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PRESENTATION

Operator

Good day, everyone, and welcome to today's -- and welcome to the James River Group Q1 2023 Earnings Call. (Operator Instructions) And finally, I would like to advise all participants that this call is being recorded. Thank you. I'd now like to welcome Brett Shirreffs, Head of Investor Relations, to begin the conference. Over to you.

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

Thanks, and good morning, everyone. Welcome to the James River Group First Quarter 2023 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 results -- 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 and other reports and filings we have 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 reference non-GAAP financial measures such as adjusted net operating income, underwriting profit, tangible equity, tangible common equity and adjusted net operating return on tangible common equity.

Please refer to our earnings press release for a reconciliation of these numbers to GAAP. A copy of which can be found on our website at www.jrvrgroup.com. Lastly, unless otherwise specified for 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 Dâ€™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 joining you today to provide additional color on our strong first quarter results, while also sharing some thoughts on market conditions and growth opportunities for our company. The results we released last night demonstrated a continuation of the positive momentum we established 5 quarters ago as we delivered another strong quarter of consistent mid-double-digit returns on tangible equity. We delivered impressive premium growth in our flagship E&S segment in concert with solid underwriting profitability and a meaningful increase in our investment income. Additionally, our shareholders continue to benefit from the strategic actions we executed in prior quarters to protect our balance sheet. All in, we produced adjusted net operating income of $21.6 million our highest quarterly total in more than 3 years. Our adjusted net operating return on tangible common equity ex AOCI was 16.3% in the first quarter, which is consistent with the guidance we provided on our fourth quarter call and by all means a very strong result.

Tangible common equity per share increased 15% from year-end 2022. In short, we are off to a very strong start to the year. As I have frequently commented, our focus remains on producing consistent earnings and returns for shareholders, and I believe we're delivering on that objective. We are also experiencing numerous positive developments throughout the organization that inspire confidence in our future, whether through investments in technology to amplify our efficiency and growth or our plans to further diversify our E&S product offerings. The momentum we are seeing in the market reinforces our decision to focus our resources on the core strengths of our business. We believe our franchise has a few public company peers relative to its concentration of [inaudible]Â business, and we remain optimistic about the outlook for James River and confident in our ability to produce returns in line with our expectations as we've now done for the last 5 consecutive quarters.

Turning to the market for a moment. During the first quarter in our E&S segment, we were pleased to achieve renewal rate increases of 8.9%, which was almost 250 basis points higher than the rate change we received in Q4 2022 and moderately higher than the prior year quarter. Further support that demonstrates the strength of the market conditions in our core product lines and reaffirms our view that we are achieving rate increases ahead of our view of loss trends as well as the assumptions in our business plan for 2023. As many of our peers have discussed, pricing in the property market led the way during the first quarter. Our excess property book experienced renewal rate increases of 45%, while all of our remaining underwriting units achieved positive rate increases in the first quarter, with the vast majority of our E&S segment reporting increases in the high single or low double-digit range.

As we have noted in the past, headline pricing metrics will fluctuate from quarter to quarter, but I'm encouraged by the breadth of the market strength to begin the year, particularly after 25 consecutive quarters of positive rate, now compounding to upwards of 68%. These conditions continue to support our outlook for profitable growth. Looking at our E&S results more closely, gross premium written increased 12.1%, while net premium increased 17.3% during the first quarter. Submission activity remained strong and increased year-over-year for both new and renewal submissions while our policy count grew by 13%. The combined ratio in E&S was 86.8% during the first quarter, and we reported $20 million of underwriting profit for the period. Our combined ratio increased 3 points from the prior year quarter, with approximately 2 points of this driven by the change in our retention in the excess casualty unit and its impact on the expense ratio. Our accident year loss ratio increased 1 point from the prior year quarter. Much of this increase is related to business mix, but we also continue to be patient and reflecting the rate increases we have achieved at our initial loss picks.

We believe we are prudently building an attractive reserve base for the future. From a commercial auto standpoint, we did recognize $41 million of adverse prior year development on the business subject to the commercial auto LPT that we put in place during the third quarter of 2021. We believe the development is fully covered by the LPT, which has been provided without an aggregate limit. Overall, E&S has had a great start to the year with strong top line momentum and a continued focus on profitability. Just as importantly, we remain excited about the market opportunities for the business going forward. Moving to the Specialty Admitted segment, gross premiums written were down less than 1%, while net premium increased 32%. On a gross basis, our workers' compensation premium declined 7%, while the remainder of our fronting business grew a little bit more than 2% as fee income increased by 3% relative to the prior year quarter.

In workers' compensation during the quarter, we saw some stabilization in rates in our individual risk unit with pricing up 1% while rates in our California workers' compensation program continue to experience more pressure. The market remains competitive, and we have proactively reduced these portfolios as a result of our pricing and underwriting discipline. The increase in our net premium this quarter is due to a change in the reinsurance structure on January 1 was in the primary layer of our individual risk book. While we have a long track record of profitability in this business, we will continue to actively manage the portfolio to navigate changing market conditions and ensure long-term profitability. In our fronting business, we continue to have an active pipeline of opportunities in front of us, while several of our existing programs continue to gain scale and push rate increases. During a period where the reinsurance market has tightened for new programs and operational issues have been exposed at several competitors, our focus remains on underwriting profitability and tightly managed collateral and security requirements.

Turning briefly to our Casualty Reinsurance segment, JRG Re, the results this quarter reflect earned premium on in-force treaties that were written in prior years as well as $10 million of premium adjustments recorded in the quarter. These adjustments are on plan, but a normal occurrence in our business and are generally earned as written. The segment reported a small underwriting profit during the quarter despite some modest reserve strengthening. Reserve movements have added to a few small changes in IBNR on older accident years. We also experienced some development on treaties that are subject to the casualty re LPT totaling $7.8 million. At the end of the first quarter, we had an aggregate limit of $51 million remaining on the Casualty re LPT.

To summarize, our first quarter 2023 results further demonstrate the strength and earnings potential of our franchise as well as the underwriting culture we have worked to develop and enhance over the past 2 years. We are thrilled to be back on our front foot with a refocused energy, expanding our valuable and unique franchise through attractive market conditions and select new products. We will continue to deploy our capital where we have the most confidence in generating consistent profitability and attractive returns for shareholders. The E&S market continues to show signs of strength, and we remain very excited about the opportunities ahead of us. And with that, let me turn the call over to Sarah.

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

Thanks very much, Frank, and good morning to everybody. Thanks for joining us today. We're starting out the year in a very strong financial position, a continuation of our powerful momentum these last 5 quarters. This quarter, we're reporting adjusted net operating income of $0.56 per share, an increase of over 50% as compared to the prior year quarter. Tangible book value per common share increased 14.7% from last quarter to $10.91, carrying strong momentum forward into 2023. We are delivering $21.6 million of adjusted net operating income this quarter, which included $10.6 million of underwriting profit and $25.8 million of net investment income, each on a pretax basis. For the quarter, adjusted net operating return on tangible common equity, excluding AOCI, was 16.3%, as Frank mentioned, an increase of over 60 basis points from last quarter and over 230 basis points from the full year 2022, including AOCI. Our annualized return moves from 16.3% to 22.5%.

Our expense ratio for the quarter was 28.4%, in line with what we cited from this year during our earnings -- our last earnings call in February. Our expense ratio was higher from a year ago for 2 primary reasons. Most impactfully, as previously discussed, we decided to increase the retention in our excess casualty line within E&S. That line represents about 1/3 of the segment. We did this at midyear last year by reducing the quota share we purchased by about 10%. This is a line that's taken on about 135% of cumulative rate over the last 6 years, roughly double the increase that we've seen in the full E&S segment. We believe this is meaningfully in excess of our loss costs. And given our long and positive experience in this line, we wanted to retain more of our underwriting profits. In the meantime, this will mean less of an expense offset in the form of reduced overall seeding commissions. Second, and to a much lesser extent, given the amount of earned premium in the segment, the changes we made to our reinsurance structure within our Specialty Admitted segment at 1/1 will have a similar impact of reducing seeding commission and its result in reduction of expenses. Taken together, these 2 items increased the group expense ratio by about 2.5 points compared to the prior year quarter, in line with what we discussed back in February.

Turning to investment income. As mentioned earlier, the level of NII was a second consecutive record this quarter at $25.8 million. It grew 12.9% from the sequential quarter and 58.4% from the prior year quarter. Reinvestment rates moved higher with interest rates. We've had strong cash flow, and we also continue to benefit from the opportunistic sale of a portion of our renewable energy portfolio, which we announced last quarter. Approximately $1.2 million of this total NII is related to the sale of 2 of our renewable energy investments above carrying value. Reinvestment yields in the core fixed income portfolio averaged 4.8% during the quarter, and we continue to see rates in excess of our average 3.9% book yields. I would note that our reinvestment rates were higher during the fourth quarter of last year, above 5%. So we've kicked down a bit during the first quarter. The combination of our growing base of invested assets, natural portfolio turnover and exposure to floating rate assets positions us well to continue to deliver strong NII. I would note, however, that we trimmed a bit of our bank loan portfolio during the quarter, given the strength in that market earlier in the year, and we've also seen reinvestment rates move a little bit lower to 4.5% during April.

Altogether, with the $1.2 million nonrecurring gain in our renewable energy portfolio, this is an exceptionally strong NII quarter. Let me take a second now to just make a few comments on investments given recent economic and market events. We continue to maintain our conservative approach to our investment process, and our portfolio remains high quality with an average credit quality of A+. Our overall exposure to banks is about 10% of invested assets and the majority of that is in G-SIFIs. We have no exposure to Silicon Valley Bank Signature or First Republic Bank nor exposure to contingent convertibles. Our exposure to regional banks is less than 2% of our invested assets and is in high-quality names. Finally, regarding our tax rate. Our tax rate for the quarter was 24.6%, and as always, is impacted by the geographic location of profits across our business. We do expect our effective tax rate to be modestly lower than it was this quarter on a full year basis.

We're off to a great start in 2023 and continue to see very attractive opportunities to invest and continue to scale our company. So with that, I'll turn it back to the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Brian Meredith.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head & Global Insurance Strategist*

A couple of questions here for you, Frank. The first one, maybe talk a little bit about your business mix in the E&S business and the growth you're putting on there, particularly when it comes to the excess property business, geographically, where is that business? Is it cat exposed? Is this something we should think about going forward with James over the maybe given the opportunity in that market, you may have a little bit of more cat volatility in your results? Or am I thinking that the wrong way?

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

Sure, Brian. Thanks for the question. So let me talk first, I guess, just more broadly about the opportunities that we're seeing, and then I want to address your property question more specifically. So we saw very healthy growth opportunities across most of our UNS platform during the first quarter. with the majority of our underwriting divisions, reporting solid growth and all divisions reporting positive renewal rate changes. We also saw continued strong growth in renewal submissions. In particular, they were up 8%, while new submission activity also showed growth. I would say that most of our underwriting divisions have experienced continued renewal submission growth in our 3 largest divisions, excess casualty, general casualty and manufacturing contractors all experienced renewal submission growth of more than 10% with General Casualty coming in above 20%. We saw a similar dynamic from a policy count perspective across the segment. Policies in force increased nearly 13%, as I said earlier. That was led by Excess Casuality that was up 19%. General Casualty also up 19% and manufacturers and contractors, up 17%. And we would expect to see these trends continue certainly through 2023.

From a gross premium standpoint if you want some of our larger unearned visions experienced strong growth like Excess Casualty, which is up 16%, manufacturers and contractors, which was up 18%. And we also saw some growth in some of our smaller underenunits like small business, up 14.5%. Fortune Entertainment, up 23.1%. And maybe to your point, excess property, which grew 68.6% with most of that coming from rate. The first quarter, just relative to your question on property, the first quarter has historically been a quarter where we've seen growth opportunities in property, and that was very much the case in Q1, '23. As I suggested, premiums were up significantly due to very strong rate increases. Although premiums were up almost 70%, they were off of a relatively small base in comparison to the segment. So we wrote $16.5 million of GWP in excess property. That represents about 7% of our E&S premium and less than 5% of the total group premium.

Policy count actually declined 7% from the prior year quarter. So this is a market where you can see some significant growth based on rate but not necessarily increase your exposure all that much. And we're not expecting to make any significant changes for our appetite for property exposure. We have a continued focus on our target classes and achieving meaningful rate increases. So again, market is definitely facing capacity stress. I expect we'll see some growth around the edges there relative to premium volume, again, driven by rate. In terms of the portfolio and location from a risk. So I would say cat exposed Southeast and Gulf Wind, we see some Texas wind, to a lesser extent, in California and Pacific Northwest quake. But as I said, policy count is actually down. We are not putting on commensurate exposure with the premium increase that we're seeing. And our attachment strategy hasn't really changed. Quite frankly, we were at year-end 2021. I want to say, attaching on average at about $33.2 million. I think that moved down $1 million as of year-end '22. So staying the course, if anything, probably being more selective, just relative to the industry classes that we're pursuing.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head & Global Insurance Strategist*

That was helpful. And then my second question, just pivoting over to the Admitted Segment, 102.3% combined ratio. Is that a level of the combined ratio that you're kind of comfortable with? Are you in the acceptable return on capital above 100 combined ratio in that segment?

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

Â So Brian, what I'd say is on a calendar year basis, the Specialty Admitted Segment has generally had a long track record of profitable results, which has been aided over time by favorable reserve development. We have a strong team leading this business, and they've carefully managed the top line through the cycle. We obviously can't control what happens in the market, particularly in the workers' comp market, but we can actively manage our portfolio and navigate market conditions. And that doesn't end with some decision that we make on a reinsurance structure. So longer term, we certainly expect the business to continue to be profitable. So fundamentals, as you know, Brian, it's 2 separate business units. The fundamentals of the workers' compensation market are challenged right now, but the fronting program business does provide some nice balance for our E&S segment based on the strong fee income and the capital light structure of the segment.

Operator

Your next question comes from Meyer Shields.

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

First question, I don't know if this is for Frank or for Sarah. But based on the evolution of business mix, specifically, I guess, the growth was in excess casualty, is the duration of your liabilities and therefore, the duration of your investment -- targeted investment portfolio changing over like the last 2, 3 years?

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

I don't think so, Meyer. I think most of our E&S book is longer duration business and our portfolio -- our investment portfolio has had a duration of around 4 for quite some time. I don't think we feel like we need to manage the asset liability mix exactly with the business mix. But I think we're very close and continuing to grow in excess casualty, which is now 1/3 of the book as we've said, is probably making it a little bit longer, but I would say it's largely a rounding error compared to the rest of the business mix in the segment.

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

Okay. Understood. And second question, I guess, when I look at either the net underwriting expenses or the expenses gross fee income in specialty admitted, they're up something like 20% on a year-over-year basis. And I was hoping you could talk through what's driving that and whether we should expect that growth to profit.

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

Â Sure. And you're just focused on the underwriting -- the net underwriting expenses in specialty [inaudible], just to be super clear on your question, right?

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

Net or growth. So we're seeing similar growth rates.

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

Yes, yes. I mean I think much of it is really just due to the change in the reinsurance structure that we mentioned, not having the quota share at 1/1 on the workers' comp business that was providing a significant amount of offset towards expenses in that segment in the form of the ceding commission. And I think you'll -- that will continue to, call it, grade down as the business earns in over the next couple of quarters. So we certainly had some contribution from ceding commission in this first quarter, but I think there will be less of that going forward, considering that was a 1/1 nonrenewal. So that's really the biggest dynamic, I think. There are small things around just regular G&A, but it is really being driven by the change in the reinsurance structure. And you see, to some degree, an offset there in the form of a loss ratio and some of the structure that some of the structure contributes as it kind of feeds into some other components of that. And of course, the increase on the net overall just given that we've moved away from that structure.

Operator

Next question comes from Tracy.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

Sticking with the expense ratio, I'm just wondering a lower ceding commission was that considered in your 28% guidance for the year? Or is that something you may want to revisit as we go through the remainder of the year?

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

No. When we -- when I gave that guidance in our February call, Tracy, and thank you for the clarifying question of around 28%, and we consider the 28.4% around 28% that we delivered this quarter. So the change in the reinsurance structures, both that we've mentioned, were incorporated in that guidance.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

Â Perfect. And I also realize it's tough just to completely exit business. I did see you had some gross written premium in your reinsurance business this quarter. How should we think about that through the course of the year? Is that something where we could expect that to go closer to 0 in the near term?

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

Yes, that's a great question. I appreciate you clarifying that. We had about $10 million of audit premium -- premium adjustments in that line this quarter. So that's what you're seeing. Otherwise, the business is effectively grading down through the suspension of underwriting activities. I would say that premium adjustment, premium driven by premium models, et cetera, are very consistent thing in that business for us, for anyone. And those are coming from multiple treaties, multiple lines, et cetera. I would say it was a little bit -- and we don't typically budget those because you don't have line of sight into them. And they're also earned as they're written, so they're having really an immediate effect on the quarter. I would also say that $10 million is a little higher than it has been in previous quarters as well. Again, there's really no pattern to it. It just happens as a normal course of the business. So I would expect and we have expected that the top line that there's little to no GWP, NWP and then the earned continues to grade down as I think we've said, but just to take a moment to clarify the business that we write in that segment does earn over a multiyear period. So we certainly were expecting earned premium in the segment to continue for the year, but the gross and the written, I think those are entirely -- or no, those were entirely driven by the auto premium adjustments.

Operator

(Operator Instructions) Your next question comes from Mark Hughes.

Mark Douglas Hughes - *Truist Securities, Inc., Research Division - MD*

Sarah, the ceded premium in the E&S, it's 36%. I assume that's influenced by mix. Is that a good run rate if excess casualty continues to grow more quickly? Will that grade up over time?

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

I think that's a good run rate, Mark. I think we would expect kind of a similar mix as we look at the balance of the year and certainly in our plan, we do. But we speak a little bit out of both sides of my mouth. Certainly, given rate and dynamics every quarter, it can bump around. But I think that's a fine assumption. There's no other kind of one-off or anomaly that I'm seeing in the quarter that would make me give you different advice.

Mark Douglas Hughes - *Truist Securities, Inc., Research Division - MD*

Â Yes. And then the -- in specialty admitted, earned this quarter around $21 million, your gross written has been relatively stable. If one were to assume it was to remain stable with the earned also remained stable at about $21 million. I'm just trying to understand the relationship between the written and earned more clearly. Would that be the case?

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

I think that's right. It's -- the relationship should be pretty straightforward. I think there -- we certainly would expect and hope to continue to put on new programs as we did this quarter. But I think that you know that those will -- those develop in terms of premium impact, they can develop slowly as they come online.

Mark Douglas Hughes - *Truist Securities, Inc., Research Division - MD*

Â Yes. A question for Frank. Is this the right growth rate in this environment of low double digits is a very healthy growth. I know you've been bringing in new people. And I think your appetite around what you retain and what you write has been maybe evolving over time. Does it feel like with what you're seeing with submission growth, with the book of business you're finding attractive that's in front of you? Is this a sensible growth rate for you? I'll ask it that way.

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

Yes, Mark, thanks for the question. I would say that we're very pleased with the growth opportunities that we see in front of us. We're pleased with where the rate environment is across the portfolio, and we are starting to think about broadening out our product set and diversifying it and we announced a new initiative over the course of the quarter. So I'd say that growth rates will fluctuate, obviously, from quarter to quarter. But given where the rate environment is right now, we feel comfortable with the current rate.

Operator

(Operator Instructions) So there are no further questions at this time. I turn back the call over to Brett.

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

Actually, I'll take that. 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 just a few months to discuss our second quarter results. Thank you, and enjoy your day.

Operator

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