S&P Global
Market Intelligence

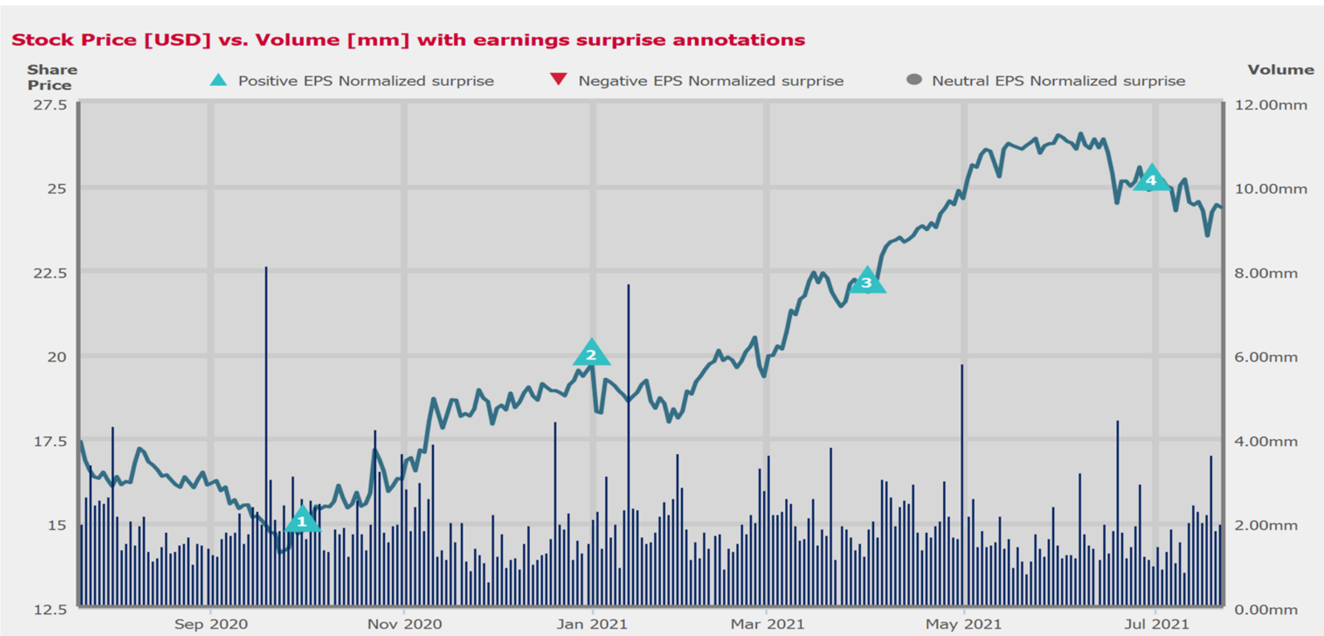
Old Republic International Corporation
NYSE:ORI
FQ2 2021 Earnings Call Transcripts

Thursday, July 22, 2021 7:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.52	0.73	▲40.38	0.56	2.38	NA
Revenue (mm)	1708.00	2132.80	▲24.87	1693.00	7606.00	NA

Currency: USD
Consensus as of Jul-14-2021 6:57 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	0.44	0.62	▲1 40.91 %
FQ4 2020	0.44	0.75	▲2 66.67 %
FQ1 2021	0.45	0.69	▲3 53.33 %
FQ2 2021	0.52	0.73	▲4 40.38 %

Table of Contents

Call Participants

EXECUTIVES

Carolyn Jean Monroe
President

Craig Richard Smiddy
President, CEO & Director

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

ANALYSTS

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

ATTENDEES

Joe Calabrese

Presentation

Operator

Good day. Thank you for standing by, and welcome to the Old Republic International Second Quarter 2021 Earnings Conference Call. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Joe Calabrese. The floor is yours.

Joe Calabrese

Thank you. Good afternoon, everyone, and thank you for joining us for the Old Republic conference call to discuss second quarter 2021 results. This morning, we distributed a copy of the press release and posted a fiscal supplement, which we assume you have seen and/or otherwise have access to during the call. Both of the documents are available on our 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 the fiscal supplements dated July 22, 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. Thank you, Joe. Well, good afternoon, everyone, and welcome again to Old Republic's second quarter earnings call. With me today, we have our CFO, Frank Sodaro, Frank's joining us for the first time on this call following Karl Mueller's retirement, but Frank has been working alongside Karl for several years as Deputy CFO. So Frank, welcome. And we also have Carolyn Monroe, the President of our Title Insurance Group.

So I'll kick things off here. ORI produced another terrific quarter with General Insurance and Title Insurance each posting exceptional results that drove the strong consolidated results that we posted. Compared to the second quarter of 2020, total net premium and fees increased to just under $2 billion, up almost 30%.

Pretax operating income increased to $275 million, and that's up 80% and the consolidated combined ratio improved to 90.6%, a 5.5 percentage point improvement. Again, comparing to the second quarter of '20, General Insurance saw growth return with net written premium increasing by 13%. And in Title Insurance, we grew net premiums and fees earned by 57%. So our specialty strategy with our diverse portfolio of specialty products in both the General Insurance and Title Insurance Groups continue to deliver strong growth and strong profitability.

So with that introduction, I'll now turn the discussion over to Frank to discuss some of the per share figures along with our investment portfolio. And then he'll turn things back to me to cover General Insurance. And that will be followed by Carolyn, who will discuss Title Insurance and then, of course, we'll open it up to Q&A after that. So Frank, I hand it over to you.

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Thank you, Craig, and good afternoon, everyone. This morning, we announced first quarter net income, excluding all investment gains and losses of $221 million or $0.73 per share, a 78% increase compared to last year's second quarter. For the first 6 months of this year, net operating income was $427 million, which was up 61%. Results for both periods were driven by substantial growth in underwriting probability within our General and Title Insurance segments, and you'll hear more about that shortly. Additionally, shareholders' equity rose to just under $6.8 billion, resulting in book value per share growing to a record $22.59.

So taking into account dividends, this was an 11% increase from last year-end. This growth was driven by a combination of our strong earnings along with further market appreciation within the investment portfolio. At June 30, that investment portfolio consisted of approximately 68% of highly-rated bonds and short-term investments, with the remaining 32% allocated to large-cap stocks that have a long history of not only paying dividends but increasing them.

The fair value of the equity portfolio improved by another $120 million during the quarter and ended with an unrealized gain of nearly $1.3 billion. Net investment income decreased slightly for the quarter and almost 5% year-to-date as the impact of lower yields on new investment purchases more than offset a modest increase in the average investment base.

The average maturity on the bond portfolio remained consistent at approximately 4 years, and the book yield was 2.6% compared to a market yield of 2.5%. Now turning to the liability side of the balance sheet. Claim reserves grew to just over $11 billion at June 30. All 3 operating segments recognized favorable claim reserve development for the quarter.

In total, the consolidated claim ratio benefited by 1.8 percentage points for both this year's second quarter and first half compared to 0.3 and 0.6 percentage points for the same periods a year ago. Finally, our mortgage runoff operations continue to generate results aligned with our expectations. The Group paid another $25 million dividend to parent, bringing the total to $50 million for the year. We expect that pace of dividends to continue through the remainder of the year. Total GAAP shareholders' equity for the mortgage companies ended the quarter at just under $220 million. I'll now turn the call back to Craig for a discussion of General Insurance.

Craig Richard Smiddy
President, CEO & Director

Okay. Frank, thank you. So turning to general insurance. As I already noted, we saw growth return with net written premium increasing by 13% and net premiums earned increasing 6%. Compared to the second quarter of 2020, pretax operating income rose by almost 45%, primarily from our improved claim ratios. The overall combined ratio improved 4.4 percentage points from 98.4% to 94%. The claim ratios we reported were, of course, inclusive of favorable prior year development, and that came in at 2.9 percentage points for the quarter.

Net premiums written in commercial auto grew by 13% with the tailwind we have from continued rate increases in auto liability. And those rate increases right now are coming in, in the 15% range. Our second quarter commercial auto claim ratio improved to 75.4% compared to 83.4% in the second quarter of '20. As far as frequency, claim frequency is returning, but still lower than pre-pandemic levels. And however, offsetting that is higher severity that continues due to greater speed than the continued pressure on settlement values.

Turning to workers' compensation. Net premiums written were even compared with the second quarter of '20. However, that's a notable improvement from recent quarters where we've experienced some declines. Rates in work comp were slightly negative, and that's fluctuated between quarters between a range of plus or minus 2% over the most recent quarters.

So relatively flat trend there. The workers' compensation second quarter claim ratio came in at 59.6%, and that compares to 65.7% in the second quarter of 2020. Claim frequency here in workers' comp is trending back toward pre-pandemic levels.

Given that we typically provide commercial auto, workers' comp and general liability together in our product offering, this combined claim ratio came in at 69.1% compared to 74.6% in last year's second quarter. Highlighting the results in financial indemnity, property and other coverages, which we show in the financial supplement, we've expanded our product offering in these areas. And collectively, in those 3 areas, we grew net written premium by 25% this quarter, and the favorable claim ratios helped contribute to the improved combined ratio in the General Insurance Group.

So we in General Insurance continue to enhance our underwriting excellence through better segmentation, improved risk selection, pricing precision and increased use of analytics. And we feel confident that these efforts will continue to facilitate strong underwriting profitability as we move through the year. The marketplace is generally disciplined.

And it's, therefore, favorable for us to continue to obtain appropriate prices for our products while maintaining our high retention ratios. So that will wrap it up for the General Insurance Group for the time being. And I'll now turn the discussion over to Carolyn, who, along with the rest of our team have put together a string of terrific quarters. So Carolyn, I'll let you take it from here.

Carolyn Jean Monroe
President

Thank you, Craig. As reported this morning, the Title Group posted all-time second quarter and year-to-date highs for both underwriting revenue and operating profit. Total premium and fee revenue for the quarter of $1.1 billion was up nearly

57% from the prior year. This is a combination of strong contributions from both agency business up 61% and our direct production channels up 44%.

For the 6-month year-to-date period, premium and fee revenue has already surpassed the $2 billion mark, a 48.6% increase from the comparable period last year. Our pretax operating income of $138 million for the quarter compared to $65 million in last year's second quarter, an increase of approximately $73 million or 112.3%.

The second quarter also marks 4 consecutive quarters in which the $100 million pretax operating income threshold has been exceeded. The high premium and fee volume provide greater leverage of our expense structure, as noted in our 85.4% expense ratio for the second quarter this year and 86.3% for year-to-date June results versus 89.6% and 90.6% for the comparable prior periods.

Per the Mortgage Banker Associations, full year 2021 mortgage originations are expected to be one of the top tiers on record, although trailing by 10.5% the record-setting 2020 results. Since second quarter 2020, refinances have made up the lion's share of the mortgage origination growth, and this trend continued through the second quarter of 2021. There's a marked decrease expected in refinances for the second half of the year as compared to the strong volumes experienced during the second half of 2020.

However, on the flip side, the purchase market is expected to increase by over 15% in 2021, which helps the Title Insurance industry with a higher fee profile. Technology continues to be a cornerstone for advancement in our industry as well as a key piece of Old Republic's ability to deliver on our business goals and objectives.

During the third quarter 2020 earnings call, we introduced a proof-of-concept project we had initiated around robotic process automation, or RPA, while creating our first bot. This proof-of-concept proved measurable ability to reallocate human hours of work.

More importantly and really more exciting, the early metrics are showing a 35% reduction in the time to complete the processes while providing elasticity to handle changes in volume. This elasticity allows for increases in volume without an increase in corresponding expense. The proof-of-concept created the results we were hoping for, and we will continue to deploy and leverage this technology. We know that we are only starting to tap the potential of RPA and other automation technologies and are excited to implement their capabilities.

This represents just one initiative in our portfolio of technology projects that we are working on. The last year showed the increased usage of all digital solutions and platforms. we saw a similar trend with the usage of our digital closing platform, Pavaso. In fact, we remain the clear market leader in this space as the majority of the digital closings and e-notes completed nationwide occur on Pavaso.

As a result, we constantly reinvest in improvements that will continue to expand the adoption of digital closings in the industry. One other quick example of our technology focus that I would like to share with you is that one of the major challenges identified in the industry was the work required to tag documents to allow electronic signatures by all parties in the transaction.

Historically, on the Title side, it required manual and time-consuming preparation to apply the tags. To address this, we released the recent enhancement of -- text tagging, which allows for the reduction of or even eliminates manual tagging efforts. Though this is specifically targeted for the title industry, it will be used by any party that doesn't currently have a document tagging standard.

We are committed to easing the challenges to adoption and we'll have a continued focus on that. Essentially, our business road map and our technology road map have converged into one as they must to achieve our results. I look forward to continuing to share the results of these with you in the future. Our plan is to blend the history of Old Republic solid business practices, procedures and expertise with technology to fully unlock their measurable benefits across our business units. As we enter the second half of the year, our order counts remain strong, mortgage rates are projected to remain low and continued improvements in the unemployment rate are all drivers that should equate to a healthy real estate market to finish off the year.

I'd like to close with my appreciation to all our employees and customers as they continue to meet the high demands of the current real estate market. As always, our guiding principles of integrity, managing for the long run, financial strength, protection of our policyholders and the well-being of our employees and customers will be at the forefront of all that we do. And with that, I'll turn the call back over to Craig.

Craig Richard Smiddy
President, CEO & Director
Okay. Carolyn, thank you very much. Well, again, we're very pleased with another quarter of exceptional operating results. And we're also very pleased with our specialty strategy, providing specialty insurance and products to core industries served by General Insurance and Title Insurance, which, in turn, produces value for our shareholders. So that concludes our prepared remarks. And we'll now open up the discussion to Q&A. And I'll either answer your question or I'll ask Frank or Carolyn to respond.

Question and Answer

Operator

[Operator Instructions]

Your first question comes from the line of Greg Peters from Raymond James.

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

Congratulations, Frank, on the promotion. You did a good job with your first conference call. So...

Craig Richard Smiddy
President, CEO & Director

Thank you.

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

Hopefully, many more to come. Let's -- just in order of General Insurance, thank you for the color. I was wondering if you could give us -- as we look at the growth, can you give us a sense of where the growth is coming? Is it in exposure? Is it new business? Is it rate? Sort of give us how is the balance of that working across the entire book. And then maybe as you're answering that question, Craig, include the discussion around retention.

Craig Richard Smiddy
President, CEO & Director

Okay. I'd be happy to do that, Greg. So the answer to your question is that it is indeed coming from all 3. Exposure is up, particularly in workers' comp as people have returned to work, and we've seen our payroll numbers grow on our existing business. Other example of exposures, of course, is miles driven and number of vehicles and fleets that are returning and increasing. So exposure growth is certainly one component.

New business, absolutely. The folks here have been working very hard through exceptional constraints throughout the pandemic to continue to have relationships with various distribution sources that we have relationships with and expand those and make sure that the flow of business opportunities have continued.

So new business writing is a portion of it. And included in that would be some areas geographically where we have expanded some of our businesses. And also, as I touched on earlier -- our product offering has also expanded. And so that contributes to new business growth as well. And then rate. Obviously, my comments about comp being relatively flat, that doesn't help growth on the comp line.

However, where we do get help, as I mentioned, the tailwind on commercial auto liability in particular, we're still getting rates of 15%. On our D&O business, on our aviation business, I know I've talked about those 2 areas in prior quarters because we were getting significant rates in those areas. The rate increases there are less robust than they were, but still around the 10% range for those lines.

So that's helpful. So it's a combination of the 3, Greg. And as far as retention is concerned, our retention ratios across virtually all of our lines of coverages, all of our various specialty segments is extremely strong. We -- believe through our specialty offering, that's the specialty risk control, the specialty claims services, the specialty underwriting approach that we have really creates a stickiness and some greater pricing elasticity because of that. And as such, we enjoy very high retention ratios. And as my comments earlier indicated, the marketplace certainly can influence that as well but in a disciplined -- relatively disciplined marketplace that's helpful to retention as well. So hopefully, that answers your question, Greg.

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

That was great additional color. Appreciate it. Just one more question on the General Insurance before I pivot to Title. You did report favorable reserve development in the second quarter and through the 6 months. Can you talk to us about where the sources, what years, what accident years, where the development is coming from just to give us some additional perspective?

Craig Richard Smiddy
President, CEO & Director

Well, I'll kick it off and then see if Frank has any follow-up. But it's fair to say that the -- there's been favorable development on workers' compensation. And the other contributing factor is that we really have not seen any contributing unfavorable development of a significant nature from any other lines. So once you put it all together, it creates a pretty decent favorable development number on an aggregated basis. So I don't know, Frank, if there's anything you would add to that.

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

No. I mean that's it for the quarter, in a nutshell, it's $25 million of favorable in total. The year, as you would expect, it's coming from older years predominantly. 2012 to 2017 are the main years that it's coming from. But workers' comp is the lion's share.

Craig Richard Smiddy
President, CEO & Director

And as you know, Greg, we're very conservative when we set our loss ratio and very conservative about releasing favorable development. If we see unfavorable development, we put it up immediately. If we see favorable development, we're going to hold loss ratios until we're absolutely certain. And on long-tail lines, we're holding those loss ratios from 3 to 5 years, generally speaking, and that continues to be our practice. And I'll just add that as well to the mix of your question.

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

Yes. Thanks for reminding me about that. I appreciate it. I'll pivot to the Title business and Carolyn, what a phenomenal result. Congratulations. Obviously, it's the tailwind of the housing boom that's really helping you here. And if -- I was listening with interest about your comments around agency being up over 60%, direct being up over 40%, all really positive stats, but you really didn't comment on what's going on in commercial versus noncommercial. And I was wondering maybe you could add some color. Just give us a sense of how your commercial book is growing during this period of time relative to the residential side.

Carolyn Jean Monroe
President

So our commercial premiums were up 19.4% for the second quarter over second quarter of 2020. And -- they represented about 14% of our total premiums, but that's really more of a result of how strong the residential market was. But we're starting to see a little more of an uptick in commercial. We started seeing it towards the end of the second quarter.

And -- we feel like going into the third quarter that we'll see stronger commercial results. We're seeing more, I would say, midsized -- and by midsize, we mean $100 million up to $250 million in deals, we're starting to see a lot more construction projects than we did during the pandemic, which just -- it makes sense, but we're excited about seeing that. And we're still seeing a lot of energy projects come our way.

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

And when I think about the midsize, you said the $100 million to $200 million, is that sort of your sweet spot? Are you doing deals larger than that? Or how should I...

Carolyn Jean Monroe
President

No, we're doing deals larger than that, but the pandemic had slowed a lot of those deals down. And we're starting to see a lot of investor -- more investor activity, getting excited, and that's where you see a lot of the more -- the $100 million and up deals. But no, we have a couple of pretty large portfolio deals we're working on right now, but we're just seeing a lot more activity in that we're excited about.

Operator

[Operator Instructions]

Again, we have a follow-up question coming from the line of Greg Peters from Raymond James.

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

Carolyn, when you spoke about the commercial being about 14%, that was the second quarter. Is it still 14% for the first half of '21, too? Or is that -- I'm just trying to get my percentages right.

Carolyn Jean Monroe
President

Yes. It represented 14% of our overall business year-to-date.

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

Year-to-date, year-to-date. Perfect. And then the other thing I noticed, Carolyn, in the disclosure on -- in the supplement was that the reserves to paid loss ratio has crept up again. It looks like at this point in time, it's as high as it's ever been. Can you give us some views on what's going on there ?

Carolyn Jean Monroe
President

A lot of that, I would say, is because of the slowdown in paid activity because of the pandemic. Things -- courts were closed, that type -- claims were slow to be processed by attorneys and the -- lawsuits couldn't be filed, those types of things.

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

Got it. Okay. The last question I have for you is I did notice that the -- in your press release on Page 8, where you give us segment composition of shareholders' equity per share, that the RFIG runoff segment had $1.50 of equity in it at year-end and through June, it's come down to $1.40. I think you've talked about pulling some or upstreaming some of the capital from that subsidiary. Can you give us just sort of a status update of that? And that's my last question.

Craig Richard Smiddy
President, CEO & Director

Sure, Greg. Yes, we took $25 million out in the first quarter and did the same in the second quarter. So $50 million for the year. And we just anticipate that, that's probably the pace for this -- no guarantees, but that's the pace we're expecting throughout the rest of this year. So shareholders' equity there on a GAAP basis ended at $420 million.

Operator

You have no more questions at this time. I'll turn the call back over to the presenters for closing remarks.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, thank you, everyone, who participated. We appreciate your interest. It's obviously the middle of summer. And when you have a quarter like this, there tends to be less questions, the better it is. So again, thank you, everyone. Enjoy the rest of your summer, and we look forward to talking to you all next quarter. Thank you.

Operator

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