

Old Republic International Corporation

NYSE:ORI

FQ2 2016 Earnings Call Transcripts

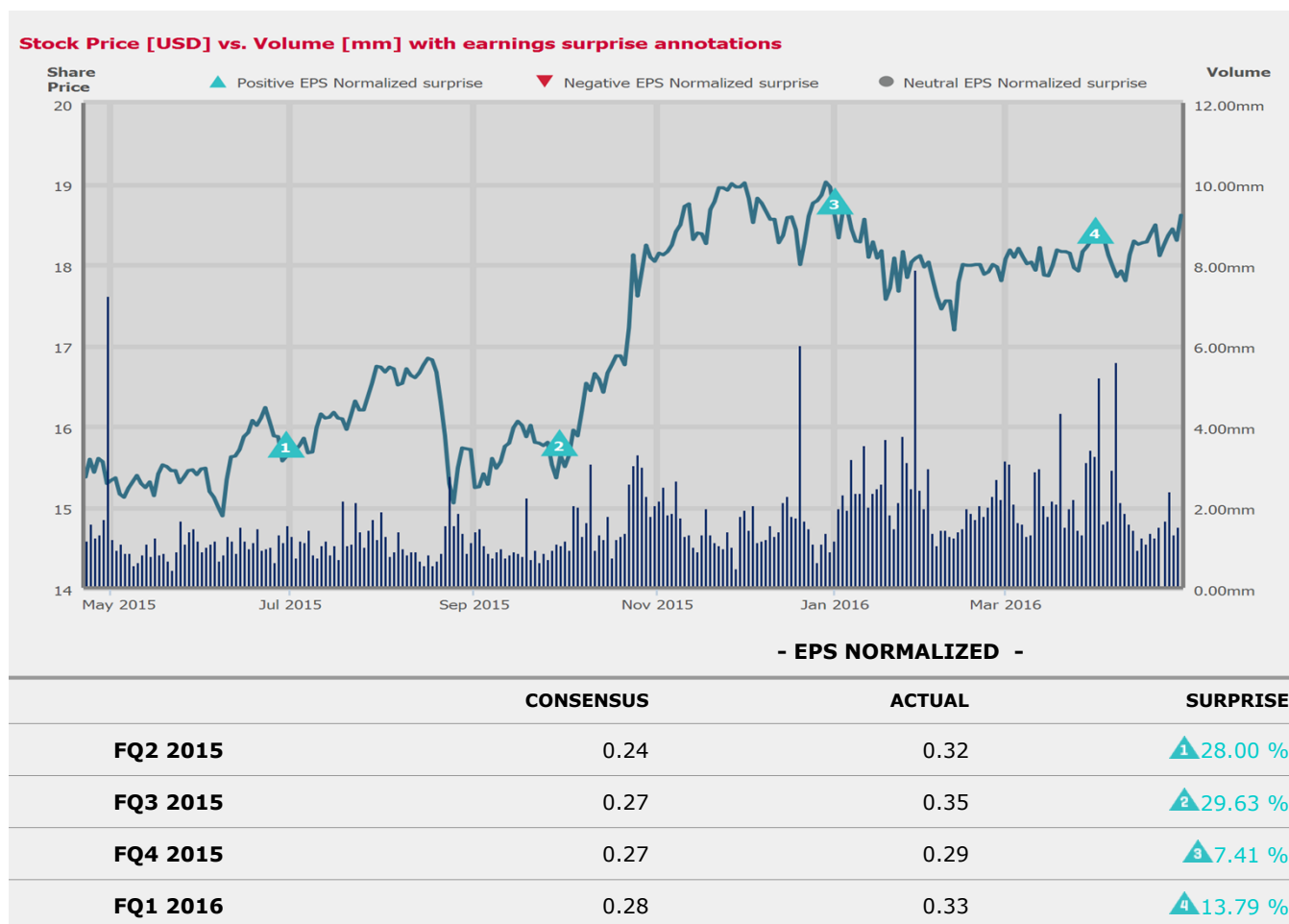
Thursday, July 28, 2016 7:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.32	0.31	▼ (6.06 %)	0.36	1.35	1.42
Revenue (mm)	1444.00	1442.20	▼ (0.12 %)	1558.00	5934.00	5801.00

Currency: USD

Consensus as of Jul-18-2016 7:40 AM GMT



Call Participants

EXECUTIVES

Aldo Charles Zucaro

Chairman and Chief Executive Officer

Craig R. Smiddy

President & COO of Old Republic General Insurance Group Inc

Marilynn Meek

Mark A. Bilbrey

President of Old Republic Title Insurance Company

ANALYSTS

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

Gary Kent Ransom

Dowling & Partners Securities, LLC

Presentation

Operator

Good day, and welcome to the Old Republic Second Quarter 2016 Earnings Conference Call. [Operator Instructions] I would like to remind everyone that this conference is being recorded and would now like to turn the conference over to Marilynn Meek with MWW Group. Please go ahead.

Marilynn Meek

Thank you. Good afternoon, everyone, and thank you for joining us for Old Republic's conference call to discuss second quarter 2016 results. This morning, we distributed a copy of the press release and posted a separate statistical exhibit, which we assume you have seen and/or otherwise have access to during the call. Both documents are available at Old Republic's website, which is www.oldrepublic.com.

Please be advised that this call may involve forward-looking statements as discussed in the press release and statistical exhibit dated July 28, 2016. Risks associated with these statements can be found in the company's latest SEC filings.

Participating in today's call, we have Karl Mueller, Senior Vice President and Chief Financial Officer; Craig Smiddy, President of the Old Republic's General Insurance Corp's Group; Mark Bilbrey, President of Old Republic's Title Insurance Company; and Al Zucaro, Chairman and Chief Executive Officer.

At this time, I'd like to turn the call over Al Zucaro. Please go ahead, sir.

Aldo Charles Zucaro

Chairman and Chief Executive Officer

Okay. Thank you and again, good afternoon to all. And as it was just announced, we have several Old Republic's senior executives on the line and they'll participate and answer such questions that may come up relative to this morning's earnings release.

With the second's quarters call, we thought we would once again limit ourselves to just a few remarks that highlight what we believe the most important points in the release, and then we'll open the visit to the Q&A question, as was just indicated.

So here it goes. The results for the most recent quarter were somewhat below par for both General and Title Insurance and the reasons for that were given I think fairly clearly on pages 2 and 3 of the release. On the other hand, again, as we said in the release, the RFIG runoff business provided the most positive lift to the latest quarter's performance and to a lesser degree, to that of the first half of this year.

Taking a look at the General Insurance. It's obviously -- it's increasingly clear to us as the year is progressing that we'll perhaps -- probably experience a mid-single-digit rise in earned premiums for this year in its totality and hasn't been the case so far. Most of this is going to come from organic growth and a bit more from a still -- a small startup underwriting facility that we set up early in 2015. We think that the -- as we look at it today, we think that the North American economy is likely to be stuck in a slow gear for the foreseeable future. And this means that we'll be looking to strong business retention, a modicum of new business in various specialty areas and also to the benefits of expanding the segment's footprint from both continuing geographic as well as from product distribution and type standpoints in order to achieve that mid-single-digit rise in volume.

In General Insurance, our claim costs remained relatively stable in -- from an overall standpoint. We think they are benefiting from prior period's rate improvements, which continued to flow through the earnings stream as well as from favorable developments of reserves established in prior periods. It's noteworthy as you read the release, we think, that this is the first -- the very first quarter out of the last 9 consecutive quarters that prior periods General Insurance reserves have thrown off a bit of redundancy. And in this, we're reasonably and increasingly comfortable with the idea that we've finally gotten ourselves back on

track as to expect that prior years' loss costs should not emerge adversely and thus, impinge upon current year results.

Expense-wise, the release points to some noise as you read from the combination of relatively minor expense items that are flowing through the latest quarter's income statement. In this regard, we think that subsequent quarter's premium inputs for the rest of this year should better cover the -- what we view as blips in the period costs.

From -- therefore, from an overall standpoint, we're reasonably confident that General Insurance pretax earnings will look moderately better as the year wears on.

The same thing holds true for Title Insurance. The year-to-date comparisons with 2015 suffer a bit from out of the -- from some of the, again, out of the ordinary positives that existed last year. For the rest of this year, however, we think that the combination of the strong pipeline of orders at the end of June and the prospect of an extended period of relatively low interest rates, as well as fairly improving job environments in this country that all of that bodes well for this important core segment of our business.

Finally with respect to the RFIG runoff. The release points to the key elements that drove its earnings as well as their impact on Old Republic's consolidated results for the first half of both '15 and '16. And again, say, for the continuing saga of a couple of CCI litigations that continue to be resistant to resolution as well as a remaining exposure of sorts in the mortgage guaranty MI area. The combined runoff operations, we think, are likely to fairly mosey along consistently for the foreseeable future.

Turning to other matters. The consolidated operating cash flows that are disclosed on Page 5 of the release, are down about 46% year-over-year. This is driven mostly by the slower top line growth in both the General and Title businesses. And this is, of course, a main reason for the 1.1% year-to-date rise of the cash and invested asset balance shown on top of Page 6 on a cost basis. And to some extent, this is also impacting the consolidated investment income line shown on Page 5, i.e., as cash and invested assets are grow more slowly, you can, all things being equal, you can expect investment income to slow down a bit accordingly.

Let's see. Balance sheet-wise, there isn't much change in either its composition or its continued strength. If we look again at the summary tables on Page 6, it's readily apparent that the approximate 12.8% year-to-date GAAP basis increase in the common shareholders' equity account came mostly from market appreciation of the securities portfolio, particularly the common equity portfolio. And of course, this is particularly due to the equities portion, as I say, which reflect the stronger U.S. market performance in the second quarter in particular.

So I think those -- as I look at my notes here, those are the key takeaways that we think from this morning's release. So as we said before, we'll turn this visit over to whoever is listening and address whatever pertinent questions that may be out there and we've got real talent in my associates here and I'm sure we'll come up with the answers that will be satisfactory.

So operator, take care of that.

Question and Answer

Operator

[Operator Instructions] We'll move forward to our first question from Greg Peters with Raymond James.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

I just thought to take this opportunity to circle back to some of your opening comments and certainly what you said in your press release. The large account construction book, is that risk management-related business or traditional risk transfer? And is there something more insidious on a competitive -- from a competitive standpoint that's happening in that business?

Aldo Charles Zucaro

Chairman and Chief Executive Officer

Craig, do you want to address that?

Craig R. Smiddy

President & COO of Old Republic General Insurance Group Inc

Sure. Hi, Greg. It's a combination of large deductible business and guaranteed cost business. So when we say large account construction, it would include both. And as we also say, we're operating in a very competitive environment. There is definitely evidence in the marketplace of competitive behaviors. And I think as I discussed in the prior quarter or 2, we are committed to not chasing business to maintain a top line. And we're willing to let business go that we don't think is priced adequately. So as we move down the line, we'll continue to respond to the marketplace. And if the competitiveness doesn't improve, then we'll continue to maintain our underwriting discipline and let that business go.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

So on a -- just to follow-up, Craig, on that point. How big is the construction book in its totality in the context of Old Republic's General Insurance business? Just so we have some idea of what the downside potential is.

Craig R. Smiddy

President & COO of Old Republic General Insurance Group Inc

Yes, the -- we break construction in several of our segments. So when we talk about large construction business, it's -- it involves primarily a segment that is currently at about \$300 million of premium on a gross written basis.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

Okay. So I can't recall the last time I've seen you in your press release signal any expenses related to start-up business. I'm sure you probably don't want to share much about what that actual business is, but perhaps you can quantify what the actual expense is. And then I'll have one follow-up and then I'll requeue.

Craig R. Smiddy

President & COO of Old Republic General Insurance Group Inc

Greg I would -- I'm sorry. Yes, I would refer back to the beginning of 2015 when we had our press release about a new joint underwriting venture that we are starting. And so when we talk about the new startup, we also talked about it in our first quarter 2015 conference call. So this is primarily coming from that operation.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

Just -- what the expense -- the relative expense, I was -- that's what I was curious about.

Aldo Charles Zucaro

Chairman and Chief Executive Officer

Well, we have -- Karl, correct me, but we're all over the lot there. You're talking \$2 million, \$3 million here, \$4 million, \$5 million there, pluses and minuses. The point we are making, Greg, is that when you take all these somewhat different types of expenses that are flowing through the income statement, particularly this past quarter, we believe that, that accounts for most of the difference you see from longer-term trends in the expense ratio. And that's why we also said on the release as I recall, right, that we expected that as the year wears on, these what I refer to as blips should evanesce to some degree and be absorbed in the overall premium stream of the year.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

And just the one final question. In the Title business, you mentioned -- you singled out how operating cost rose faster than revenue. And maybe Mark wants to comment on this or Rande, but I'm curious what's changed in the business model that would cause cost to go faster than -- rise faster than revenue or was there a shortfall in revenue relative to rec expectations?

Mark A. Bilbrey

President of Old Republic Title Insurance Company

Greg, this is Mark. I don't think we really have a shortfall in that. What we have done in some key areas, commercial and others, we've increased some staffing opportunities for us. Obviously with new people on board their book of business and follow-up on that is just a little delayed. A lot of it is just a timing issue for us. Certain things have hit the bottom line before on the revenue side, so I don't think there's any shortfall at all, but we're comfortable about that.

Operator

[Operator Instructions]

Aldo Charles Zucaro

Chairman and Chief Executive Officer

I guess, everybody's on vacation in the Hampton's or something.

Operator

And at this time, it seems we have no further questions in the queue. I'd like to hand the conference -- never mind, we just received a question in the conference queue from Jennifer Callahan with Dowling & Partners.

Gary Kent Ransom

Dowling & Partners Securities, LLC

It's actually Gary Ransom from Dowling. I had a question on the commercial auto. I was wondering if you're still seeing rate increases there. That was one of the places where the loss ratio was still rising. What is going on the rate side there?

Aldo Charles Zucaro

Chairman and Chief Executive Officer

Craig?

Craig R. Smiddy

President & COO of Old Republic General Insurance Group Inc

Right. On the commercial auto, we continue to see some severity in that business. And as such, as we talked about for the last few years and as have many in the industry that are -- that write commercial auto, we have taken necessary rate action and continue to take that, so we're still getting the necessary rate to offset those severity trends that we're seeing. And I would put those in the mid-single digits. And different than what I spoke about some of the behaviors we were seeing in the construction area, in the commercial auto area, most of the competition is seeing the same kind of trends that we are, and therefore, responding accordingly. And we are able to get the necessary rate increases that we need. So the marketplace is more supportive, certainly, in that line of business.

Gary Kent Ransom

Dowling & Partners Securities, LLC

Are there any other lines where you're still getting rate increase?

Craig R. Smiddy

President & COO of Old Republic General Insurance Group Inc

I think as we said, generally what's contributing to our top line growth is some moderate low-single digit rate increases on average if you average together all of our lines of business. So in general and in the aggregate, we are, but the marketplace is certainly competitive. And as we always say, it varies dramatically by class of business, line of business, geography. So depending upon those variables, the answer is -- can be very different.

Gary Kent Ransom

Dowling & Partners Securities, LLC

And then over on Title, I wanted to understand better what you think the outlook might be for refis. With low interest rates, obviously, there's a lot of activity, but it seems to me there's some limited to that activity over the long run. Do you have an outlook for what the refi activity might be doing over the next several months, say, or year?

Mark A. Bilbrey

President of Old Republic Title Insurance Company

Yes, thank you. This is Mark. On that -- We follow a lot of the MDA projections on that. And they're saying, it should be up to 44% this year, but it should drop down to about 27% for '17. July started off very, very strongly in that. As long as the rates stay low, there's still some opportunities in that. And I think we'll see a fairly solid, for -- or at least the next quarter positive cushions to the end of the year because of our agency network. Sometimes we're delayed a little bit in premiums hitting our bottom line. It should slow as '17 goes if you follow the projections.

Operator

[Operator Instructions] And it seems that there are no further questions at this time. Mr. Zucaro, I'd like to turn the conference back to you for any additional or closing remarks.

Aldo Charles Zucaro

Chairman and Chief Executive Officer

Okay. Well, thank you. Appreciate everyone's interest in Old Republic and your attendance in this visit. And -- so we look forward to the next one in a few months. So you all have a good afternoon. Thank you.

Operator

And ladies and gentlemen, that concludes today's conference call. We thank you for your participation. You may now disconnect.

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