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JRVR - Q2 2016 James River Group Holdings Ltd Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the James River 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, Adam Abram, Head of Investor Relations.

Kevin Copeland - *James River Group Holdings, Ltd. - Head of IR*

Thank you, Caitlin. This is actually Kevin Copeland. We will hand it over to Adam briefly. Good morning, everyone, and welcome to the James River Group second-quarter 2016 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 the forward-looking statements in yesterday's earnings release and the Risk Factors section in 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 Adam Abram, Chairman and CEO of James River Group.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Thanks, Kevin. And welcome, everybody. I am here in Bermuda today with Bob Myron, our President and COO, and Gregg Davis, our Chief Financial Officer. I am going to have just a few brief remarks and then we are anxious to get into a dialogue with those of you who may have questions.

We had a strong and very straight ahead results this quarter that I think reflect the enduring earnings power of our franchise. So we were really pleased. Here are a few of the indicators that came through to us and that we look at in analyzing the quarter and that give us a feeling of real strength about our earnings and the potential for our Company.

Our earnings per share are up. Our combined ratio is down. We reported redundancies at all three of our segments, our underwriting segments and their reserves. Our very profitable E&S segment grew by 26% in the quarter compared to the second quarter of last year.

Fee income in the Group, which you know we've been emphasizing, doubled from $3.3 million in the first six months of last year to $6.6 million in the first six months of this year and some more about that in just a second.

And then finally, another thing we were looking at is that pricing is steady and loss trends remain benign. So we feel confident about the future profitability of the business we are writing.

Another indicator that we are very proud of is that A.M. Best recognizes the consistency of our earnings and our operations and the strength of our balance sheet by awarding us an A rating. And that was announced last week and we are very pleased about that. I think that will certainly help us in our fronting business and our reinsurance business.

It is a nice recognition and a good validation for both of those parts of our operation. I will say though that we were doing just fine with our growth and underwriting profitability sporting the A- that we have had since inception, but we are very glad to have that A.

Just another little point of clarification before we get to questions. If you read our financials, and I am sure many of you on the phone have, you might get the impression that we are shrinking our third-party reinsurance business. But the apparent decline is not really so.

We book 100% of the expected premium from a reinsurance contract when we book the contract or when we renew the contract. And so, a delay in a renewal or a push out of a contract from 12 to 15 months can create some volatility in reported gross written premiums. But we actually expect that gross written premiums in the reinsurance business will be flat across the year.

I want to talk a little bit, I mentioned fee income and so I would like to talk just a second about that. We signaled during our last earnings call that we thought 2016 would be the year in which we showed substantial progress in our fee business.

And so, I am really, really pleased to report that in the last month our specialty admitted segment signed a fronting transaction which we expect to generate between $6 million and $7 million in fees over the course of a year.

Now that estimate is based on $200 million in gross written premiums in that program during the year; our net retention is very modest in the program. This is a book that we have seen before as a reinsurer and we are very happy now to be the fronting Company and to take a small piece of the risk in that.

Based on the first couple of months our production and our history with that we believe we will be on track to achieve the estimated gross written premiums and the fee income.

However, for friends on this phone call who are working on Excel spreadsheets with models of future earnings, let me remind you that these fees will be earned over 24 months. And so -- and that the $6 million to $7 million in fees that I mentioned will be spread out over a long period of time.

But it is an indication that our fronting and fee generation business is taking off, it is another indication of that and we are proud of it.

So, given the strong top and bottom line we have had this quarter, as well as what we see in the pipeline, we remain very pleased and optimistic about our prospects. And we're anxious to get to your questions about the business. And so, operator, Kevin, let's open up the line and take questions from people who might have them.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Charles Sebaski, BMO Capital Markets.

Charles Sebaski - *BMO Capital Markets - Analyst*

Just I guess E&S -- really nice quarter. Just appreciate any additional color on some of the submission flow. If there is any insight on where it is coming from. If there is any geography skew and if that is something you think in the current market is just going to continue on for you guys.

I mean, I think double-digit submissions and quoting. There is no abnormality; this was just a particularly strong quarter. Is this something that you expect to continue at this pace, is that reasonable?

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

I think we feel really, really good about the leading indicators we are seeing in E&S. And I don't like us to make too far out projections in terms of market conditions because they can change.

But I want to emphasize that we think our relationships with our wholesalers are really strong. Submissions, as you noted, Charles, are up -- they are up really across the board in most of our divisions. And we are writing more business.

Let me give you an example. I don't think we mentioned this because, believe it or not, in our Allied Health division, I think we were up 9.4% in that division and it didn't even make the list of the top income lifts that we had there.

But there we are seeing small care homes, larger skilled homes coming in, more healthcare, there are more people who are ill or elderly or just for some other reason need home healthcare and we are insuring the companies who provide that.

And so, there is a division, not huge premium but it is up 9.4%. We mentioned of course our manufacture and contractors division, we mentioned commercial auto. We have become in hired and non-owned auto -- so, if you have someone who is engaged in transportation on your behalf using their vehicle we become a go to market for that. And I think that we are really seeing an awful lot of that business across the board.

Now we wouldn't have seen it if we hadn't built the infrastructure to handle that business really efficiently. We have made a major investment and had great success by doing that and commend our leadership in Richmond for the great job they have done of driving that business for us. But that is really a big business.

Small business is up. So I am trying to give you a sense that this is broad and it is deep. And we don't see a diminution in the flow. Small business, submissions were up 60%, the volume is only up 20% to 25%. But that will show you. We think more business is flowing into the E&S business than is leaving it.

Now we know that others are commenting about competition they are seeing from admitted markets. But remember, we only write casualty, we are not on the property side of this account. We do write some property but it is -- our emphasis is 97% to 98% casualty. And those casualty accounts are coming in.

Let me give you another example. There have been significant construction of condominiums and apartments in New York, New Jersey, Alabama and Georgia. And there we have seen those markets have been well priced and we have been able to go in those markets. We are not writing the property, we are writing the liability in those complexes and that has been another really nice growth area for us.

So it is broad, it is -- we see it continuing and we feel really -- we feel very positive. And we like the pricing on it quite a bit. And some of these are complicated classes. And we have added a lot of underwriters who are skilled, by the way.

If you are on this phone call and if you have someone in your family, a young person in your family, bright, talented person, we are recruiting. So, send them our way. So very positive from our point of view. Bob, did you have anything?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

No, I wouldn't add anything to that.

Charles Sebaski - *BMO Capital Markets - Analyst*

Excellent. And just for confirmation. For this growth in E&S you guys haven't changed your risk appetite? This growth hasn't come from putting down bigger lines, from changing your historic view on risk in these lines of business?

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Absolutely not. We are always tweaking our policies to reflect the reality or new opportunities. But our risk appetite is constant.

Charles Sebaski - *BMO Capital Markets - Analyst*

All right. And just a couple quick numbers questions. Corporate and operating expenses ticked up a little bit year over year. Is this $5.5 million level is kind of viewed as a run rate going forward?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Well, let me first just talk about the uptick. It is really more related to personnel cost than anything else. And just as we have grown we have got a few more people from a headcount perspective at corporate. We have had to build an internal audit team, for example.

The other thing is that naturally of course with another year under our belt we had another round of equity grants in February. And as a result of that you have got expense associated with -- some expenses associated with those grants and you have got expense associated with the grants that were made in the IPO date.

So, that is really the biggest piece of that. And I would say that the -- it is likely more of a run rate for the year. Obviously that could change again next year with another set of equity grants. But overall of course the expense ratio on a group wide basis is down 2.4 points in the quarter. So we have certainly been able to stomach the increase, so to speak.

Charles Sebaski - *BMO Capital Markets - Analyst*

All right. And the I guess going along with that, Bob, on the expenses for the E&S, the step down to roughly 21% in the quarter, down meaningfully from last year. This just growth related -- I mean even from last quarter down. Is this at your current pace and size due to growth in this business? Do you think, is this a 21% to 22% run rate expense business or is there some unusualness in this quarter?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Well, as you know, we don't provide guidance specifically on expense ratio either for the Group as a whole or by individual segment.

But to answer the question, the story of the segment is really the story of the whole group, which is that that continues to decline not only because of scale, and we think we are in a nice position from a fixed cost leverage perspective. But also because the fee income growth and the fee income of course is meaningful in the excess and surplus line segment. We book that as a reduction to the expense ratio.

So, good scale and then improving fee income. Obviously back to the scale, that segment had 34% growth in net earned premium. And so, while there are obviously variable expenses such as brokerage and other things that come along with that growth, we know that we have great leverage with respect to systems and claims and other fixed overhead that is pretty powerful.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

One example of that is that in the most recent quarter our ratio of policies bound to quotes was as good as it has been since the first quarter of 2015. And that is a combination of growing experience, systems, relationships with the agents and just growing more efficient in the way that we are processing this slew of submissions that we are seeing. So very positive from our point of view.

Charles Sebaski - *BMO Capital Markets - Analyst*

Excellent. And then just one final one. Does the -- Bob, do you think the -- does the A.M. Best rating upgrade in the quarter help at all from debt cost prospect? I mean, is there ability to lower or refinance existing debt or is that just kind of comfortable where it is?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Yes, so it doesn't in terms of the in force debt, it doesn't make any -- make for any specific changes, for example, for the spreads on the trust preferred debt or on our bank facility or anything like that.

We like the cost of the debt that we have in place currently and a fair amount of it is of course -- I think what we would think about as the junior subordinated stuff for the trust preferred that was issued a long time ago and is pretty deeply subordinated and has a very reasonable cost and we get good equity credit from the rating agencies.

I don't -- that window to issue new debt there or refinance that is really not open right now. But certainly if we were to consider something more in the senior debt space of the bank loan space in a new issuance or rolling something over it probably would help a little bit on the margin. But I don't -- in terms of the impact it would have in the near-term on our interest expense, I think it is negligible.

Charles Sebaski - *BMO Capital Markets - Analyst*

Excellent. Thanks a lot for the answers, guys.

Operator

Mark Hughes, SunTrust.

Kevin Elliott - *SunTrust Advisors - Analyst*

Hi, this is actually [Kevin Elliott] on for Mark Hughes. You talked a little bit about fees in specialty admitted. I was wondering if you could look at E&S. Do you expect that the kind of move along at the same level? Are you pursuing more outsourcing of claims there? Just a little more color on that, please.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Kevin, let me make sure that I understand that you are asking whether we are outsourcing claims in E&S or whether we are earning fees off of the claims activity? I guess it is the latter, yes?

Kevin Elliott - *SunTrust Advisors - Analyst*

Yes.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Yes. Well, what is happening is that we do earn fees for handling claims for which we have no liability associated with the claim and we earn fees for that. And that is generating part of that fee income for us and it is a business that we are constantly working at becoming more efficient in and it is generating good revenues and it is part of the drive down of the expense ratio in that segment. We very substantially expanded our capability in that area.

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Yes, and I think you may have also been asking about the trajectory of them. And I would think that as we continue to grow relationships and continue to do the servicing that the modest growth trajectory that we have had on fees in that segment can continue.

I think we have got a little bit more fee income than we did in the first quarter. So, on a sequential quarter basis, and obviously a bit more than we had a year ago.

Kevin Elliott - *SunTrust Advisors - Analyst*

Right, okay. Makes sense, thank you.

Operator

Christopher Campbell, Keefe, Bruyette Woods.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Congrats on the quarter. My first question is on the casualty reinsurance premium growth where you guided towards kind of a flat growth rate year over year. Given that you are only at half of year-to-date levels, how should we think about the earnings for that second half of or the premium growth for the second half?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

So, Adam mentioned in his comments that we expect by the end of the year gross premiums written will be about the same as the prior year plus or minus probably a little bit.

Because of the timing of it, timing of the production there could be a small decrease in net earned premium and the segment for the year. It won't be -- we don't have an expectation that it will be huge, but definitely could be $5 million to $10 million.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Okay, thanks. And my second question is on the strong fronting and program growth in specialty admitted. Where are you seeing this demand come from? Like what types of customers or product lines are you seeing increased demand for?

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Well, primarily right now it is casualty-related business. Workers comp is the area where we are seeing the most submissions right now but it is also in commercial auto, it is also in general liability lines. So it is across the book. We have not done any significant property fronting.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Okay. And do your retentions vary for each of those lines? Because you do --?

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

They do.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Okay. Perfect. And then --.

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

But generally as mentioned, they are quite low. On certain relationships we may have a 5% retention, we may have a 10% retention. We are not retaining most of the risk whether it is in fronting or programs.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Programs, right.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Okay. And just a follow on question on the E&S progress. So as Charles mentioned, the expense ratio was down pretty significantly. But the core loss ratio was also up 200 bps year over year. So, is there any pricing adjustment that is happening in that segment for the scale advantages you are starting to see?

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

No, as I mentioned, we think pricing is flat and loss trends are benign. But this really has to do with the methodology that we have used for 15 -- for a long, long, time -- for years and years and years, which is let's build a strong balance sheet that we have ahead level of confidence in and let the facts emerge over time.

So we put up using our methodology, we put our reserves that we think are prudent. And if you look at our combined ratios, accident year combined ratios expressed over time you will see a remarkable consistency even as we have also enjoyed a long, long many, many year string of reductions in our calendar year loss ratios because of reserve for leases from prior years.

So for example, I was looking last night -- we reported a accident year combined ratio at June 30, 2015 of 100.2 compared to 100.1 today. And for the quarter -- the second quarter of 2015 we reported a calendar year -- I'm sorry, an accident year combined ratio of 100.2 versus 100.1.

So we are really very consistent about the way and the methodology we use to develop our conservative, we hope, or prudent balance sheet and let the facts emerge over time. And that has worked really well for us and we expect it will continue to work well for us and well for our investors.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Gray, that is really helpful. And then just finally a very macro level question just with some market rumors out there. Are you seeing any just more chatter on like specialty M&A?

There has been things out there. So I'm just trying to see if that is becoming more of an interest possibly, what is happening at Lloyds, or any just background or color you could give on that would be great.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

I have never been through a period of time in 30 plus years when there wasn't a lot of chatter about this combination or couldn't we imagine that combination or what. And so, it seems like a constant to me. And we are really focused -- very focused on building the business, serving the customers. We don't get too wrapped up in the background noise associated with that.

I'm probably reading the same things you are, that Brexit or interest rates in Asia or other world macro conditions are going to lead to M&A activity or not. But we are just really focused on building the business. It doesn't feel to me like it is different than it has been at many times (multiple speakers).

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Okay, so it is roughly constant. So you are not (multiple speakers).

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Yes.

Christopher Campbell - *Keefe, Bruyette & Woods - Analyst*

Not a dramatic improvement, okay. Well, great. Thanks for all the extra color and best of luck on 3Q.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Thank you very much.

Operator

Brian Meredith, UBS.

Unidentified Participant

Good morning, this is Mike on for Brian. I have got a couple questions. Last quarter you provided guidance for the year in terms of 12% or better return on average tangible equity and combined ratio between 92% and 95%. Are you still on track to hit these targets or have they become a bit more difficult to achieve?

And then as a follow on, I know you briefly touched on this before, but the companywide underlying loss ratio ticked up during the quarter. Do you expect that to be more consistent going forward?

And then lastly and more broadly, could you discuss competition across the segments and how that is impacting rates? Thank you.

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Well, this is Bob Myron, why don't I take the first one which -- sorry, remind me what that was again? Oh, with respect to guidance.

There is no change to our guidance, I guess by being silent we were in effect suggesting that there is no change. And I rethink our plan would be to give it in February once a year and if we don't comment on it then there would be no change.

With respect to the change in the loss -- I think you said the underlying and I think you mean the underlying loss ratio. I would default back to what Adam just said in answering the previous question. I think, unless you are asking a different question, I think that probably answered it pretty comprehensively.

And then do you want to take the last one, Adam, the third one? I think it was a question about competition.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Yes. Look, it is a competitive world, but we are growing with flat rates and we see plenty of opportunities and we are taking advantage of those. We feel like across the board the rate per unit of risk, if you assemble the whole portfolio, is pretty constant and we like that and we are growing. So we are getting more of it.

This is a competitive industry, it always is a competitive industry. But right now in this period of low interest rates when people can't reasonably look themselves or their investors in the eye and estimate long series of earnings off of reserves at a high yield rate, I think the discipline in the industry is pretty decent.

And meanwhile the E&S segment, which represents the overwhelming majority of our total premium because you have to add the E&S business that we write in our reinsurance segment in when you measure this. The E&S segment is enjoying continued growth and really good profitability. So, don't feel at all squeezed and just to the contrary, we feel very optimistic.

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

And let me just add to that that in a rate environment that we think is good and rates are flat and with benign loss trend the scale benefit that we are getting with our growth and the lower expense ratio makes us feel good about the existing margins that we are getting. And that the fact for us the margins can improve because of that expense scale.

So, we think that this is a good environment to be continuing writing business, in particular excess and surplus lines business at these prices given our expense efficiency.

Unidentified Participant

Great, thanks.

Unidentified Participant

Great, thanks.

Operator

Alex Combs, FBR Capital Markets.

Alex Combs - *FBR Capital Markets - Analyst*

Mostly asked and answered at this point, but I guess if you could talk about reserves quickly. Redundancies continue to be strong in the E&S segment this quarter. Can you give any color on what accident years or classes you are saying redundancies in here?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Sure. It is pretty spread out, there wasn't one year in particular where there was a huge movement in reserves from an accident year perspective. And so, it was I think 2009, 2010, 2011, 2012, 2013, 2014 and no one year was particularly large when we look at the group as a whole. So we were pleased with that.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

And it is back ended. You might want to just talk about the approach to reserving generally being back in the second half of the year.

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Yes, generally, as you may know, we, in conjunction with having third-party actuarial studies done in the third and fourth quarter, we have a tendency to wait until the latter half of the year to give consideration to potentially larger reserve releases as a result of that.

We have always guided to the last two quarters of the year potentially having higher underwriting income than the first. And so -- than the first couple quarters in the year. And that is the case in any period and it was the case in our actual results in the prior year.

Alex Combs - *FBR Capital Markets - Analyst*

Okay, understood. And then a pretty diverse spread across the various underwriting divisions within E&S as well?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

Yes, I would say that it was. Nothing jumped out in terms of different divisions. I mean we do have a tendency to focus very much on the accident years, but there is also a divisional analysis. And I don't think that there was anything that was -- any wild swings or significant swings between divisions.

Alex Combs - *FBR Capital Markets - Analyst*

Okay. And then sticking on reserves and jumping over to the casualty reinsurance segment. The past few quarters we've seen some adverse development here and in this quarter we actually saw a redundancy come through. So how should we think about this going forward? And anything in particular that drove this redundancy?

Bob Myron - *James River Group Holdings, Ltd. - President & COO*

I will just point out that we have got favorable development on a year-to-date basis as well. I think that it is several things. I think we have got a new team of people that have been on board in our reinsurance segment since 2012 and we have been really pleased with how they have priced and underwritten the business.

The underlying business has been moved to more of a specialty focus. Obviously there is a significant amount of excess and surplus lines in there with a focus on general liability. The underlying pricing for the business and, as you know, is 95% plus quota share. The underlying pricing has been pretty good over the last few years.

And so, we think that it is a situation whereby we have had several years of a new team with improved underwriting and improved underlying rates, [2011] and prior is farther away in the rearview mirror. So, we feel better about the reserve position there than we would have a few years ago. And that's been manifested in the results that we have seen in the reserves.

Alex Combs - *FBR Capital Markets - Analyst*

Okay, great. Thanks for the answers. That is all I have.

Operator

(Operator Instructions). Mark Hughes, SunTrust.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Good morning, Mark.

Kevin Elliott - *SunTrust Advisors - Analyst*

Sorry, this is Kevin again. A quick follow up on the increased submissions. Do you see those coming in as more of a -- from existing relationships or are these new relationships coming on?

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

These are existing relationships where we are working very hard to make sure that they're deep. And we do from time to time add relationships, but we have very broad relationships with the wholesale brokerage community. We are -- by the way it is worth noting that we are completely a wholesale market in the E&S side of that business.

And those relationships are deep and they are broad and we work very hard. Our team in Richmond and their offices in Arizona and Atlanta worked very hard to service that business efficiently for ourselves and for the brokers. And it pays off in terms of increased submissions and deeper penetration. And so, we are very appreciative of those partners and proud of what we are doing together.

Kevin Elliott - *SunTrust Advisors - Analyst*

Great, thank you so much.

Operator

We have no further questions at this time. I turn the call back over to Adam Abram.

Adam Abram - *James River Group Holdings, Ltd. - CEO & Chairman*

Thank you, Caitlin. And thank you, everybody, who participated on the call. And we look forward to further communications with you and appreciate the support for our Company. Thank you and we will speak soon.

Operator

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