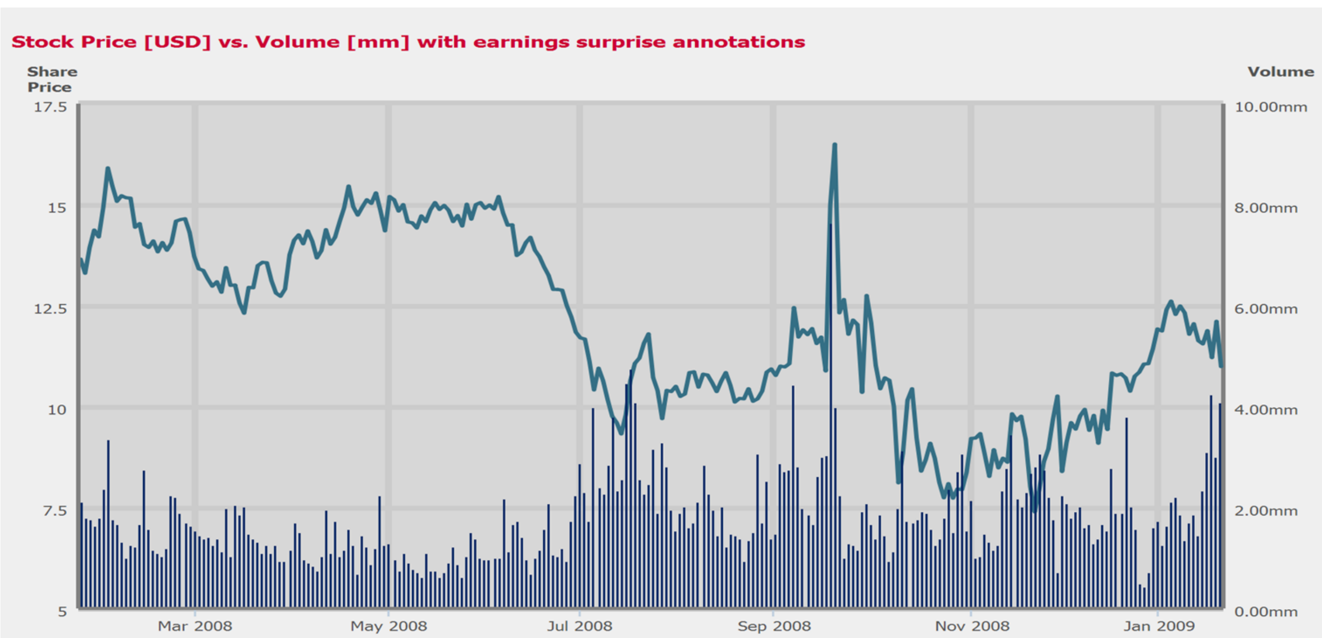
S&P Global
Market Intelligence

Old Republic International Corporation
NYSE:ORI
FQ1 2009 Earnings Call Transcripts
Thursday, April 23, 2009 12:30 PM GMT
S&P Global Market Intelligence Estimates

	-FQ1 2009-			-FQ2 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.34)	(0.23)	NM	(0.30)	(0.84)	0.75
Revenue	-	-	▲(5.40 %)	-	-	-
Revenue (mm)	928.60	878.50	-	916.60	3674.00	3803.00

Currency: USD
Consensus as of Apr-17-2009 3:42 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2008	(0.02)	(0.08)	NM
FQ2 2008	(0.16)	(0.22)	NM
FQ3 2008	(0.16)	(0.20)	NM
FQ4 2008	(0.25)	(0.31)	NM

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Call Participants

EXECUTIVES

Aldo Charles Zucaro
Chairman & CEO

Chris Nard

Jim Kellogg

Leslie Loyet

ANALYSTS

David Lewis
Raymond James

Joe Gaggan
Atlantic Equity Research

Richard Wagner
Citadel

Presentation

Operator

Good day everyone and thank you for standing by. Welcome to the Old Republic International first quarter 2009 earnings conference call. Today's call is being recorded. (Operator Instructions)

Now I will turn the conference over to Leslie Loyet of the Financial Relations Board; please go ahead.

Leslie Loyet

Good morning and thank you for joining us today for Old Republic's conference call, to discuss first quarter 2009 results. Yesterday afternoon 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 on Old Republic's website at www.oldrepublic.com or you may call Liz Dolezal at 312-640-6771 and she will send you a copy immediately.

Please be advised that this call may involve forward-looking statements as discussed in the press release dated April 22, 2009. Risks associated with these statements can be found in the company's latest SEC filings.

At this time, I'd like to turn the call over to Al Zucaro, Chairman and Chief Executive Officer for his opening remarks. Al, please go ahead.

Aldo Charles Zucaro
Chairman & CEO

Thank you, Leslie. As always we appreciate everyone's interest in joining this regular quarterly earnings conference call at Old Republic. We will proceed now as we usually do with some overview commentary and then we'll open it up to questions.

For this quarter we are changing a little bit our approach, by having three persons do the talking in our initial commentary, as well as in the question-and-answers portion of the call. Jim Kellogg, who is President of our company, and Chris Nard, the CEO of our Mortgage Guaranty Group, will therefore participate with me.

The news in this morning's release was not much different in terms of operating trends, bottom line results, than we have posted for the last six or seven quarters. The effect of it all is that we have now reported six consecutive quarters unfortunately, of negative bottom line results.

As we indicated at the top of this morning's or I should of yesterday's earnings release, we're holding to the view that given the continuing operating difficulties in our mortgage guaranty line in particular, that we're not likely to see a consistently black bottom line before the second half of 2010. At least that's our best guess at the moment and it is of course predicated on several expectations.

One, that the general insurance business should continue to perform well and by that, in particular, we mean that it should produce a positive under-writing result; that the title business could get out of the penalty box if you will, in the second half of this year; and that mortgage guaranty is more likely than not to continue spilling some red ink, during most if not all of 2010. All of that is as I say, pretty much in line with what we've been saying now for about a year and a half or so.

In this year's first quarter, the consolidated operating results continue to benefit from reasonably good underwriting and investment income contributions by the general insurance business, the mortgage guaranty business as you see in the release, and the title results, we're a tad better than was the case in 4Q 2008. That's to some degree due to the inherent seasonality of that particular business.

Having said that, I'll turn the call to Jim Kellogg, who will embroider on our general insurance performance; who will then follow that with Chris Nard who will speak to our mortgage guaranty operations, and then I'll come back with a few more closing comments before the Q-and-A portion of the meeting. Jim.

Jim Kellogg

General insurance continues as our largest segment, representing about 59% of our consolidated net premiums. We experienced some slippage in our underwriting results this quarter compared to a year ago, as well as the most recent fourth quarter in 2008. A major contributor to this outcome was our consumer credit indemnity segment which contributed right around 600 basis points or 6 percentage points to the general insurance group's underwriting ratio.

To a lesser degree this quarter, our D&O and E&O unit saw a bit of an up-tick in its loss ratio. As we noted before in the past calls, the consumer indemnity or the CCI product as we refer to it here internally, currently represents less than 8% of our general insurance group on a premium base. The line as the name implies is tied to consumer borrowings for purchases, such as home improvements and expenditures that are financed typically with second liens on home ownership.

As you might expect, the CCI underwriting experience is being impacted by the very stressed credit conditions that are currently affecting the American economy. We currently expect that the underwriting trend line for this product will probably mimic that of the mortgage guarantee line, because of its relationship to the credit finance business of this country.

The dollar impact on our results however, do not or did not overwhelm the overall general insurance performance, due to the much smaller size of the line and the different pricing and underwriting considerations that have been applied for many years here at Old Republic.

I may comment the D&O loss experience this quarter, which contributed right around a 100 basis point or one percentage point of the underwriting ratio, is not indicative of a trend in our opinion, but is simply the result of a handful of adverse court rulings recently received. We should note that none of these D&O losses involved any financial institutional customers. In fact, we have a very limited exposure to that class of business.

Without the impact of both the CCI and the D&O business, the first quarter's composite ratio would have been roughly 700 basis points or seven plus percentage points lower; which mean that the rest of the general insurance group operated at about a 92.9% composite ratio, versus the actual ratio that you saw we posted of 100.4%.

The first quarter 2008 ratio equivalent to that 92.9% was 90.9%; the majority then of the general insurance group coverages delivered flattish, but still very good underwriting results. Investment income and general insurance in the latest quarter was relatively flat, down about a million dollars. This reflected flattish or somewhat reduced yields on our long and short term fixed income securities, and our small amount of equity holdings. Operating cash flow remained nicely positive at around $40 million for this segment here in the first quarter.

The rate environment in our general insurance business is still exhibiting some softness in that we are seeing modest single digit rate reductions. We are of the opinion that by the end of this year or beginning of 2010, rate reductions should begin to abate.

Offsetting this a little is the fact that, as we reported last quarter, that we are buying a bit less reinsurance this year, so from an earned premium standpoint in 2009, we expect a flat to modestly reduced amount compared to 2008.

Underwriting lines, we still think our general insurance group ratio in that 96% to 98% range is attainable for 2009 as a whole. We also believe this will be supported by our continued posting of reserve adequacy by our claim reserve structure which we believe is sufficiently strong as to preclude any material adverse development and therefore, no negative impact on the current year's profitability. Al.

Aldo Charles Zucaro
Chairman & CEO

Okay, that does it for general insurance. Why don't you pick up Chris?

Chris Nard

All right. Good morning everybody. Much like the last six to seven quarters as Al has mentioned, the continued negative trends in the general economy and the housing market as a whole continued to drive our results for the first quarter of 2009. While the trends continue to be demanding, they played out pretty much as expected in the first quarter of the year.

What we saw on the premium side, trends were reflective of things that had been going on for about the last six quarters. Those are changes in our underwriting guidelines and increases in the pricing of our products, have contributed to a smaller general market size for us, as well as a general slowdown in home purchase activity and as a result of much of this tightening in the MI guidelines, we've seen a significant growth in the FHA over the last four to five quarters.

These negative trends in premium were somewhat offset by the much higher persistency levels we're seeing over time, and it will be supported in the long run by the increasing rates that we are seeing in the new production.

One of things I've mentioned in the past is as a result of the changes in the underwriting guidelines and pricing, the guidelines for us today look very similar to the early to mid 1990s, with an increase in rates depending on the mix of business of between 25% to 30%. So, we feel good about the guideline and the pricing that's on the new production today.

Claims costs continue to be as they have been again for the last six to seven quarters, driven by the general malaise in the housing economy. Continued declines in home price appreciation and employment are impacting that claim line significantly. These trends are particularly accentuated in the states of California, Florida and to a lesser extent, Arizona. In those states, their contribution to the claim side far outweighs their contribution to the total mix in the book as a whole.

One thing we did see in the first quarter was the continuation of a kind of normal seasonality trend we have seen over the last probably eight to ten years, where you see an increase in delinquency through the fourth quarter and in to January, and then an abatement of that increase at the end of the first quarter. That did happen as it has for the last several years and did help with a slower increase in the rate of new delinquency development that we saw in the first quarter.

As we've talked about on the previous calls, we would expect these trends to continue through this year and then likely into the early half of 2010. The bright spot in the numbers for the quarter continue to be the expense management trends.

The reduction in the expense ratio for the first quarter, driven largely by a decline in staffing as we right the size of the organization to the current market, lower production-related expenses and also higher fees in our contract underwriting area, which would be reflective of an increase in activity as we see the refinance volume increase.

Just a kind of closing thought; we'll continue through 2009 to manage the businesses as we have in the past, constantly adjusting the underwriting guidelines and the pricing to get the right balance in the book and continue to focus on supporting the policyholders through the stressful period in the market.

Aldo Charles Zucaro
Chairman & CEO

Okay. Let's see. A couple of comments from the title business, though we don't need to say much, other than to refer to what's already been said about the impact of housing and mortgage lending on any business that's related to those industries and title of course is so related in states.

From an underwriting standpoint, earnings standpoint I should say, the title segment produced results which were, again, somewhat better than we had anticipated at the beginning of the year.

We think that one of the silver linings for this segment lies in the statistics we publish each quarter and that you can see in yesterday's press release. This of course has to do with the number of open and closed title order accounts which were up ever so slightly, about 1.5%, 2% as I recall, but this is occurring for the first time in several quarters.

A lot of that we think is being driven by the much higher level of refinance activity which started sometime in the fall of last year as interest rates came down and people who have the ability to borrow and make good on their obligations, have been able to refinance at very good interest rates. As I say, we think that's a big part of what's driving the additional orders.

We as a result continue to hold to the view that title insurance could indeed pull out of the doldrums, somewhat earlier than mortgage guaranty, and that would be by virtue of what is expected to a significant up-tick in housing-related transactions.

Looking at our balance sheet, as always, it has we believe quite a great deal of staying power built into it. The asset side and given the large chunk of equity holdings that was written down significantly at mid-year 2008, now supports a relatively pristine and highly liquid set of qualities.

Other assets do not; in our view contain any seeds of the potential for significant write-downs. As Jim said, in particular with respect to our general insurance business, though it applies to all of our segments, our claim reserves continue to hold up very well and should pan out pretty close to the amounts posted across the board.

As you saw earlier this year, we announced that the dividend payout for the first quarter would be kept at the higher rate that was announced back in February of 2008. As we have said quite often, we look at our dividend payout every quarter, in conjunction with the quarterly board meetings, so that the next time we visit this matter we'll be in May of this year.

There was a little bit of a departure on our part and that whenever we've announced dividend increases, we've done so in conjunction with that February meeting and this year we thought that we wanted to test our expectations for the rest of the year, for a couple of quarters before we took similar action. Capital wise, we think we are in good shape as well. Our debt-to-equity ratio remains at about the same level as it was at year end, about 6.1%.

In this last regard, I think it's appropriate to note that you may have seen the press release that was issued almost concurrently yesterday with the earnings release. In that second press release we announced a proposed convertible debt offering. For reasons of securities regulations that I'm sure all of you are familiar with, we are not able to discuss the offering or any of the filings that have been made in conjunction with that offering in this particular call or otherwise until that offering is completed.
So for this reason, we will therefore appreciate you in not seeking any additional information relative to the offering during the question-and-answer period, which we will now go in to. Operator.

Question and Answer

Operator

(Operator Instructions) We will turn to David Lewis with Raymond James.

David Lewis
Raymond James

Thank you and good morning.

Aldo Charles Zucaro
Chairman & CEO

Hi, Dave.

David Lewis
Raymond James

Al or Chris, the mortgage insurance segment reported first sequential combined ratio decline in 11 quarters. Do you think that we've seen the peak in the fourth quarter or can you get any sense based on some of the trends that you are seeing today if we kind of made it over the top of the hill and slowly maybe, but we're kind of working our way down?

Chris Nard

This is Chris here David. We wouldn't make that statement. I'd refer you back to what we said in the opening comments which we did see again, as we have for the last seven or eight years, this seasonal effect wherein end of the first quarter, we see a slowdown in the growth of new delinquents. That was the primary driver to this reduction in the loss ratio for the quarter.

So I don't think any of us would be so bold as to say that we've seen the peak or make that prediction, but we were encouraged to see that development of usual seasonal effects. Also we saw a little bit more of the loss seeded to the captive re-insurers in the quarter, which also helped in that area as well.

David Lewis
Raymond James

I guess from my understanding, the government tried to slow the delinquencies for a couple of months, and I restored installed the foreclosures and I guess those have now been lifted and now maybe we get another flurry as that kind of your thought that you may see that because of the lag period will pick up a little?

Chris Nard

Well, we've got a couple of things working. The government has had a moratorium as its affected Fannie and Freddie and then many of the large lenders also adopted a voluntary moratorium.

So that has helped to pay claims area, but one thing you will get is when they release those moratoriums, you still have to work those foreclosures through the legal system and you will simply create a big backlog in the legal workings until those things get moved through.

So I wouldn't expect essentially the plug to be pulled out of the dam, but it will take some time for that elimination of the moratorium to really work its way through the foreclosure system in America.

David Lewis
Raymond James

And lastly Chris, do you get any sense that if the Obama plans to potentially pay funds directly to mortgage investors and banks to try to rework these loans will have any great impact?

Chris Nard

It will certainly help. If you look at all of the various loss mitigation programs that are out there from the modifications to the refi support, certainly they should help. Those are meaningful programs that we are supporting with all of our energies in the business, but we do not count on any of those helping us when we think about the financials and our actions going forward, but certainly those are a big positive that are not counted on today.

David Lewis
Raymond James

Thank you. One last question for Al; if I could try to read through your comments on the common dividend, you kind of indicate you kept it at the higher levels in the first quarter payout, but if the trends are still pretty much as you anticipated in the first quarter and potentially moving forward, does that mean that you may hold it at levels. I know that's a full bore decision, but any more clarity there?

Aldo Charles Zucaro
Chairman & CEO

As you know Dave, we've got a long history of dividend consistency at Old Republic and particularly in the last 27; 28 years we've had a steady increase of the dividends. We think that's an important part. The dividend increases are an important part of the covenant we have with our shareholders and therefore, if at all possible we would like to continue that history.

As you know, we're no different than most other companies. We've got our models, our projections and so forth, but given the volatility of the markets currently, we thought that we would wait a quarter or two before we took any further action on that score.

David Lewis
Raymond James

That's helpful. Thank you.

Operator

(Operator Instructions) Next we'll turn to Joe Gaggan with Atlantic Equity Research.

Joe Gaggan
Atlantic Equity Research

Hi, how are you doing? Just some questions about the claims ratio on the mortgage insurance business. Now I guess the claims ratio was 199.9% this quarter and it was 220.5% in the fourth quarter, is that correct?

Aldo Charles Zucaro
Chairman & CEO

Yes, I think so. Then I thought someone earlier said that the delinquencies were slowing down recently compared to the previous quarter, is that right?

Jim Kellogg

What I said is there was a slowdown in the rate of the increase.

Joe Gaggan
Atlantic Equity Research

Okay. Is that the rate of increase from the year-over-year quarter a year ago or is that from…?

Chris Nard

Fourth quarter to first quarter, so that the seasonality we see is usually the delinquencies increase through the fourth quarter and generally the first month of the year, and then the rate of growth slows down in the months of February and March.

Joe Gaggan
Atlantic Equity Research

Okay. So it's a normal seasonality it slows down is what you are saying?

Chris Nard

Yes, normal to the extent that patterns over the last seven or eight years we classify as normal.

Joe Gaggan
Atlantic Equity Research

So the normal pattern is the growth slows from the fourth to the first, is that right?

Chris Nard

Correct.

Joe Gaggan
Atlantic Equity Research

Because all the data I've seen has indicated that delinquencies are going up, not down, as each month moves by right, and obviously the job loss accelerations are going up, and that's the biggest data point around people not paying their mortgages.

Chris Nard

Well, I wouldn't agree with you there. I think there's a lot of moving parts in here. Remember, mortgage insurance doesn't have 100% of the mortgage population, so when you look at commonly published statistics like the MBA or whatever other delinquency stats you'd be looking at, remember we're only a small percentage of that. So that could be one impact where you would see a slight moderation in our trend and where you might see something different in the overall population.

The other thing is, delinquencies and unemployment don't track right on top of each other. There's a lot of, essentially life between a job loss and a missed payment on a mortgage. So you've got to look at the interplay between unemployment and home price appreciation. Track more closely home price appreciation than an immediate response to an increase in an unemployment number.

Joe Gaggan
Atlantic Equity Research

I understand that. So, obviously people don't lose their job and the next month lose their house, but the increases of unemployment started in the first quarter 2008, so now we're a year into it, and the house price decelerations have been going on for a couple of years. I mean it just seems interesting how you're seeing delinquency rates are getting better and henceforth your claim ratio was lower than the fourth quarter.

Chris Nard

Well, as I said, it gets better in the first quarter, really for the last seven or eight years. Now I can't explain that. We spend a lot of time looking at it, but it's just a seasonal pattern that's held up even under the stressful scenario which was somewhat encouraging.

Joe Gaggan
Atlantic Equity Research

All right. Thank you.

Operator

Now we'll move to Richard Wagner with Citadel.

Richard Wagner
Citadel

Hi, Al and Chris. How are you guys doing?

Aldo Charles Zucaro
Chairman & CEO

Good. How are you Richard?

Richard Wagner
Citadel

I had a question on the comment that California, Florida and Arizona were in particular laggard and wanted to know if it's relative to the rest of the country; if conditions in these states are improving or continuing to deteriorate faster than in other states?

Chris Nard

Well, I think if you'd like at some of the commonly reported numbers that stress in Florida continues. We continue to worry about not seeing a bottom there. We are not seeing any positive signs. We have seen a little bit of a positive in California, albeit the home sales there, a huge percentage of them are foreclosure sales or stressed sales, but at least we have seen a little bit of life in California.

Arizona, more closely akin to California than it would be to Florida. So feel better about California and Arizona beginning to see a little activity; a little bit more concerned in Florida as to when we'll see something there improve.

Richard Wagner
Citadel

Excellent. Thanks a lot.

Operator

(Operator instructions) And we'll go to David Lewis with Raymond James.

David Lewis
Raymond James

Thank you. Just a couple of follow-ups; just to clarify Jim's earlier comments on the D&O one-time claim addition to one point, so is that roughly $4.5 million?

Jim Kellogg

It's roughly in the ballpark David.

David Lewis
Raymond James

Okay, and was there any general insurance favorable development in the first quarter, and if you can give us maybe the comparison a year ago?

Aldo Charles Zucaro
Chairman & CEO

On annual basis in the last few years David, it runs about 1%, 2% over time, and there is no change in the pattern of loss developments that we can tell this year. So there was nothing unusual from a loss development standpoint in this quarter, other than what we mentioned about the D&O and E&O.

David Lewis

Raymond James

That's helpful, and just lastly on the title insurance. Do you have a sense of how much volumes have to go up before you break even on that operation?

Aldo Charles Zucaro
Chairman & CEO

Well, the sense that we have is what we have said, and that is that we think we've got a very good chance of getting back into the black, the second half of this year. As I indicated, the volume is up about 1.5%, 2%, almost 3% if you look at open orders which ultimately translate into some closed orders.

As you know David, we are working closely with a Florida company. We made an announcement a month or so ago, that has been having some difficulties and we're trying to be helpful and that's going to be useful in terms of growing the book of business and then there are any number of market dislocations that have occurred by virtue of several mergers or implosions of the title business in the last year or so.

We think we are going to be beneficiaries of some of that build dislocations and therefore, we feel a lot more comfortable today than six months ago about the title business turning on us positively.

David Lewis
Raymond James

Sure, but can you put a number on it? Like volumes need to go up another 2% or…?

Aldo Charles Zucaro
Chairman & CEO

Well, I think I would say at least 5%; that would be my best guess right now.

David Lewis
Raymond James

Okay. That's very helpful. Well, thank you.

Operator

At this point there are no further questions in the queue. Mr. Zucaro, I will turn the conference back to you for any additional or closing remarks.

Aldo Charles Zucaro
Chairman & CEO

Okay. Well, thank you everybody. As we said before, we always appreciate your joining these calls and certainly appreciate your interest in our company. We look forward to visiting with you all again in a couple of months. With that said, you all have a good day.

Operator
That will conclude today's conference. Thank you everyone for your participation.