and CEO.

J. Adam Abram - *James River Group Holdings, Ltd. - Chairman, CEO and Chairman of James River Group, Inc*

Well, we thank you. Thanks to all of our colleagues, once again. Thanks to our shareholders and to those of you who follow our company. And we look forward to speaking to you next quarter, if not before.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation, and have a wonderful day. You may all disconnect.