S&P Global
Market Intelligence

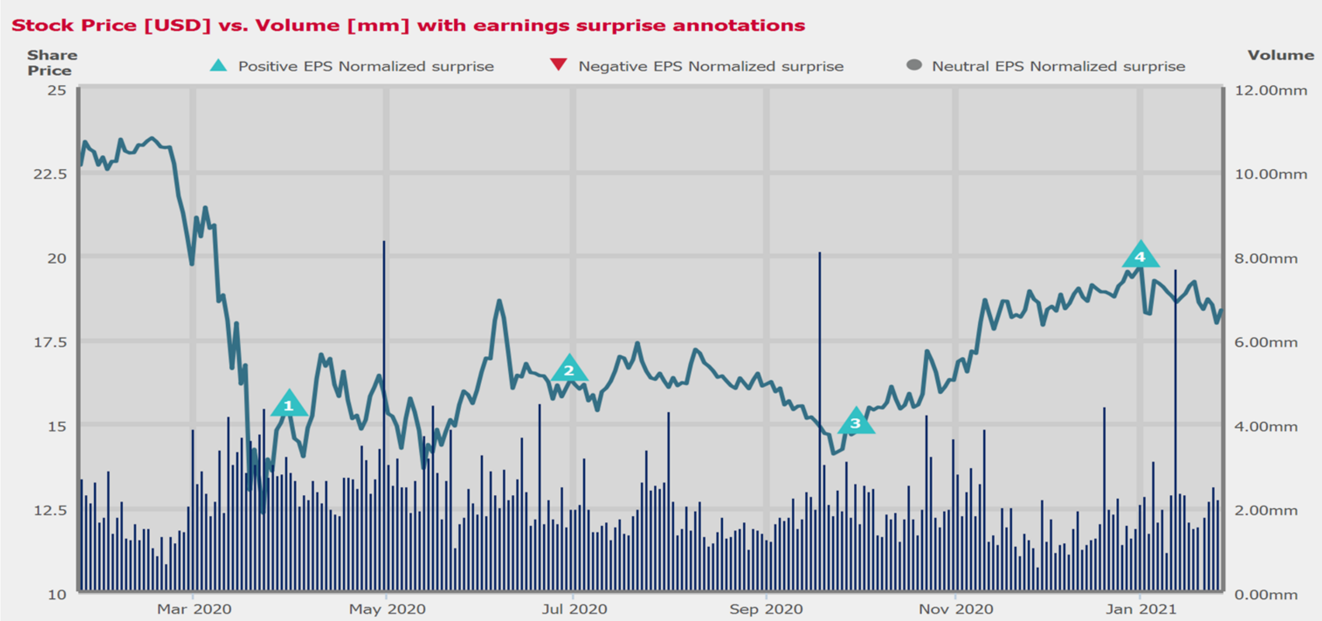
Old Republic International Corporation
NYSE:ORI
FQ4 2020 Earnings Call Transcripts

Thursday, January 28, 2021 8:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2020-			-FQ1 2021-	-FY 2020-			-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.44	0.75	▲66.67	0.44	1.95	2.24	▲14.87	1.82
Revenue (mm)	1754.00	2423.20	▲38.15	1600.00	6309.00	7166.00	▲13.58	6820.00

Currency: USD
Consensus as of Jan-29-2021 1:15 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2020	0.31	0.47	▲1 51.61 %
FQ2 2020	0.40	0.42	▲2 2.44 %
FQ3 2020	0.44	0.62	▲3 40.91 %
FQ4 2020	0.44	0.75	▲4 66.67 %

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Call Participants

EXECUTIVES

Carolyn Jean Monroe
President

Craig Richard Smiddy
President, CEO & Director

Karl William Mueller
Senior VP & CFO

ANALYSTS

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Nicholas Karzon

Ryan Winrick

ATTENDEES

Joe Calabrese

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Old Republic International Fourth Quarter 2020 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Joe Calabrese with MWW PR. Thank you. Please go ahead.

Joe Calabrese

Thank you. Good afternoon, everyone, and thank you for joining us for the old Republic conference call to discuss fourth quarter 2020 results. This morning, we distributed a copy of the press release and posted a separate statistical supplement, which we assume you've seen and/or otherwise have access to during the call. Both of the documents are available at Old Republic's website, which is www.oldrepublic.com.

Please be advised this call may involve forward-looking statements as discussed in the press release and statistical supplements dated January 2021. Risks associated with these statements can be found in the company's latest SEC filings.

This afternoon's conference call will be led by Craig Smiddy, President and CEO of Old Republic International Corporation and several other senior executive members as planned for this meeting. At this time, I'd like to turn the call over to Craig Smiddy. Please go ahead, sir.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, thank you, Joe, and good afternoon, everyone, again, and welcome to Old Republic's Fourth Quarter and Full Year 2020 Earnings Call. With me today, we have our CFO, Karl Mueller; and Carolyn Monroe, the President of our Title Insurance Group.

So we're obviously very happy with the strong results we posted for the fourth quarter and the full year with record-setting performance on a consolidated basis as well as individually and General Insurance and Title Insurance groups.

Overall, a very pleasing quarter with $0.75 of operating income per share and ending book value per share of $20.75 and a consolidated combined ratio of 90.3% for the quarter and 93.3% for the full year.

Growth in net written premiums continued from the third quarter into the fourth quarter in General Insurance, although the effects of the pandemic and slightly lower net earned premiums for the quarter and the year in General Insurance. On the other hand, Title Insurance grew net premiums and fees earned by just over 30% for the quarter and 20% for the year.

As demonstrated in these strong results, our diverse portfolio of specialty products, combined with our exceptional customer service in General Insurance and Title Insurance, has, again, delivered value. Our specialty strategy continues to contribute to our track record of more consistent growth and profitability over the long run.

So with these brief opening comments, I think at this point, I'll turn it over to Karl to review in greater detail our overall consolidated financial results. And then he'll turn things back to me to cover General Insurance. Followed by Carolyn, who will discuss Title Insurance. And then, of course, we'll open up our discussion to Q&A. So, Karl?

Karl William Mueller
Senior VP & CFO

Thank you, Craig, and good afternoon. This morning, we announced fourth quarter net income, excluding all investment gains and losses of $0.75 per diluted share, which represents an increase of almost 60% by comparison to the final quarter a year ago. For the full year, net income, again, excluding investment gains and losses, rose nearly 22% to $2.24 per share. Consolidated net premiums and fees earned increased by 13% for the fourth quarter and 8% for the year. As

Craig mentioned, this growth was driven mostly by our Title operation, as it reported significant growth for both the final quarter of 2020 as well as for the full year.

This morning's release also disclosed that certain adjustments were made to previously reported Title amounts to conform to presentation that we adopted in the fourth quarter of 2020. In effect, these adjustments, simply gross up income statement, as revenues and expenses were increased by the same amounts. And consequently, there was no impact to either segment or consolidated pretax operating income.

As Craig mentioned in his opening remarks, General Insurance net premiums earned were down slightly in 2020 compared to the same period a year ago. The runoff mortgage business earned premiums fell 23% for the year, pretty much in line with the decline in the outstanding amount of risk in force.

Net investment income decreased by almost 3% for the quarter, and roughly 2.6% for the year, basically following the same trends we've experienced throughout all of 2020. Those being primarily from the effect of lower yields on new investment purchases that more than offset the growth in the invested asset base.

With regard to underwriting performance, we achieved significantly lower combined ratios. Again, as Craig touched upon earlier, this year's fourth quarter consolidated combined ratio improved by 5 percentage points from a year ago. For the year, we realized a 2 percentage point reduction. These improvements resulted from better underwriting performance in both our General as well as Title Insurance operations, as Carolyn and Craig will discuss in greater detail momentarily.

Underwriting results for all 3 segments also reflect favorable reserve development in both 2020 periods. In total, the consolidated claim ratio benefited by 2.3 percentage points for the quarter and 1.3 points for the full year. At year-end, the composition of the investment portfolio remained essentially unchanged. Approximately 74% of the portfolio is invested in highly rated bonds and short-term investments. Less than 3% of the bond portfolio is invested in below investment-grade securities. The remaining 26% of the overall portfolio is dedicated to large-cap equity securities. Typically, those companies that have a long history of paying and regularly increasing dividends to their shareholders.

The valuation of the equity portfolio improved by $373 million during the final quarter of 2020, and ended the year with an unrealized gain of $785 million. For the foreseeable future, we do not anticipate making any material changes to our investment strategy.

We ended 2020 with a book value per share reaching $20.75, which represents a 13.1% increase when you include all regular and special dividends for the year. And then finally, with respect to our MI runoff operations. I would simply point out that its operating results are consistently becoming an even smaller contributor to the consolidated totals. As an example, the MI net premiums earned represents -- represented in 2020, just 0.7% of the consolidated total and a modest 1.2% of pretax income for the entire year.

Total delinquencies trended down by roughly 6.5% during the quarter, although they remain elevated compared to year-end 2019 levels. The proportion of total delinquent loans reported to us as being in forbearance, decreased from 47% at the end of September to 29% at year-end. We continue to closely monitor the claim experience for this population and reserve for this group of loans separately.

Looking forward, just given the declining revenue base and the increased level of uncertainty surrounding loss costs attributable to these loans and forbearance, we would expect there to be some near term -- how do I say it, lumpiness in quarter-to-quarter operating results.

From a capital perspective, the mortgage company's GAAP basis shareholders' equity had accumulated to $445 million at December 31. Our objectives with respect to the future of the MI runoff are summarized in the recent letter to shareholders that was dated January 6.

So I think that about covers it. Let me now turn things back to Craig for a discussion of General Insurance.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, we've already commented on the net premiums written increasing in the third and fourth quarter, while net premiums earned reflect the effects of the pandemic coming in slightly lower for the quarter and the year. Compared to 2019 fourth quarter and year-end, pretax operating income rose by almost 60% in the quarter and 19% in the year, resulting primarily from our improved claim ratios. The overall combined ratio improved from 98.8% to 92.7% quarter-over-quarter and from 97.5% to 95.5% year-over-year. The claim ratio, as reported, were inclusive of prior year favorable development of 1.8 percentage points in the quarter and 0.8 percentage points for the year. Compared to the 2019 fourth quarter, net premiums earned in commercial auto grew by almost 6%, while net premiums written grew by nearly 8%. This growth in commercial auto reflects restoration of our exposure base along with the positive effect of rate increases, which are currently in the low double digits for commercial auto.

Our fourth quarter commercial auto claim ratio improved from 82.3% compared to 91.3% in the fourth quarter of 2019, and we think this shows that our work on this line of coverage is paying off as we continue with rate increases, enhanced risk selection to bring that claim ratio down to our target in the low 70s.

Claim frequency on commercial auto is still not at pre-pandemic levels, but this lower frequency is being offset by higher severity that continues due to greater speeds with less congested roads and highways and the continued social inflation influences on settlements.

Moving to workers' compensation. Compared to the 2019 fourth quarter workers' comp, net premiums earned and written fell 20%, while for the full year, net premiums earned and written declined by roughly 13%. These lower premium levels mostly reflect the reduced exposure base as payrolls have not recovered. And although I would comment that premium rates are now slightly up for workers' comp, thereby no longer contributing to the reduction in premiums.

The workers' compensation fourth quarter claim ratio came in at 51.7% compared to 57.4% in the fourth quarter of 2019. Aside from the COVID-19-related claims, claim frequency here is also still lower than pre-pandemic levels.

COVID-19 workers' compensation claims continue to behave exactly as we have discussed in each of our earnings calls that followed the first, second and third quarter with 95% of the COVID-19 work comp claims coming from loss-sensitive business such as large deductibles. And 95% of the COVID-19 claims continue to be mild in nature with very low claim payments and less than 1% of all claims are severe or fatal.

So we continue to remain confident with our 2020 accident year loss ratio selection for workers' comp, again, taking into consideration the lower frequencies, the loss-sensitive nature of our business and the high proportion of mild cases for COVID-19 claims.

We typically provide commercial auto workers' compensation and general liability combined. And this combined fourth quarter claim ratio came in at 71% compared to 78.1% in last year's fourth quarter. We also saw improvement in the financial indemnity and property claim ratios, while we did see some deterioration in the claim ratio for the other coverages category.

So our strategy in General Insurance to enhance underwriting excellence through better segmentation, improved selection, increased use of analytics, along with our continued focus on providing loss-sensitive programs should enable us to sustain greater underwriting profitability over the long term. And I'll point out this is necessarily so because given the declining investment income situation, it's imperative that we continue to focus on improved claim ratios, combined ratios and margins.

Additionally, I'll just add that the marketplace is favorable for us to continue to obtain appropriate prices for our products. On average, overall, we're seeing double-digit rate increases on our business at this point in time.

So I'll turn the discussion over to you, Carolyn, for your comments on the Title Insurance group. And again, I congratulate you and your team who continue to execute at an extremely high level.

Carolyn Jean Monroe
President

Thank you, Craig. As reported this morning, the Title group posted record-setting fourth quarter and year-to-date results to wrap up an outstanding and demanding last 12 months. We continue to be extremely proud and grateful to all our employees, as they remained focused and positive in dealing with the daily challenges, both professionally and personally in these unprecedented times. Our accomplishments are achieved with the unwavering commitment of our employees and the support of our customers. I'm honored to be reporting our results on behalf of all of our dedicated and hard working employees.

All-time fourth quarter and year-to-date highs were set for both underwriting revenue and operating profit. Total premium and fee revenue were up approximately 31% for the quarter and 20% year-to-date. Our pretax operating income of $132 million for the quarter compared to $77 million in last year's fourth quarter, an increase of $55 million or 71%.

Full year pretax operating income of $344 million compares to $231 million for the prior year, an increase of $113 million or 49%. For the full year, our 2020 combined ratio of 90.7% compares favorably to the 93% reported for full year 2019 results. This record-setting performance was driven by a robust real estate market, supported by a continued low interest rate environment, resulting in an increase in home sales and refinance activity.

Technology continues to be a cornerstone for advancement in our industry. As our company has moved forward with Title technology, we have employed the use of a Robotic Process Automation platform typically referred to as RPA and the deployment of bots throughout key processes in the company. We are piloting and soon will be implementing a Title automation engine to increase the speed in our servicing of refinance orders. This automated technology gives us the ability to produce a title more efficiently with the utilization of multiple data sources through RPA, algorithms and rules-based decision engines while keeping the product integrity intact.

While we continue to embrace advancements in technology, Title related and otherwise, we are dedicated to analyzing the breadth of service improvements in the application of our technological progressions. We remain mindful of the needs of our customers and will continue to provide connective solutions for all of them.

As we started New Year, our guiding principles and integrity, managing for the long run, financial strength, protection of our policyholders and the well-being of our employees and customers will always be at the forefront of all that we do. And with that, I'll turn it back over to Craig.

Craig Richard Smiddy
President, CEO & Director

Thank you, Carolyn. So again, all of us here at Old Republic are very pleased with this quarter and this year's operating results. Our strategy that offers numerous specialty insurance and related products to core industries, served by General Insurance and Title Insurance, continues to produce superior, more consistent results. And going forward, we will, of course, continue with our focus on underwriting excellence and profitability.
So that concludes our prepared remarks, and we'll now open up the discussion to Q&A.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I'd like to ask just a couple of questions on the General Insurance and then also a question on Title. First of all, on the General Insurance business. First of all, if I'm not mistaken, you said, Craig, that there was low double-digit rate increases in commercial auto in the fourth quarter. And that seems to be somewhat of a moderation from what I think we've been hearing, which should have been more mid to high teens before. Has there been some sort of moderation of your rate in commercial auto or maybe other lines?

Craig Richard Smiddy
President, CEO & Director

Well, I think your observation is somewhat accurate, Greg. I would point out that over the course of the last few years, it's ebb and flowed a little bit -- we'll see low double digits. In other quarters, we'll see did -- rate increases in the in the teens. And it has moved around over the last couple of years. So I'm not reading anything specifically into what we're seeing thus far. I would say it's pretty much a continuation of what we've seen. And quarter-to-quarter, you're going to see a little bit of up and down. But bottom line is we're still getting very strong rate increases.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Excellent. Now just stepping back big picture, the net premium written number on -- so in '20, it was almost somewhere identical to what you reported in 2019. When we think about '21, what do you think about how the net premium written and net earned will look like when we reflect back on '21 versus '20? Will it be growing? Will it be stagnant? Will it be down a little bit? What's your gut reaction based on what you're seeing today?

Craig Richard Smiddy
President, CEO & Director

Yes. Well, first, I would point out that we're showing net premiums written and we felt that, that was important at the start of the pandemic just to give a greater insight into leading indicator on where things would eventually head. So the fact that we've seen growth in premiums written would indicate that growth in premiums earned is around the corner. More specifically, we're -- we've seen the biggest decline in premiums is workers' compensation.

And I would tell you that from a policy count standpoint, we are not seeing that level of decline whatsoever. Our policy retention ratios are very consistent with the past. So it really is an exposure issue. And therefore, I would think that as the economy recovers, as employment levels recover, as vaccinations occur, that we'll see a rebound in workers' compensation in 2021.

Similar to the rebound we're already seeing on commercial auto where it's practically back to pre-pandemic levels.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Got it. I'll just pivot Carolyn to the Title operations. Clearly, a phenomenal result for the quarter and for the year. And when we think about how are you going to replicate that in '21, some of the conditions still exist, the low interest rate environment, the housing market. What's your view on the outlook for '21 versus '20?

Do you think you can grow both revenue and earnings? Are you hoping for just to achieve status quo or keep it flat with the 2020 year result? Or give us some perspective on how you're looking at your business for the year.

Carolyn Jean Monroe
President

Well, we believe that as a result of the pandemic, 2020 was a pretty extraordinary year for our industry. And the outlook is still very good. I mean, if you follow Zillow at all and what they say about the housing market still being strong for 2021. We've started the year out strong. Refinance is expect -- that activity is expected to drop some. So we remain very optimistic about 2021. And we'll just hold on and really see what happens. It's just so hard to predict, but all indications, this will be a strong year for us.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

And the follow-up question is, in your comments, Carolyn, you talked about some of the ongoing technology initiatives that you're utilizing to enhance the performance of your segment. Are these -- most of these things developed internally? Are these done in partnerships with outside vendors? Could you give us some perspective on that?

Carolyn Jean Monroe
President

Yes. So we do what we can internally, but we also recognize that we're a Title Insurance company. And so if we can partner instead of having to reinvent, we definitely look at that as well. It's really all about what is most efficient and cost-effective for us. But we're fortunate to have a technology group that understand how to -- the best process to go through for us.

Operator

[Operator Instructions] Your next question comes from Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Just had a quick question on the -- I guess, both the accident year improvement as well as the favorable development in the quarter. Can you give a little bit more color there? Were there particular lines driving that as it relates to the PPD? Was there -- did it come from certain lines of business more than others or which accident years did it relate to? Just if you could go back to the ending little bit, that would help.

Craig Richard Smiddy
President, CEO & Director

Sure, sure. On the -- I'll speak first to the current accident year and tell you that mix of business is always going to have some impact on that. And so for instance, to the extent that you might be writing more property or your writing business mix that has a lower loss ratio, that will have an impact on it.

But as we have said quarter-after-quarter, there is no question whatsoever that we are very focused on an underwriting excellence, pricing our business such that we will achieve lower loss ratios, and we see that coming through in the prior years. And as I also commented on earlier, we have to. Our investment income is coming down as yields continue to decline. And as we reinvest at lower yields, there is no choice except to improve that claim ratio and lower that combined ratio.

As far as the development is concerned, we have said for many, many years, quarter-after-quarter, that our history -- our long history has been that we aim to have slight redundancy as opposed to slight deficiency. And that we were working very hard to make sure that we were getting back to that track record. And part of that is recognizing bad news very quickly and being very slow to recognize good news and especially on longer tail lines of business. So it's fair to say that our long tail line of business, workers' comp is -- has performed very well in prior accident years. Whereas as Karl, I think, mentioned, there's still a little bit of headwind from prior accident years on commercial auto.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then maybe just more high-level philosophical to that point. How do you approach in the current environment, right, let's say, 2020. There's a lot of mixed signals in the data, I can imagine, between what's going on at the court levels with courts closed for a while, but I think slowly reopening. But by no means back to normal, write-down to kind of some things being observed in workers' comp. How do you approach kind of the murkier picture in 2020 on all open accident years when you kind of go through your process of what's recognized versus not recognized?

Craig Richard Smiddy
President, CEO & Director

Yes. Well, we would agree with you. It is a little murky with so many different variables in flux, no question. I would say that with respect to severity and social inflation, our expectation is that, that is not going to go away. So therefore -- and I'll talk more specifically on commercial auto. We are not taking any comfort in the temporary nature of some short-term frequency reduction because right now, we're seeing all of that frequency reduction being offset with severity increases.

So while anecdotally, we hear from our claim departments that there seems to be a greater incentive by plaintiff attorneys to go ahead and come to the table and settle claims. There is still overriding propensity for claims to be settling higher because of the social dynamic -- social inflation dynamic.

So there, too, we're not taking any comfort in short-term frequency. We think severity is going to continue. And therefore, we firmly believe that the rate increases that we're getting on commercial auto must continue. And that might tie back to Greg's earlier question, it's -- by no means do we think that we're now in good shape on commercial auto and I speak that, I think, even where the industry stands, I think there's a recognition that double-digit rate increases are necessary from what we see at this point in time.

Operator

Our next question comes from Ryan Winrick with Guggenheim.

Ryan Winrick

Great. Another great quarter. I wanted to ask, since you've provided operating margin objective around 10 -- between 10% to 12%. Are 2 consecutive quarters of exceeding that enough to consider revising that upward? I guess I wanted to get your thoughts, and especially how well Title is doing and the discussion of the Title automation, how that might impact that guidance going forward or that objective?

Craig Richard Smiddy
President, CEO & Director

Well, as you know, the operating margin, of course, includes what we might have in the way of investment income as well as underwriting margin. And we're going to expect to see less margin coming from investment income, more margin coming from underwriting income going forward. And to the extent that there continues to be pressure on investment income, we will always take a step back and look at those margins and make sure that they get us to where we need to be. But we -- at this point in time, we remain comfortable where those are at, recognizing that more margin needs to come from underwriting as opposed to investment income.

Operator

Your next question comes from Nicholas Karzon with Franklin Templeton.

Nicholas Karzon

First, on capital management. We understand and support the prioritization of organic growth and recognize Old Republic's impressive historical dividend track record and recent special dividends. However, I wanted to get your latest view on whether share repurchases could be additive to the company's capital return toolkit.

Anecdotally, we've observed that a much larger and well-respected insurance company that has historically refrained from repurchases along similar grounds is now buying back stock above book value. This thought process seems especially timely in the context of the widening down of the runoff segment, which is currently tying up to close to $450 million of equity.

Hypothetically, a buyback could be accretive to both book value and high single-digit accretive to earnings per share. While I understand all of this isn't available for today, maybe repurchases could produce some flexibility in the timing of future capital return as well.

Can you help us understand financially and perhaps philosophically why share repurchases aren't in Old Republic's capital management framework at this point?

Craig Richard Smiddy

President, CEO & Director

Well, Nick, first, I certainly wouldn't want to get ahead of the Board and the letter that we provided to all shareholders on January 6, and I won't reiterate that letter. But I thought, at least we try to provide as much insight into our process as possible and reassure shareholders that there is a tremendous amount of rigor around our capital management approach.

And when we evaluate capital and capital management at the Board level and management level, we certainly take into consideration all aspects of capital management, including buybacks as well as cash dividends. And again, I won't try to reiterate what is -- what has been said in that letter. But I think it speaks for itself. And therefore, on a go-forward basis, we will use that same rigor and same process to look at all aspects of capital management and all alternatives.

I would point out, I'm not sure if I heard all of your question regarding any excess capital relative to what we have in our mortgage operation. But in that same letter I referenced, we do talk about that capital that's in that operation. And that capital will eventually become available, or otherwise over the course of time, as we say in our letter, it will be freed up. So that capital is not immediately available, and it's currently in our mortgage runoff business. And certainly, the regulators from the state of North Carolina would be involved in any decisions to free up that capital.

Nicholas Karzon

Okay. And as a second question, we wanted to acknowledge some of the steps taken to improve corporate governance over the past year, including and not limited to, the adoption of the proxy access provision as well as the return to hosting quarterly conference calls following earnings reports. However, Old Republic continues to lag peers with respect to several elements of corporate governance best practices, including maintaining a staggered board with plurality voting and a rights plan.

While we, like many of your shareholders believe that business should be run for the long term, we also don't view these policies as necessary to support that objective. And the fact they may be destroying public market value. Are these issues something that you have evaluated? And can we expect to see further improvements on material corporate governance issues going forward?

Craig Richard Smiddy
President, CEO & Director

Well, Matt -- Nick, I think we're well aware of the concerns that you have raised. And we're just -- like other issues, our Board is also very much aware of these issues that you've raised, and we constantly evaluate the issues and make decisions that we think are in the best interest of all shareholders. So again, this is an ever-evolving process, something we continuously revisit and analyze collectively.

Operator

Okay there are no further questions at this time. I will now turn the call back over to management for closing remarks.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, again, we appreciate everyone's interest and support. And all of us that Old Republic feel we have delivered exceptional value as is evidenced in our fourth quarter and full year 2020 results. And we wish everyone the very best as we hopefully emerge from the pandemic, and we're able to move on to greener pastures as we move further into 2021. So again, thank you all very much for your interest and your time.

Operator
Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.