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PRESENTATION

Operator

Thank you for holding, and welcome everyone, to the James River Group Third Quarter 2022 Earnings Call. (Operator Instructions)

It is now my pleasure to turn the call over to Brett Shirreffs, Head of Investor Relations. Mr. Shirreffs, please go ahead.

Brett Shirreffs - *James River Group Holdings, Ltd. - Senior VP of Finance, Investments & Head of IR*

Good morning, everyone, and welcome to the James River Group Third 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 of 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.

In addition, during this presentation, we may make reference to non-GAAP financial measures such as adjusted net operating income and adjusted net operating return on tangible common equity. Please refer to our earnings press release for a reconciliation of these numbers to GAAP. Lastly, unless otherwise specified for the reasons described in our earnings press release, all underwriting performance ratios referred to are for our business that is not subject to retroactive reinsurance accounting for loss portfolio transfers.

I will now turn the call over to Frank D'Orazio, Chief Executive Officer of James River Group.

Frank N. D'Orazio - *James River Group Holdings, Ltd. - 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 additional color on our third quarter results as our focus on underwriting profitability and disciplined risk management continues to drive our results through the first 9 months of the year. The combination of strong underwriting margins and growing investment income resulted in a third quarter group combined ratio of 94.1% and 91.5% excluding the impact of catastrophe losses as well as an adjusted net operating return on tangible common equity of 17.5% for the quarter and 16% on a year-to-date basis.

As I've repeated before, generating consistent returns for shareholders is our ultimate focus and our enviable expense ratio of 24.6% for this quarter continues to shine through in our results. In a quarter marked by significant industry catastrophe activity and volatile investment markets, we believe we've posted very compelling results. Overall, market conditions remain broadly attractive with E&S renewal rates up 8.4%, very much in line with the positive rate change we recorded during the same period last year. On a year-to-date basis, rate increases in our E&S segment stand at greater than 10%. And over the last 23 quarters, our renewal rate increases have compounded to 61.5%.

As noted in the past, headline rate changes or excuse me, headline rate change figures will vary from quarter-to-quarter based on mix and other factors, but continue to be well ahead of our plan and our view of loss cost trends across the vast majority of our portfolio. I would note that most of our underwriting units, including general casualty, excess casualty, excess property, Allied Health, Environmental and Sports & Entertainment continued to achieve rate increases in the high single and low double digits during the third quarter that the majority of our E&S premium formulas are revenue rated, providing us meaningful inflation protection. While rate versus loss trend dynamics certainly remain positive and bode well for future margins, our underwriting culture remains highly disciplined and bottom line focused.

During the end of the second quarter, we introduced new underwriting directives and increased pricing strategies in discrete areas of our underwriting portfolio, primarily aimed at large trucking and transportation risks in our excess casualty and commercial auto portfolios and in certain states in our general casualty unit. As a result of these actions, our gross premium E&S declined 5.9% from the prior year quarter as we nonrenewed several large dollar accounts that did not meet our new profitability thresholds. We've continued to experience strong submission activity, particularly in our renewal portfolio and our conversion ratio on those submissions has remained very strong.

Despite the underwriting actions that I've referenced, aimed primarily at larger insureds and premium items, our E&S segment still increased our policy count by 7.3% in the quarter. From a profitability standpoint, I believe replacing larger insurers with smaller accounts, the lifeblood of James River is generally a very good trade. Also notable from a portfolio management standpoint, net written premium in our E&S segment increased 10.2% during the third quarter despite the slight reduction in gross premiums, partially driven by our midyear decision to increase our net retention by 10 percentage points on our excess casualty business, a historically profitable line for River where renewal rate increases have compounded an ex 100% over the last few years.

Notably, the combined ratio in the E&S segment was 88.2% during the third quarter or 84.6%, excluding catastrophes, both impressive and consistent results. While Hurricane Ian was a significant event for the industry that will have lasting effects on certain segments of the market, we have again benefited from carefully managing our property catastrophe exposure and related volatility as property remains a small portion of our portfolio. Net catastrophe losses during the third quarter were limited to the $5 million retention under our catastrophe treaty and were primarily related to the excess property division of our E&S segment. As such, we expect losses from the event to be contained in the third quarter.

Also during the quarter, shareholders benefited from the legacy commercial auto loss portfolio transfer transaction that we executed last September. Recent claims data for this portfolio has shown adverse paid loss trends, which drove an increase in our gross loss expectations, highlighting the value of our recent strategic actions and focus on enterprise risk management.

As a reminder, the LPT provides unlimited coverage for the subject portfolio. And as a result, we do not expect to have any economic impact from the increase in gross reserves. While the existence of the LPT does create some accounting administration and intermediate volatility that Sarah will explain in more detail, the bottom line is that the LPT covers future development on this transferred portfolio. In the remainder of our business, reserve development overall was modestly favorable, driven by releases from our Specialty Admitted segment, while E&S and Casualty Re were generally flat.

Turning to results in Specialty Admitted. For the third quarter, we reported 1.8% growth in gross premium and a combined ratio of 98.4%. We continue to feel the effects of the competitive workers' compensation market as premium for our individual risk portfolio and large California workers' compensation program were down a combined 4% compared to the prior year. The remainder of our fronting and program business reported premium growth of 5.1% in the quarter or 19.2%, excluding a program partner that was acquired late last year, which is approximately in line with trends over the last few quarters. Fee income of $5.9 million was up 5.5% compared to the prior year quarter.

We also increased the current accident year loss pick for individual risk corporate compensation portfolio in the quarter in recognition of both rate pressures and recent accident year loss activity. The year-to-date loss pick is representative of our view of the business and is yet another example of how we react quickly to developing trends to make sure we're maintaining a strong reserve position. We also experienced modest favorable reserve development in the quarter, primarily from our workers' compensation business across several accident years dating back to 2016 and consistent with favorable industry experience for the period.

In Casualty Reinsurance, we remain on track to deliver on the plan we discussed earlier in the year to optimize the portfolio while significantly reducing its size. I'm pleased that the segment was again profitable and reported a combined ratio of 90.9% with no reserve movement, resulting in $3 million of underwriting income. While gross premium for the quarter increased significantly on a year-over-year basis, this was largely due to premium adjustments on the existing treaties and the effective date extension of another client.

For the full year, we still anticipate reducing our top line by approximately $100 million relative to 2021. To sum up our results, I'm extremely pleased that all 3 of our segments have once again produced an underwriting profit for the quarter, and our investment income continued to grow at a strong pace. We remain very well positioned to take advantage of growth opportunities in the core markets while maintaining our discipline and focus on risk management. Our earnings potential is clear, and we believe the outlook for James River is very strong.

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

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

Thanks, Frank, and good morning, everyone. James River is reporting another solid and consistent quarter characterized by our year-to-date annualized adjusted net operating return on tangible common equity of 16%. Once again, our return accelerated meaningfully from the first quarter of this year. I'm going to spend a moment providing a high-level overview of the performance of the quarter and then come back to highlight the very significant benefit we realized from the commercial auto loss portfolio transfer restructured about 14 months ago and how this materializes in our numbers.

But first the quarter, we're delivering $15.5 million of adjusted net operating income and moving further to the back half of the strong 2022. This included $11.3 million of underwriting profit and $17.3 million of net investment income on a pretax basis. Net investment income grew 18% from the sequential quarter. Our competitive expense ratio of 24.6% improved from that last quarter and continues to be a meaningful advantage we enjoy as compared to our peers and the sector generally. As mentioned earlier, investment income was $17.3 million this quarter. We continue to benefit from improved yields in the portfolio, including both higher new money yields on fixed maturities and higher base rates in our bank loan portfolio.

Income, excluding renewable energy and other private investments was $17.7 million as compared to $13.5 million in the prior year quarter. Overall, our book yield on the portfolio improved approximately 20 basis points sequentially and was approximately 3.1% during the third quarter. Portfolio duration is 4.2 years, and it's remained stable. We expect that 20% of our existing portfolio will have the opportunity for reinvestment or reset over the next year. Cash flow from operations continued to be strong at $28 million this quarter and about $170 million year-to-date. Reinvestment yields in the core fixed income maturity portfolio averaged 4.75% during the third quarter and have moved above 5% during October. The combination of strong operating cash flow and rising reinvestment yields positions us well going forward. Realized losses were about $7.8 million this quarter, largely due to our high-grade preferred stock portfolio, which we continue to hold.

In total, our equity, which is largely preferred and bank loan portfolios represent about 12% of our portfolio, including cash. Like others, AOCI declined $60.7 million during the third quarter, largely on par with that during the second quarter, just given the interest rate moves. As a reminder, we tend to hold substantially all of our fixed income maturities in an unrealized loss position until they mature and average credit quality of the fixed income portfolio remains A+. We ended the quarter with tangible common equity of $330 million, intangible equity of $475 million, which includes the Series A preferred we issued during the first quarter. The decline was driven by the third quarter rise in interest rates, particularly towards the long end of the curve. But excluding the impact of AOCI, our tangible equity totaled $650 million at the end of the quarter, and we feel this is a more meaningful representative representation of our capital position.

So moving on, second and arguably more importantly, I wanted to review the very meaningful benefits of the runoff commercial auto reinsurance transaction we negotiated and completed in September of 2021. These came to bear in a very substantial way on the current quarter. Taking a step back, claims on the runoff commercial auto book have been paying off fairly quickly. And given paid loss trends, we experienced adverse prior year development on the portfolio of $46.7 million this quarter. Recall that these reserves are fully subject to the loss portfolio transfer, so we'll have no economic impact on the company over time.

Also, because the agreement is unlimited and does not have a cap, any potential future increase in loss reserves would also be subject to the agreement and similarly would have no economic impact. In terms of our GAAP results, under retroactive accounting, we are required to recognize 100% of any adverse development related to the covered liabilities in our GAAP net income. This will create and does create some volatility in the GAAP financial statement. This quarter, given the pace at which claims have been paid off on the portfolio, $25.9 million of that adverse development was offset by a recovery. That leaves the remaining $20.8 million of the reserve increase to flow through the financials in losses and loss adjustment expenses of the consolidated income statement without an offsetting recovery this quarter, and that will create an additional liability on the balance sheet.

Importantly, or most importantly, this impact is temporary. The $20.8 million deferred gain is on our balance sheet will earn into our financials according to the time line at which the claims are paid which, as I mentioned a moment ago, is a reasonably short time line for this type of risk. So that will effectively reverse out a meaningful component of this period's GAAP loss over future periods. But as I referred to above, and as Brett also referred to earlier, all profitability ratios and operating income figures are not subject to the retroactive reinsurance accounting.

In conclusion, James River ended the third quarter in an excellent financial and strategic position. We're very well positioned from a reinsurance and risk management point of view, and we have ample capital to operate in the current environment. And most importantly, we continue to see very attractive opportunities to invest and continue to scale our company.

So with that, I'll turn it back to the moderator to open up the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mark Hughes with Truist Securities.

Michael John Ramirez - *Truist Securities, Inc., Research Division - Associate*

This is Michael Ramirez on for Mark Hughes. First what will be the impact on future quarters, your decision to not renew certain businesses? And will there be more quarters that include pressure on this growth?

Frank N. D'Orazio - *James River Group Holdings, Ltd. - CEO & Director*

Mike, I'm sorry, the last part of your question was what?

Michael John Ramirez - *Truist Securities, Inc., Research Division - Associate*

Sure. I apologize. And will there be more quarters that include pressure on growth?

Frank N. D'Orazio - *James River Group Holdings, Ltd. - CEO & Director*

Okay. Sure. So let me first of all, thank you for the question. Let me take a step back and just talk a little bit about what we did and then we can talk about what I think you're getting at is relative to future impact. So first and foremost, the underwriting culture at James River is really a strength of the company. And we will remain bottom line focused. So even in this period of strong market conditions, you need to remain vigilant. You need to underwrite because it's not a foolproof business. So we regularly review the portfolio to make sure we react quickly to any emerging trends that we see in our loss data as well as any changes that we might see in the broader competitive landscape.

Again, we actually grew the net premiums in the E&S by 10%. We increased our policy count by over 7%, but the decline in E&S gross premium that I think you're referring to, it was primarily a result of a few discrete underwriting actions both underwriting and pricing actions that we took in select underwriting units, primarily in general casualty, commercial auto and some parts of general casualty as well. The end result of those actions resulted in us not renewing some large dollar items of the 7-figure variety. Most of them larger trucking or auto exposures, primarily impacting excess casualty.

Let me talk a little bit more about the actions that we took. So we really have strengthened the feedback loops that we have in place between underwriting, claims and actuarial. We saw what we identified as some loss drivers in the sectors, and we addressed them. So we acted upon what we saw and we moved on. It's not a long-term ongoing project. We made some tactical adjustments and now we'll continue to monitor and remain vigilant. And just to give you some additional perspective of all the underwriting actions we took, the biggest impact on GWP in the quarter were a handful of the large trucking or transportation accounts, again, in excess casualty, happen to be 7-figure premium items, but trucking overall accounts for less than 5% of that excess casualty portfolio.

And $1 million premiums are very rare in the segment. I think it kind of gets to what you were looking for. We've got roughly 32,000 in-force clients across all E&S and only a few dozen have premiums of greater than $1 million. So we're talking about 10 to 1% of our counter in that kind of premium range. So in all these cases, we believe the action that we took will help us maintain strong margin in the segment. And this is really the discipline that you should continue to expect from us. At the end of the day and really at the expense of oversimplifying matters, we're very comfortable with the market conditions and the rate environment. We grew our policy count to smaller insurers.

And by taking a tougher stance in a few of these areas that I just talked about, we ended up not renewing a couple of large trucker accounts. So in terms of what's the carryover relative to future growth? Or do I see that changing. Again, we had a concentration of these large premium items that were impacted by the underwriting actions that we took in Q3. I've looked at our large dollar items from the current quarter.

I don't see that same type of concentration. We've got less than 40 accounts in force overall, a greater than $1 million in premium for the entire segment. And we don't write large trucking risk in our commercial auto unit and the sector really accounts for less than 5% of the excess casualty book. So please appreciate we've got a very limited view in terms of what fourth quarter production looks like, but I'll leave you with this. October has gotten off to a good start and much more in line with the production that we've experienced the rest of the year.

Michael John Ramirez - *Truist Securities, Inc., Research Division - Associate*

Okay. Thanks for the extra detail on the end market lines of business that are expected. Maybe just a quick follow-up on that. How much of the decision to nonrenew these businesses, the ones you just spoke about the line was based on market conditions versus your own sort of internal evaluation of your past underwriting?

Frank N. D'Orazio - *James River Group Holdings, Ltd. - CEO & Director*

Yes. No, it's a good question, Mike. Again, I'll come back to my earlier comment about the feedback loops in terms of picking up some trends that we're seeing in the data and what drivers of loss activity are and spending time between underwriting, our COO, our claims department and our actuarial group and kind of breaking down what steps and actions we thought were prudent. In some respects, it's changing some of your underwriting guidelines and others, it's just about pricing changes. So I would say it's based on what we saw in the market, and we pretty quickly implemented them. And to my earlier point, this isn't like a long gone out process that we expect to be ongoing. We saw something we reacted to it, and we took the steps that we did.

Michael John Ramirez - *Truist Securities, Inc., Research Division - Associate*

All right. That's helpful. Maybe one last one for us, and we'll go back in the queue. We noticed the current accident year loss ratio in E&S was up about 1 point sequentially. Are you putting up more reserves in light of your updated evaluation of the attractiveness of these business lines you've been writing?

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

No, Mike, that's really this is Sarah Doran that's really just a mix. I think within 100 basis points of E&S that things are going to move around as we look at business that we're renewing and taking on in any given quarter. So there's no different look as regards our accident year loss picks in E&S, our current year pick. It's really just mix coming out and kind of proving through that 100 basis point data.

Operator

(Operator Instructions) James Bach with KBW.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

So just kind of working off that last question. Can you kind of describe within that 90 or 100 basis points kind of what is causing the erosion in core loss ratio in E&S. And at the same time, what's kind of causing it in specialty admitted, which you also saw kind of a worsening in the core loss ratios?

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

Sure. Just going to largely repeat myself on E&S, it's mix. Certain lines have certain loss picks just for the budget for how we kind of go through any renewal and certain lines grow at different paces over the quarter. So again, there's nothing specific with regard to changing our PICCs and E&S. It's really just a question of what we renewed and what we put on during the quarter. With regard to specialty admitted, I think what's fairly clear is both in the top line as well as in the loss ratio is that a decent portion of this segment is related to the workers' comp market.

And in this quarter, in particular, we have a fairly small but concentrated individual risk workers' comp book, mostly concentrated in a handful of Southeastern states and others, and we took up the current year loss pick in the quarter. So by taking it up in the quarter, reflecting over the full year, you're going to feel it a little bit more in the quarter. So that's where you see the delta and the accident or loss ratios in that segment. I think at the same time, so why did we do that? Really, we just haven't seen the pricing come through in that line. And I don't think we're alone there with regard to kind of how states have looked at workers' comp rate increases. So we've seen some of our outlook there. And obviously, our top line has been fairly small in terms of growth and even shrinkage over the course of the year as we've tried to manage the conditions in that business.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

All right. Perfect. And also, there was a pretty meaningful increase in the net ratio of net to gross in E&S, and I wanted to know if that reflects any onetime items.

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

It's really what Frank referred to in his good color on underwriting appetite in his prepared comments and that we changed the retention in our excess casualty reinsurance treaty. That's a treaty that renews midyear as the treaty that the company has had in place for many, many years. It is very attractive to us. It's always had a high ceding commission, and our reinsurers have enjoyed the benefits of our strong underwriting for our excess casualty business in particular.

So we had the opportunity to renew that, the same pricing in terms and conditions. But we really just given our outlook on that business and the consistent performance, underwriting performance, in particular of the portfolio, we wanted to increase our retention there. So you really see that in E&S that bumped the retention 10 points quarter-over-quarter. And again, that was a midyear renewal.

So I would think about that E&S premium retention right now is about 69%. That's likely the number that carries through, just given the change in that treaty, and that will continue for the next few quarters. So we think that is good trade to just keep more underwriting income given the really attractive conditions and the way that book has performed.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

And broadly speaking, which lines net premium retentions are rising?

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

Yes, it's excess casualty. Like we said, it's just excess casualty. It's 1/3 of our business in E&S. It's grown the fastest. It's had a rate increase of over 100% in the last few years. It is a treaty that just relates to that excess casualty book. So as you've seen excess casualty grow in the last few years, you've seen that retention come down because of that treaty, which again has been stable and always in place. Now we're changing our retention to basically that's a better way to describe it, keep more of our underwriting profits there. And so that's the line that will be impacted, and that's the history and the rate strength as to why we decided to do that.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

All right. And then kind of concerning the loss picks, how are you has James River currently being medical inflation? And how has that kind of evolved?

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

It's certainly something that we're watching very, very much. So we certainly think that I think it shows up more for the personal lines. And obviously, it's been a theme for some of the more concentrated personal lines writers, Hard to think that it would be at some point, have a little bit of a presence in our workers' comp business and potentially other lines. But right now, we're not seeing a big delta with regard to this dynamic across our business, not in a way that's really changing our loss cost trends or focus on loss costs there.

Frank N. D'Orazio - *James River Group Holdings, Ltd. - CEO & Director*

Yes. And just to maybe tack on some additional comments there. I think we probably were more concerned about that coming directly out of COVID. And it hasn't proven to be as significant as an issue, maybe a couple of months or so in terms of what we've seen. That's kind of our view on it. I think it's less about medical cost inflation. It's more as a dynamic in the workers' comp field to monitor is just the impact of the fantastic improvements that are being made in medical technology and the fact that folks are surviving some pretty brutal accidents. So that's an issue that we obviously watch closely, but probably something that we're seeing more versus a concern with medical cost inflation.

James Paul Bach - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

I just have one last question. I just wanted to just get some explanation behind the kind of elevated tax rate this quarter.

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

Yes. Happy to take you down there. But at the end of the day, our tax rate, like any multinational company is a little complicated just given where we earn income. And I think you're probably focused on the operating income tax rate, which obviously we pay taxes based on net income, and it's implied back through operating income. And if you look at what's excluded through operating income, obviously, the deferred gain is a significant piece as well but I think the most important piece that I would highlight there is we focus on in the transcript, it's about 30% year-to-date. We expect the year to end up that way.

Why is it higher than statutory rates because we've -in the first quarter, as we were structuring kind of the impact of the casualty reinsurance LPT. We did have a loss in Bermuda, and that's that really kind of tips that over, so to speak. So that's how I think about our tax rate on a net income basis. I think if you do the math, it's a 26% tax rate on operating earnings, which again is not how the tax rate is actually calculated, but it implied math that falls out of that calculation from net income. And I don't think we have a reason to think that, that number is anything abnormal compared to the quarter that we just reported. That helps you kind of project it going forward.

Operator

Casey Alexander with Compass Point.

Casey Jay Alexander - *Compass Point Research & Trading, LLC, Research Division - Senior VP & Research Analyst*

As you mentioned, there's been a little bit of a slowdown in the specialty admitted sort of growth rate. I'm curious what the opportunities are for additional fronting arrangements that could sort of accelerate potentially improve the underwriting ratios and accelerate the fee income growth?

Frank N. D'Orazio - *James River Group Holdings, Ltd. - CEO & Director*

Thanks for the question, Casey. So no, we still feel that we've got a great opportunity. We've got a robust pipeline in terms of new opportunities.

We've added several new programs over the course of the year that will get traction through the remainder of this year and into next year. But our pipeline is full of different programs across a number of different product lines. As you might imagine, one of the downstream impacts of these favorable market conditions is the creation of MGAs. And so we see opportunities for both existing as well as new MGAs and the programs that they represent. So we still think we've got some growth runway there. I mean some of the growth over prior, as you probably appreciate, is impacted by the fact that one of the fronting partners was particulate last year. And so that's maybe not coming up as a true growth number. But otherwise, we feel we've got plenty of opportunities there to grow the business.

Operator

There are no further questions at this time. I would now like to turn the call back to Frank D'Orazio for closing comments.

Frank N. D'Orazio - *James River Group Holdings, Ltd. - CEO & Director*

Thanks very much, operator. I want to thank everyone listening on the call for their time today and for the questions we received this morning. We look forward to speaking with you again in a few months to discuss our Q4 results. Thank you, and enjoy your day.

Operator

This concludes the James River Group Third Quarter 2022 Earnings Call. We thank you for your participation. You may now disconnect.