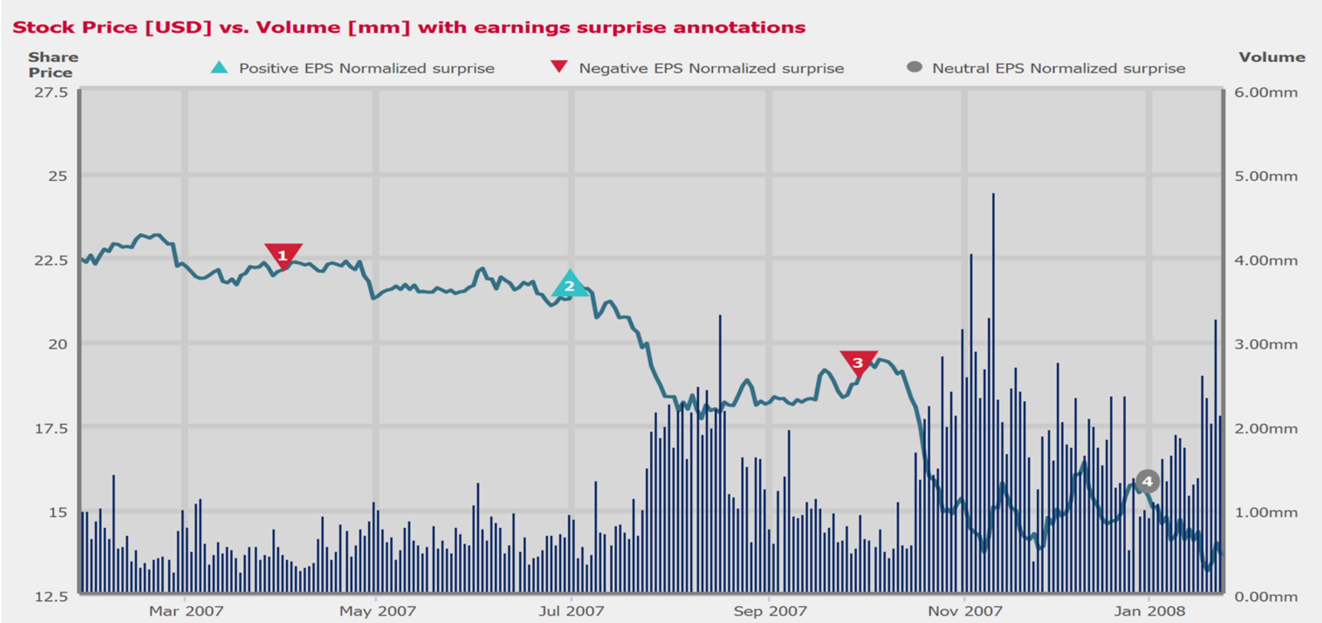
S&P Global
Market Intelligence

Old Republic International Corporation
NYSE:ORI
FQ1 2008 Earnings Call Transcripts
Thursday, April 24, 2008 7:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ1 2008-			-FQ2 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.02)	(0.08)	NM	0.03	0.18	0.92
Revenue	-	-	▲(2.39 %)	-	-	-
Revenue (mm)	973.95	950.70	-	1020.70	3994.37	4096.80

Currency: USD
Consensus as of Apr-14-2008 1:01 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2007	0.48	0.45	▼1 (6.25 %)
FQ2 2007	0.45	0.49	▲2 8.89 %
FQ3 2007	0.39	0.11	▼3 (71.79 %)
FQ4 2007	0.09	0.09	4 0.00 %

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EXECUTIVES

Aldo C. Zucaro

Christopher S. Nard

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ANALYSTS

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KeyBanc Capital Markets

Kevin Preloger
Perkins, Wolf, McDonnell and Company LLC

Michael E. Santelli
Allegiant Asset Management

Unidentified Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Old Republic International First Quarter 2008 Earnings Conference Call. Today's conference is being recorded. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session and instructions will be provided at that time for you to queue up for your questions. As a reminder, this conference is being recorded.

And now at this time, it's my pleasure to turn the conference over to Leslie Loyet of the Financial Relations Board. Ms. Loyet, please go ahead.

Leslie Loyet

Thank you. Good afternoon and thank you all for joining us today for Old Republic's conference call to discuss first quarter 2008 results. This morning we distributed a copy of the press release and hopefully you've all had a chance to review the results. If there is anyone online who did not receive a copy, you may access it at Old Republic's website at oldrepublic.com or you may call Liz Dolovar [ph] at 312-640-6771, and she will send you a copy immediately.

Before I turn the call over to Al Zucaro, Old Republic's Chairman and Chief Executive Officer, please be advised that this call may involve forward-looking statements as discussed in the press release dated April 24, 2008. Risks associated with these statements can be found in the company's latest SEC filings.

With that, I'd like to turn the call over to Al for his opening remarks. Please go ahead.

Aldo C. Zucaro

Thank you, Leslie, and good afternoon. And well, here we are for another one of our latest earnings reviews and I'm sure that if you’ve read or listened to our last report and telephonic meeting in January of this year when we covered year-end 07, I'm certain that this particular call will or probably read and sound like deja vu all over again as Yogi Berra once said.

Everyone of our business segments, large, medium and small, performed just as we anticipated late last year, as we were putting the final touches on Old Republic's 2008 operating budget. So, to get the ball rolling on this visit, then let me just say a couple of things about those businesses, to add little more color as we usually try to do, and add that color to what we’ve put into writing in this morning's release.

Starting with the smallest segment, which in our case starts at the bottom of the ladder, namely life and health operations, which we have been combining in the corporate and other section of our consolidated report. These lines continue to produce a nice, steady bottom-line profit for us. Most of what we write in this small segment is made up of travel accident, occupational accident and intra-system, annuities on closed liability insurance claims, as well a continuing run off of term life insurance products that we started to write in the US and Canada back in the 1970s, and have since have put into a run off mode about four years ago.

Of course, the small scale of this life and health business for us can produce some volatility year-to-year, but we nonetheless believe that this business is a long-term keeper for us, and as much as it does allow us to utilize its features in certain pockets of our general insurance lines such as workers’ comp and as I mentioned before the related line of what we refer to as occupational accident.

Moving up the ladder a little bit to our Title insurance line, it did exactly what we thought might happen at least for the first half of this year, which is as far as we have able to see with reasonable clarity. As we said many times over the years, the Title business is of course driven by the yin and yang of transactions volume on the one hand and the control of production and operating costs on the other hand. As you know, it's not a claims intensive business, so the name of the game is production and expense control.

It's interesting to put the business in perspective. This morning I put some numbers side-by-side here. Our operations reached an all-time high, both as to operating revenues and earnings in 2003. That was a high water mark for us. And with the exception of an uplift in 2005 when we and the rest of the title industry experienced a temporary new lease on life, if you will, by virtue on higher refinance activity during that period, we've been pretty much heading south fairly steadily since 2003.

Of course, our direct operations, as we’ve said on several occasions now in the large western states, large metropolitan areas in particular, have that to contend with some pretty dramatic or radical housing downturns from what were relatively long periods of pretty heady performance. And while we've managed to reduce our nationwide employee count by about 24%, almost 25% through year-end 2007 versus a roughly 22% decline in operating revenues since 2003, the expense reductions obviously are still not enough to provide a softer landing for this segment's bottom line.

So, at this juncture we're still pretty much in the stands of holding the fort until we've favored with greater housing activity on the national scale. In this regard, we’re still of a mind that not very much positive is going to happen until late 2008 or spring of 2009 when all the band aids that are being applied by the Fed and the Treasury and the intercession of various community and consumer groups takes hold and hopefully has a beneficial effect on the housing sector. As we said before, the title part of our business is likely to turn up before our mortgage guaranty line, but we still feel that the turnaround will come in small increments rather than being throttled into high gear very quickly.

We think that the synopsis of our mortgage guaranty performance and that was included in this morning's release as well as the statistical exhibit that's attached to that release, we think that it touches all the hot buttons that are currently pushing claims to higher levels. So, I won't bother repeating what most everyone has already read and digested since this morning's release, but I will say that as with the title part of our business, nothing has really changed since mid-year 2007 when it comes to mortgage guaranty. Here as well, we are still of a mind that when most of the shots have been fired by year-end 2009, that we will have reported a cumulative loss ratio of about 150% for the entire 30-month period.

And as a matter of fact, so far for the first nine months since mid-year 2007 through the end of March of this year, the cumulative loss ratio stands at 174.2%. So over the next several quarters, we are likely to get some relief from captive insurers kicking in with their contractual claim participations. In this regard, incidentally, we benefited by about one and three quarters points of loss ratio in this first quarter's results from captive claim recoveries and that amounts to about $26 billion of claim cost credits from that source.

We still think though that these will show a fairly gradual upswing as the individual books of businesses that are embedded in the various captive vehicles find their way into the stream of emerging claim costs. We are certain that the... I will say that the pregnant question out there is how long and how severe will this profusion of guaranty mortgage guaranty claims will be. And of course, we don't really know, and we don't know of anyone that really knows, though there are, as you know, many learned and other assumptions out there that point to varying scenarios of distress.

Currently for our part, as we've said, in terms of the likely cumulative claims ratio we could sustain for the next 30 months through year-end 2009, the magic number as I said before remains at 150% cumulatively. And that again is predicated on our study, our review, our evaluation of the loss trends which prevailed in the mortgage guaranty industry during a stress period that extended between mid-1990s and the very early 1990s. And that's the number that we are focused on in managing our ongoing risk in force, the accumulation of that risk in force, our possible market share expansion, which we think is in the cards, and other related capital management considerations that these particular factors bring to the floor.

Nine months down the path of this expected 30-month journey, and so far we are not witnessing anything that would cause us to be distracted, if you will, from those intermediate term claim cost expectations. We are certain that most everyone is aware that there are any number of band aids being applied to the housing credit infrastructure in this country and, of course, these range from outright government assumptions of some credit risk to the tax give backs to a significant segment of the US population that will kick in around mid year this year, and to the Fed turning on the liquidity faucet, if you will, and probably gunning inflation with rate cuts that could ultimately take some of the sting out of the necessary devaluation of a lot of mortgage debt.

And I might add that some of these band-aids also represented by the GSCs and FHA being encouraged to assume a greater role in financing and refinancing at least some of the mortgage debt that is out there. From our perspective, we think it's still going to take several more quarters for all these band aids to coalesce, if you will, into a bandage that stems the tide of the falls and the foreclosures that we are currently experiencing and likely going to experience for a while longer.

We also think that it will take that long because housing values themselves simply need to come down from their perch to a, if you will, more realistic levels where the long-term up trend in those values are back in greater symmetry with people’s income and productivity gains. Some of you may have seen a couple of days ago, one of the rating agency gurus reported that nationwide home values have already declined by some 18% from their early 2007 peak and that it was likely that they could decline some more to a 30% cumulative drop from top to bottom. Most of us at Old Republic thought it’s worth I think that a 30% to 40% cumulative decline is probably in the ballpark, and that's why we're expecting a more or less drawn-out process to ride the ship.

So, where does this leave us? First we think we can weather the storm and keep our mortgage guaranty ship afloat in what will expect will be a very stately way. We think that the business we are currently putting on the books is reasonably priced. It's very soundly underwritten, and it is in our view likely to stick on our books for sufficiently long period of time as to produce some profits that will go a long way toward ultimately negating the losses on the old merchandise that's beginning to run off our books and then, of course, ultimately becoming additive to the value of our franchise.

We think we currently have the necessary capital management flexibility to add funds to our MI segment, to at once repair the gashes, if you will, that are caused by the greater claim costs as well as provide necessary fuel for the expected rise of risk in force exposures. We see some pretty realistic possibilities for expanding our company's MI market share and for taking advantage of improving MI market penetration opportunities. As you can see in one of the statistical exhibit that's attached to the release this morning, our balance sheet leverage ratios are in very good shape, particularly if you consider that the make up of our risk in force is somewhat of better than average quality and that the asset side of the balance sheet that funds our liability exposures is as sound and as clean as they come. So, the bottom line of all this is that we have again the wherewithal to at once test it out over the next several quarters and maintain a sound footing for the better business opportunities that are… that we think are likely to come our way.

Before leaving this particular segment of our business, I'd like to take just one more minute to address the status of some of the relatively large passive investment decisions we've taken in the two largest MI companies in our industry. Some of you may recall those positions were accumulated mostly in the second half of 2007 and mostly on the books of our general insurance subsidiaries relative to which we've had a certain amount of capital in excess of that needed to carry current underwriting exposures. It's no secret by now that the stocks of MI and financial guaranty insurers, as well as those of most insurance and banking institutions have not fared very well in the past 12 months or so, so that the market valuations of those two holdings of ours that vest, as I say primarily, on our general insurance books, that those valuations have not been spared.

However, we made those investments in the light that we were and continue to be focused on the long run with respect to the totality of our business, including those two holdings which we bought with a three to four year time horizon in terms of our expectations for an expansion of their values. And in this context, we think that the takedown of their values by the marketplace so far is temporary in nature. It is not impeding our ability to do business and is not impacting our ability to hold those securities for a long period of time. Our balance sheet has purposefully been structured to emphasize a high degree of both credit quality and liquidity in the 85% of our investment portfolio that is consecrated to fixed maturity securities. And these features, this approach to asset management provide us with a powerful first line of defense through the entirety of our enterprise.

I might also note in passing that the decline in the market value of those two investments has cost us about $0.77… yes, $0.77 in book value per share through the end of March. It's not a big deal. It's a negative, but not a huge deal for us. Let's see.

Moving along to our largest segment of General Insurance. There are two or three, maybe four noteworthy items in this year's first three months and those items, of course, are the subdued top line that you've seen in this morning's release. The composite underwriting ratio which has landed in the first three months within the 93% to 96% range, we anticipated earlier this year for the year as a whole. Of course, the continuation of the sound reserve position which continues to develop favorably year-over-year, and a very positive operating cash flow, which is both additive to our invested asset base as well as the high level of liquidity and credit quality that I just mentioned before and that we like to maintain throughout our business.

At this stage of the underwriting cycle and property and liability insurance in this segment, it's simply not in the cards, we think, to raise expectations anywhere that the premium line will grow very much. We would categorize the current pricing situation for the composite of all of our insurance coverages and general insurances as remaining moderately soft, so that adding new business remains difficult unless one is willing to give the store away, and this is not... has never been a willful option for us.

So, absent the acquisition of one or more new books of business which are not currently in the making though, as we've said repeatedly, we never stopped looking at opportunities that are there to add books that provide some continuity to our sphere of competence. The premium line is likely to look pretty much humdrum for the next several quarters. Having said this, we've got every expectation that the combination of the reasonably positive underwriting expectations we have and a modicum of investment income growth should enable our general insurance business to perform very well, and to remain as our strongest capital anchor and steady earnings provider for the foreseeable future.

As we said in this morning's release, our overall consolidated operating cash flow remains quite strong. As a matter of fact, on an apples-to-apples basis which eliminates a one-time pick up of about $16 million in the first quarter '07 from the late 2006 acquisition of a construction book, this year's cash flow is about 45% higher than a comparable number for the first quarter of 2007. But still most of the growth and more of it came from the mortgage guaranty business where premiums are growing much faster than paid losses.

And as we indicated in the press release, that's due to the fact that the incurred loss is growing at a much faster clip than the payout of losses since we are continually and have been doing now for that several quarters, even though it's become even more accentuated in the past three quarters, since we continue to add measurably to our loss reserve levels in mortgage guaranty as more information becomes available to us and as we evaluate on a quarter to quarter basis the trends in reported default foreclosures and what have you that impact our business directly. Let's see.

Having said that, I don't think there's very much else that's new or worthy of reporting for the entirety of our business at this time, and therefore as was indicated earlier, we'll just make time now to address questions that we may not have anticipated in the release or in the comments we've just made. As we've done for a couple of quarters now, we've asked Chris Nard who is our Mortgage Guaranty Company's CEO to join me for this phase of the conference call and I'm certain that he'll welcome the opportunity to address any questions that I may not be able to do full justice to.

So, let's get rolling with your questions.
Question and Answer

Question and Answer

Operator

[Operator Instructions]. Our first question will come from David Lewis with Raymond James.

David Lewis
Raymond James & Associates

Good afternoon.

Aldo C. Zucaro

Hi, Dave.

David Lewis
Raymond James & Associates

Couple of questions to start on the mortgage guaranty side, with the rating agency actions over the past month or so and Old Republic maintaining AA rating on financial strength, do you think that that is going to have a material difference in your ability to gain market share in the business relative to your A rated carriers?

Aldo C. Zucaro

Well, we think it's not a negative for us. We think that the other companies, or at least most of them, will continue to do reasonably well. I think the GSCs in particular are very interested in working with the MI industry because it is helpful to the GSCs own self interest that that take place. But yes, we feel good about the position we're in from a rating standpoint, and more importantly about the real quality and strength of our capital structure which... and the flexibility we have to improve as it need to be that structure to accommodate any increase in market share for our business.

David Lewis
Raymond James & Associates

Now back in the November meetings that you participated in, you kind of predicted kind of a 150% loss ratio on the MI business over kind of the cycle here.

Aldo C. Zucaro

Right.

David Lewis
Raymond James & Associates

The difficult cycle. So, how would you anticipate, just from a higher level, we're running at a 180%-plus currently in this quarter, probably stays high again in the second quarter. If all goes as you may have anticipated, would you except that to start to drift off in the second half and then maybe further in '09, is that a good way to think about it?

Aldo C. Zucaro

Well, current thought for what it is worth and we're not uniform in our views internally. But I would say, the general consensus is that until… as I put it, until all these band-aids that are being applied to the system take hold, I don't think you are going to see much of an improvement in loss ratios. As to when they take hold, I think that's again going to be a gradual process. Probably by the fall of this year, we should start seeing some improvement. But our view is that 2008 is probably done for. We think that it would be a real accomplishment if we came in between 160% and 170% for the whole year. And that implies therefore that we would start seeing some improvement in loss ratio trends in the early part of next year and springtime of next year.

David Lewis
Raymond James & Associates

That's helpful. Thank you.

Operator

Our next question is from Beth Malone with KeyBanc.

Elizabeth C. Malone
KeyBanc Capital Markets

Thank you. Good afternoon.

Aldo C. Zucaro

Hi, Beth.

Elizabeth C. Malone
KeyBanc Capital Markets

Hi. Just a question on the title business, the claims rate, I know that losses aren't a big part of it, but it picked up a little bit last year, and I just wondered, it looks like it's kind of settled back down to a more normalized level in this quarter, and I just wanted to get some... of your views of what do you think on that? What do you think was driving that before and are those conditions still in evidence?

Aldo C. Zucaro

Well, whenever you've got a down cycle, as we are experiencing in housing, there has been a tendency in the industry over many years for loss cost to kick up. And if you have a recollection or if you had read some of our... some of the stuff we put out two, three year ago, when we were blessed with very low loss ratios in the 3.5% to 4%, we said at that time in anticipation of a turn in the market, that we would not be surprised to see the loss ratios in this business kick up to the 5%, I think we said the 5% to 7% level at that time.

And that's where it is right now. I think the prospect of it's going down is still removed. Would we be surprised if it kicked up to 8% in a particular quarter or a series of quarters? No. But we think it goes to calamity levels which we would view as 9%, 10%, 11%. We just don't think that's in the cards, Beth. So, I think this year our best guess is that it's probably 7%, maybe 7.25% loss ratio for the year in total.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay. All right. That's helpful. And then just a little clarification on the mortgage insurance business, I understand the dynamic that you have a book of business on your... that you wrote prior to say mid '07, where some of these higher losses are emerging from, but starting… when… is there a way that you could identify when you started writing business that you think has a much better combined loss experience on it and is that what's going to drive down the loss ratio for mortgage insurances when the newer business starts to overcome the older business, will the older business stabilize over time?

Aldo C. Zucaro

Right, right. Let me ask Chris to pipe in and kind of give us his views of… the answer to that question.

Christopher S. Nard

Sure. There's a couple of questions buried in there. One I would, say the lending in the market probably started to improve in late '06, early '07, I think that's when the market recognized that the guidelines needed to began to be pulled back. It takes a while to do that in the marketplace, you have to work through pipelines. So, but I think you are right, it was about the second half in '07 that the guidelines began to take hold and that really tightened up through the end of the year.

One thing I think I said in the past is that while the underwriting guidelines may not have tightened until really later '07, I think you had a change in perception in some of the buyers in the marketplace. Certainly some of the high-risk markets like Southern California, Florida, Arizona, Nevada, some of those markets had started to turn negative appreciably before that time. I think buyers who were buying houses in those markets, even in early '07 were less speculators than investors then they were people but simply needed houses in that market, which is always obviously a better risk for us than an investor or a speculator has.

So, that's kind of the existing book. Yes, that book will stabilize over time. The higher risk products developed to claim earlier, so we would expect to see those stabilize after they get through this little bit earlier loss development pattern and then the book that we put on really fourth quarter '07 and certainly the books that we are putting on today by risk type certainly look much better than books we put on in a long time.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay. As the market continues to improve, let's say your pricing is I would assume where you think it should be to meet historic profitable lines. Assuming there is some improvement in the overall economy over the next few years, will there be a need for Old Republic to raise capital to support that better market environment, because the pricing will be up, so you'll need it for that… how you set to liabilities?

Aldo C. Zucaro

Well, we're going to and we do take a look at our book and the finances that support it on a quarter-to-quarter basis. So, you can expect us to react as the size of the book and the experience dictate, which means that you are likely to see us progress or do capital enhancement of that part of our business on a sequential basis, which is as I say reactive of what's actually happening to our book of business. You're not going to see us throw up a bunch of capital in anticipation of this or that happening. We are going to react to actuality as opposed to supposition.

As we indicated, we think we've got a wonderful, very flexible balance sheet structure that allows us to do some leveraging of it and enables us to also raise a modicum of funds internally to achieve what we need to do with respect to the capitalization of our mortgage guaranty business.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay. And just one final question, given where the stock is trading relative to the book value, any thoughts to revisit the idea of buying back stock or would that not give you the flexibility you need in your capital structure?

Aldo C. Zucaro

I would say that that's not in the cards at all. As you know, we've been dead set against the idea certainly of buying stock above book values and there is a price below book value at which the idea buying back stock becomes pretty attractive, but we are nowhere close to that. We would be adding pennies to earnings per share even if we spent $500 million or $600 million at these prices for our stock, and it’s just not worth our while, particularly when we see a very good opportunity to increase the value of our mortgage guaranty franchise substantially.

We think that's where we want to put our money, we think we need to keep some of our powder dry also in order to enhance our ability to perhaps acquire other businesses in the general insurance area in particular. So, the combination of all those factors, Beth, is what leads us to be quite impervious to the idea of fooling around with the idea of buying back our stock.

Elizabeth C. Malone
KeyBanc Capital Markets

Okay, thank you.

Operator

Our next question is from Kevin Preloger with Perkins, Wolf.

Kevin Preloger
Perkins, Wolf, McDonnell and Company LLC

Hi, Al.

Aldo C. Zucaro

Hello, Kevin.

Kevin Preloger
Perkins, Wolf, McDonnell and Company LLC

A quick question on... not that the rating agencies have the greatest credibility anymore, but when they downgraded the whole group, MGIC has somewhat less of a rating relative to PMI, and I guess when you look at your investments and when you did your due diligence, do you agree with that, or what are the rating agencies missing or what you might you be missing?

Aldo C. Zucaro

Well, that's an interesting question, Kevin. I mean, first of all, when you start with the idea that we... nobody that we are aware of is fully familiar with the models that the various rating agencies utilize. One rating agency in particular that we're aware of is still in process of redoing its own modeling techniques. So, you have that issue, so we're into dark as to how those models drive the ratings of individual companies.

There seems to be a consistency in the rating agencies' views that companies, MI companies that are associated with perhaps larger institutions that have different sources or avenues of generating both income as well as capital may be better situated than companies that are strictly monoline companies and perhaps and that's just conjuncture on our part and perhaps that's one of the things that differentiates us from, let's say, monoline companies.

As to your specific and direct question relative to the differentiation of one rating agency between MGIC and PMI, we are just too far removed from the books of either institution to have a handle that the rating agencies may have relative to the size and the nature of the risk of each of these… the risk content of each of those companies that may be is another force that's driving the differentiation. That is the best that we can offer in answer to your question, Kevin.

Kevin Preloger
Perkins, Wolf, McDonnell and Company LLC

Okay. That's helpful. Couple other questions, Al, can you give an update on the contractors book, where is that located and how big is that now?

Aldo C. Zucaro

Yes. Well, that started Kevin as a roughly $250million, $260 million book of business gross before reinsurance, and we have the typical retentions under that business which grow up to about $1 million for comp and GL. The beauty in our eyes at least of that book is that it's fitted very well a similar book of business that we had in primarily [inaudible] operation, which was concentrated in the central part of the United States, and stayed away from the two coasts in particular. Whereas this new book has got some pretty heavy concentrations on both the east and the west coast. So, from a national book of business and spread of diversification of risk, that was a very key appeal of that book.

And then secondly, that new book is also produced through different production channels, specifically the brokerage community as opposed to the American agency system that we utilize in [inaudible] operation. So there also was a nice fit in terms of obtaining business from a new or additional marketing channel. As to where the book stands right now, it has performed exactly where we expected it to be with, as I recall, about 95%, 96% combined ratios. The reserves, as you may recall, we did assume a book of loss reserves in concurrence with the acquisition of the renewal rights business, and those reserves have played out reasonably well since we put them on the books in late 2006. So, when it comes to that entire experience, all I can say is that we are happy campus.

Kevin Preloger
Perkins, Wolf, McDonnell and Company LLC

And I know one of your competitors there was saying that they were having some difficulty in California in the quarter. Are you seeing any signs with California might be weaker than say Texas or Illinois, for example.

Aldo C. Zucaro

Well, you always worry about those large markets, whether they be California or Texas or the New York area. I mean, those are tough, tough markets, not just in the contractors business, but just about everything we touch at Old Republic. So there is always a concern but the direct answer to your question is that, so far we are not seeing any disintegration in the quality or the loss experience of that book from that part of the country.

Kevin Preloger
Perkins, Wolf, McDonnell and Company LLC

Okay. One last question, just if you can give update on the trucker's book, what you are seeing there. I know that… it seems like the mom and pop operations have shut down due to the high gas prices or slowing economy, what trends are you seeing there?

Aldo C. Zucaro

I think what you just said are issues that apply to that business. The smaller operators are having hell off a time being competitive or as competitive as the larger operations. We've got size in their favor and can buy in bulk, et cetera, et cetera. We think that the economy, the slowing down of the economy that is an actuality is impacting everybody, including the larger operators. So, that's another reason why we're having difficulties growing top line as well.

I mean, as you know, trucking is a big part of our general insurance business. And we are... as I say, we are having a tough time growing the top line for those reasons, in particular, that mileage is falling down, employment is to some degree falling down, and you've got the number of customers falling down. So I think we're going to experience some difficulties for the next six months to nine months until the economy starts back on an upswing sometimes next year, which is what our current expectation is.

David Lewis
Raymond James & Associates

Great. Thanks a lot.

Operator

[Operator Instructions]. We'll next go to [inaudible], Citadel Investment Group.

Unidentified Analyst

Hi, Al.

Aldo C. Zucaro

Yes, sir.

Unidentified Analyst

I'm interested in hearing your views on the 2008 book of business. It's still early --

Aldo C. Zucaro

Are you talking mortgage guaranty?

Unidentified Analyst

Yes, on the mortgage guaranty business, particularly the quality of the book when you consider long and [inaudible] scenario with 30% to 40% depreciation in cumulative house prices.

Aldo C. Zucaro

Okay. Well, Chris will handle it.

Christopher S. Nard

I think what it [inaudible] I think went he was talking about those very high rates of home price depreciation, we may have been talking in selective markets as opposed to nationwide. So, if you would certainly looked at San Bernardino, Riverside and parts of Florida, you may see that. But the '08 book as it is playing out today looks very good, be it by credit documentation or LTV, the industry has made significant rollbacks in underwriting guidelines really throughout the end of '07 and even into early '08.

So, you've get the positives of the improving quality of the book of business, you've got the positives in terms of the orientation of the homebuyers in this market as well. And I think the only... the only thing you would worry about in the '08 book is how the economy plays out to these early homebuyers. One of the things obviously we do to guard against that is we have limited the LTVs, particularly in some of the markets you have more concerns with home price depreciation to try to make sure that there's a cushion in those loans to handle some rough waters over the next 18 months or so.

Unidentified Analyst

And when you talk about the economy, more of a sensitivity to employment levels or house prices or --

Aldo C. Zucaro

Really a combination of both, but for us we are always very focused on employment.

Unidentified Analyst

Great. Thanks a lot.

Aldo C. Zucaro

Sure.

Operator

Our next question is from Michael Santelli with Allegiant Asset Management.

Michael E. Santelli
Allegiant Asset Management

Hi, good afternoon.

Aldo C. Zucaro

Hi, Michael.

Michael E. Santelli
Allegiant Asset Management

I have a number of questions on the --

Aldo

You still like the mortgage guaranty business?

Michael E. Santelli
Allegiant Asset Management

I love it. Great. I just wanted to clarify a few points here. Number one, are you getting any pricing on mortgage insurance? Were they the same schedules of price that have been in the industry for the past not that long?

Christopher S. Nard

We've gone through… this is Chris. We've gone through kind of an interesting cycle here. As the market first got worse, we were attacking it from a pricing standpoint, but then as the market continued to cause concern, what we did is basically went in and eliminated whole asset classes. So, instead of raising the pricing on very high LTVs, we went in and simply eliminated those from an eligible asset class standpoint.

From a documentation standpoint, I think we started out originally raising prices and as the market continued to deteriorate, again eliminated those completely. So I think if you were to look at what has been the biggest change in the quality of the mix, it's been driven by elimination of high risk products, more so than by an increase in pricing. Now on the existing book that we still do, we've raised the prices in some areas, but the bulk of the 90% fixed rate loans around the country have the same pricing today that they've had over the past few years.

Unidentified Analyst

Okay, conclusively, you think you're getting adequate pricing on that basic product of fixed-rate primary flow business?

Christopher S. Nard

Yes, the reasonable LTV fixed-rate primary flow business is not the business that's causing the industry problems today.

Unidentified Analyst

I see on your break down here on page nine I think it is, most of your primary business is fixed-rate and most of your business overall is primary, therefore the vast majority of your overall business is fixed-rate primary.

Christopher S. Nard

Correct.

Unidentified Analyst

Yet, loss ratio was still 180%.

Christopher S. Nard

Well, that's a good observation. There are other things in there in that fixed-rate primary. You're going to have some of that that is low FICO scores, that's going to generate a lot of that loss. And a lot of that business while it would be… not a lot, but a portion of that business, while it'll be fixed-rate is going to have some reduced stock component to it. So, if you were to again parse down through that, you would find the reduced stock and low FICO scores are going to be the big generators in that loss ratio, particularly in those markets of Florida and California.

Aldo C. Zucaro

Plus if I may, Chris and Michael, the other item which is of some import on the loss ratio that you're alluding to is the fact that you do have collateral damage as a result of what's happening to the housing and mortgage lending industries at large, in that when you have... when houses are not moving, you have a reduced ability to mitigate losses and that, of course, has put some upside to your loss costs.

Unidentified Analyst

That's absolutely right, and that's why we think you would raise price. Not only are you in a bad environment in terms of home price depreciation whereas the last 60 years, 70 years, we've had home appreciation. So that makes the business riskier. But what... my question is why can't the industry get pricing on the basic third-year fixed rate business?

Christopher S. Nard

While I wouldn't say anybody speaking for ourselves has given up on that, we continue to evaluate the book, look at the competitive scenario, and adjust underwriting... underwriting and guidelines as we can in the marketplace.

Unidentified Analyst

Okay, back to the one of the questions I think on gaining market share, and you basically said that there is an opportunity to gain market share versus the weaker competitors. This may be a good time to try and raise price, since now you have a reason to. You are AA, they are A, give me an extra 10%, 20%, 30%, whatever is worth on the price [inaudible].

Christopher S. Nard

Absolutely. But it is a little bit more complicated, particularly now in an environment with a resurgent FHA, which is one of... historically outside of piggybacks has been our primary competitor. Absolutely, when we can raise price to improve margins, we absolutely look at that as an option. Kind of the other thing we look at is, pricing, meaning the cost of the high LTV loan, any delivery fees that may be on that loan to sell to Fannie and Freddie and then our premium. At the point those things begin to eclipse alternative executions in the marketplace, you begin to rapidly loose share. So every day, it's a balance for us in trying to figure out the optimum mix between pricing guidelines and whether we're willing to see that business move to another investor.

Unidentified Analyst

Okay, is there any other alternate execution right now in this marketplace, no one is going to piggyback, I think?

Christopher S. Nard

Yes, it’s the… no, no, it's the FHA.

Unidentified Analyst

Okay.

Christopher S. Nard

The FHA will play out here to be a very good competitor.

Unidentified Analyst

I'm not sure if you want to compete with the government, because it’s probably an irrational competitor, right?

Aldo C. Zucaro

Well, I mean the FHA is going to serve the same similar useful purpose as the opening up of the ability of the GSCs to write or to lend on effectively on higher loan values. That improves liquidity of the market. So there is... at this time, the involvement of those government agencies can turn out to be a real welcome. And even though as Chris just said it might prevent us from increasing prices, it does stabilize the market, and that's an important consideration, we think.

Unidentified Analyst

Okay. The... given the tighter underwriting standards and everything you've done to improve the profitability of your business, do you think the '08 book of business as it seasons, that it'd be profitable? Do you think it would... let's say get a 12% return on equity... are we at that kind of book or that's still kind of break-even --

Aldo C. Zucaro

It's way too early to tell.

Unidentified Analyst

-- profitable. What's your initial sense, and I know it's kind of too early, what if I add Q4 '07, which may be a little bit less --

Christopher S. Nard

It's way to early to guess return on equities on these books. These books have losses that play out over. In good times, good times meaning with good mixes over 4,5 and 6 years, I'd be irresponsible to give you an ROE projection on that book.

Unidentified Analyst

Okay. Given your 30 to 40% cum decline in some of the weaker home price markets, what have you done to tighten underwriting standards in those markets exactly? Have you just kind of shut them off? I'm guessing you're talking about Florida, California, Nevada, Arizona?

Christopher S. Nard

Yes, what we've done is, we have severely limited the LTVs at which we lend. We significantly increased the FICO scores under which we'll, I'm sure, lend uninsured loans, sorry about that. We have gone to full documentation, we've made… we've looked at ratios, we've made significant adjustments in the quality of the business that's going on, particularly in what we would refer to there as those declining markets across the country.

Unidentified Analyst

Okay. Just a couple of questions on the captive reinsurers, what percentage of your business is protected by captives?

Christopher S. Nard

I think, roughly in the vicinity of about 50% of the book is in captive reinsurance.

Unidentified Analyst

Okay. 50% of the primary book...

Christopher S. Nard

Correct, correct.

Unidentified Analyst

And most of that's 41040 [ph] variety or is it a combination?

Christopher S. Nard

It's a combination, but I think a significant portion is in the 41040, smaller amounts in the 255 [ph] and plus.

Unidentified Analyst

Okay. At this point of time, what do you think is the probability of re-attachment after the captives are exhausted for the '07 and '06 than it is --

Christopher S. Nard

I'd want to do so more work on that. I mean, certainly, individual customers with individual books that are in high-risk markets, you're going to attach some probability to that. Larger customers that are more diversified across risk attribute, you would have a much smaller probability of that.

Unidentified Analyst

Okay, I think that does it for today.

Christopher S. Nard

Good, thank you.

Operator

[Operator Instructions]. And the last question in the queue at this point is a follow up. David Lewis with Raymond James.

Dave

Thank you. Al, could you maybe just be talk a little bit about what you're seeing with the general insurance segment pricing trends overall. Some folks are talking about a… at least the brokers are talking about the accelerating deterioration in pricing overall for general property and liability insurance. Can you say how you're seeing first quarter versus may be the second half of '07?

Aldo C. Zucaro

Yeah. We would say that particularly with respect to the large accounts, many of which are written only through a variety of loss sensitive products, that the competition has gotten more acute. With respect to your smaller accounts, it's all over the lot. I don't think when you look at any one of our competitors that you see necessarily a consistent approach across the country. You have pockets where a particular competitor is playing it close to the vest and then in another area it's a little more loosey goosey.

With respect to the makeup, but however when we look at pricing at Old Republic, we look at it through some pretty different set of eyeglasses in that we've got a lot of specialties, you take our home warranty business, you take our automobile warranty business, you take our surety business, fidelity, take E&O business, let's say, they all have different pricing complexions attached to them, and therefore we don't necessarily participate in the same wave of pricing declines as you may get in a... from a more generalized view of the market.

All of that to say that we've gone through 2007, David, we've gone through maybe a two and half year period of slowly declining pricing which we've... to which we've attributed an average decline of 2.5% to 3%, which probably gives you a cumulative 7%, 8% maybe decline across the book. We think as we speak right now we're still again for the overall book probably for 2008 looking for another 2%, 3% perhaps 4% decline as an average. But we just don't see more than that. In a few areas, which I am not at liberty to disclose because of competitive and proprietary issues, we are in fact increasing prices, and time will tell whether we will succeed in at once retaining business and having... its having an impact on the overall mix of our pricing structure.

David Lewis
Raymond James & Associates

That's helpful. And finally in your press release, I was intrigued by the comment that one of the reasons you saw the growth you did in net investment income was slightly higher yields.

Aldo C. Zucaro

Very slightly, yes.

David Lewis
Raymond James & Associates

The others have been talking about the deterioration in the yield. Have you changed durations or any other investment strategies to help get that little higher yield?

Aldo C. Zucaro

Well, when we say slightly, David, we mean it literally. We're talking four or five basis points and we measure that yield incidentally on the basis of original cost and not market value, because as you know it makes a difference whether you're taking the yield that you're talking about to the market or your original cost. On that it's... on that basis that we're talking about a very small incremental increase.

David Lewis
Raymond James & Associates

That's very helpful. Thank you very much for your comments.

Aldo C. Zucaro

Okay.

Operator

We do have one more follow-up. It is from Michael Santelli with Allegiant Asset Management.

Michael E. Santelli
Allegiant Asset Management

Hi. Sorry, one more question here. Given that the size of the origination of mortgages has going down from, call it, Q1 '07 to Q1 '08, and given your underwriting standards have effectively shut some of these lower FICO scored higher LTVs, higher risk geographies out of the market, how do you explain the traditional… I'm looking at exhibit again on page 9… traditional primary new insurance return going from $4.6 billion in '07 to $7.9 billion, call it, in '08, Q1 of '08?

Christopher S. Nard

Yes, what you see there is the lower number is really a close to the peak of the piggyback market because you would have had piggybacks eating away huge portions of the MI market share at that period of time. That grew as that market absolutely disappeared through the fourth quarter of '07, I think we were somewhere in the $10 billion NIW round very high MI penetration rate but on a much smaller mortgage market. The first quarter is down from there, not because penetration dropped, but more so because the MI total pie got smaller. So there is another dynamic in that growth which is the piggyback mortgage.

Michael E. Santelli
Allegiant Asset Management

Okay, fair enough. I thought that it still looked a little high given the shrinkage in the overall mortgage origination business. In fact, your tightened underwriting standards probably locked a lot a lot of people that you would have done a year ago out.

Christopher S. Nard

Yes. You started taking some of the amount, but the MI penetration rate at that $4 billion quarter could have been as well as... yes, I was going to say 5,6,7, it could have been as high as 18%, 19% in those last quarters.

Michael E. Santelli
Allegiant Asset Management

Well, that high, well, okay.

Aldo C. Zucaro

Yes. So, you are getting a bigger MI industry penetration of admittedly a smaller pie. And then on top of that, even though we are not in a position right now, we haven't seen the numbers to say, we sense that we are, at our mortgage guaranty business, we are getting somewhat larger market share, wouldn't you say, Chris?

Christopher S. Nard

Yes, somewhat through that period.

Michael E. Santelli
Allegiant Asset Management

Out of the MI pie, you mean?

Christopher S. Nard

Yes. But again, so...

Michael E. Santelli
Allegiant Asset Management

It seems like… obviously, growth requires capital and you guys are one of the stronger players in this market, there are 3 or 4 players that are you might say undercapitalized or close to it, and they probably can't support this kind of growth, is that right?

Christopher S. Nard

Yes. I mean I can't speak specifically to others. But I think we are in a good position to grow from a competitive standpoint throughout '08. From a share standpoint, I think the wild card will be, how big does the market turnout between the amount of business we have choked off because of the improved underwriting guidelines and the amount of increase in penetration from the FHA.

Michael E. Santelli
Allegiant Asset Management

Okay. Thank you.

Christopher S. Nard

Thank you.

Operator

And with that there are no further questions. I'd like to turn the call to Al Zucaro for a closing comment.

Aldo C. Zucaro
Okay. Well, that's fine. We appreciate very much the interest always and happy to visit with you and look forward to visiting with you again in a couple three months when we publish the next quarter's results. And on that note, again, we thank you and bid you a good afternoon. Good-bye.