S&P Capital IQ

CONTENTS

Old Republic International Corporation

NYSE:ORI

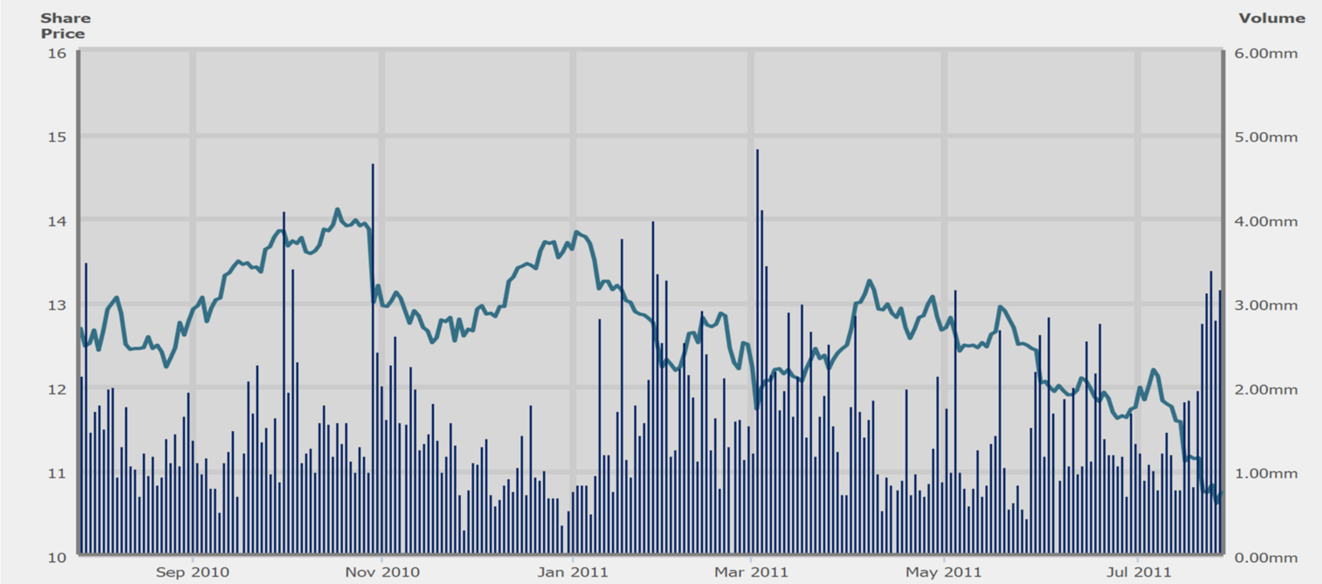
FQ3 2011 Earnings Call Transcripts

Thursday, October 27, 2011 7:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2011-			-FQ4 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.16)	(0.43)	NM	(0.05)	(0.57)	0.48
Revenue (mm)	1035.96	1113.50	▲7.48	1100.19	4316.01	4392.11

Currency: USD
Consensus as of Oct-18-2011 4:34 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2010	0.08	(0.17)	NM
FQ4 2010	0.04	(0.12)	NM
FQ1 2011	(0.04)	(0.07)	NM
FQ2 2011	0.02	(0.25)	NM

Call Participants

EXECUTIVES

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Christopher Stephen Nard
Former CEO & President of Republic Financial Indemnity Group, Inc.

Scott Eckstein
Director of Account Services

ANALYSTS

Geoffrey Murray Dunn
Dowling & Partners Securities, LLC

Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you very much for standing by. Welcome to the Old Republic International Third Quarter 2011 Earnings Conference Call. Today's call is being recorded. [Operator Instructions]

I would now like to turn the conference over to Scott Eckstein of the Financial Relations Board. Please go ahead.

Scott Eckstein
Director of Account Services

Thank you operator. Good afternoon and thank you for joining us today for Old Republic's conference call to discuss third quarter 2011 results. This morning we distributed a copy of the press release. If there is any one online who did not receive a copy, you may access it 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 dated October 27, 2011. Risks associated with these statements can be found in the company's latest SEC filings. Joining us today from management are Al Zucaro, Chairman and Chief Executive Officer and Chris Nard, President.

At this time, I'd like to turn the call over to Al Zucaro for his opening remarks. Please go ahead.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Thank you and good afternoon to everybody and again welcome to our quarterly session here. We'll make a few comments as usual about each of our segments and then we'll -- as well as the overall business I might say, and then we'll respond to your questions.

It goes without saying that we are not very happy in being bearers of bad news. But the numbers are the numbers and they are ours to both own and to explain.

As you've seen in the release this morning, our business continues to be most negatively impacted by the Mortgage Guaranty line. Title Insurance is producing a small profit as you can tell and the operating trends in it are positive just as they've been since 2009. General Insurance, our biggest segment both in terms of capital commitment, revenues, et cetera, et cetera, is also showing more positive results each quarter, and this is particularly so from the standpoint of the all important underwriting portion of the income statement.

Looking first at General Insurance then, the underwriting ratio has been now below 100% for the third consecutive quarter and this is a good news item for this part of our business which those of you who follow our company know has been running a bit of an underwriting fever in the last 2 years. We were underwriting profitable through 2008 and dipped into negative underwriting territory in '09 and '10 and as I say, these first quarters of this year have been on the profit side of the ledger, so we feel good about that.

As you can see in the General Insurance section of the release, obviously the consumer credit, or CCI product line, has become a lot less burdensome to the segment's loss ratio during the past several quarters. General Insurance from a pre-tax income standpoint as you can -- again as you can tell was up about $37 million in the third quarter and up by almost $80 million in the first 9 months of this year. And just in round numbers it might interest you to know that the improvement in the CCI product line accounted for about 70% of the improvement in the 3Q of this year, and for about 54% of the 9 months improvement. So that again shows the continuing reduction in the hit to the underwriting account from the CCI product. The rest of the improvement in these particular comparisons between 2011 and 2010, investment income accounts for a portion of it, and the merged PMA numbers which we've also shown in the release account for the remainder. That leaves the rest of the business, which accounts, and that would be our core business pre PMA merger and pre the CCI product. That portion of the business accounts for about 5% to 6% of the 3 and 9 month bottom line improvements respectively.

If you take a look at our website we've posted a financial supplement which contains quite a bit of statistics dealing with claim and expense ratio trends for the major coverages we write, not only in General Insurance but in Mortgage Guaranty as well as Title.

We respect to General Insurance, in particularly you will see that the claim ratios have held fairly steady with a few blips here and there, but no significant inference from those blips about any longer term trends that we can think of.

As we just said the financial indemnity line which incorporates the CCI coverage, as a result, shows significantly positive claim ratio trends in the most recent quarters. So again, it reflects the serious impact that CCI has had, both on the financial indemnity group of coverages as well as our overall General Insurance business.

So while we don't think that we are out of the woods as yet with regard to CCI, we think we are witnessing the beginning of the end so to speak, particularly if we can, as we think we can, extricate ourselves favorably from a couple of nuisance lawsuits that are related to the CCI line.

Let's see, in summary we think that the General Insurance portion of our business is performing pretty much in line with the expectations we had at the beginning of the year. We're experiencing a modicum of rate improvements here and there throughout the system, but as we've said on several prior occasions, and certainly since the economic difficulties that we began to experience as a nation back in 2008, what's really needed for the General Insurance segment to regain a head of steam, so to speak, is for the U.S. economy to get out of the period of laze in which it is and continues to be stuck.

We might add, moreover, that we are not lacking for opportunities to look at pieces of business that fit our risk selection parameters as well the appetite. So we're still very much a contender when it comes to new business opportunities, and we truly believe that we can go toe to toe and compete with the best of them in our industry.

From a cash flow stand point General Insurance has continued in a positive mode for the last 12 months. We were in negative cash flow position until the third quarter of last year and since the final quarter of 2010 we've been clicking along in positive territories, I say. This obviously is slightly additive to the invested asset base, but when you combine the fact that we do take out cash in the form of dividends from our various key insurance subsidiaries, and you add to that the fact that yields on our overall investment portfolio are as low as you are familiar with, then the benefit, however slight, of this cash flow improvement is pretty much erased by the lower yields in particular.

We're happy to see that, and to experience that, prior year's reserve levels in the General Insurance business are holding up very well. We keep experiencing, it varies from quarter-to-quarter, but between 1 and 3 points of savings in the overall book, and that's a good position to be in our business as you know, in that none of those prior year's reserves are having an adverse impact among the current year's results.

Let's see, the capital accounts for the key companies in this segment, they remain much more than adequate to service both the current risk profile of the book of business and, as well, we think it can support very easily any new business growth as it comes. And also provide a sound base, or the continuation of the dividend streams to the parent holding company that this segment of business has been accountable for many, many years at Old Republic.

Let's see, having said that, now I'll turn this conversation over to Chris Nard who will discuss the parts of the business, specifically the Mortgage Guaranty and Title portion that are currently the main focus of his attention. Chris you can take over.

Christopher Stephen Nard
Former CEO & President of Republic Financial Indemnity Group, Inc.

Good afternoon, everybody. As everyone knows from our discussion last quarter and our most recent 8-K filing on the matter, Old Republic's Mortgage Guaranty business was put into run-off effective August 31st of this year. Our flagship mortgage insurance carrier, which operates as Republic Mortgage Insurance Company, had been operating under a waiver to the minimum risk-to-capital ratio standards by the North Carolina Department of Insurance. That waiver officially expired at the end of August of this year. And in relation to that, we were also unable to secure an agreement with Fannie Mae or Freddie Mac for the purpose of writing Mortgage Guaranty business in a separately capitalized and held Mortgage Guaranty subsidiary of Old Republic.

Given these recent events, we're currently in the process of working with the North Carolina Department of Insurance, who is our flagship's primary regulator, for the purpose of implementing an effective run-off plan for the business.

Our objective when it comes to that is to contain the impact of the run-off within the constraints of the existing capital commitment to this segment, and to obviously assure the fairest of all treatments to all the policyholders of the Mortgage Guaranty business and its claimants.

I'll take a second, if you look at the trends in the Mortgage Guaranty business for the quarter, the quarter and the year-to-date comparisons continued to deteriorate from the prior periods. These negative trends, if you set aside the impact of the one-time charges for the quarter, continue to be driven by the elevated claim payment levels we've seen really since the third quarter of 2010. Changes to our reserve provisions that are driven by reduced levels of rescission expectations and a continuing decline in the operating revenues that we've seen up until the point that we put the businesses into run-off.

If we take a second now and if we look at the book of business going forward, our standard premium deficiency models continue to show that the book of business should run-off positively over its remaining life. However, within this projection, timing issues exist in so much as there is always the possibility of a timing mismatch in the business between the payment of claims and the collection of the premium over the life of the loans. At this point in the cycle the model indicates that the next 8 to 10 quarters could possibly reflect periods in which the losses are in excess of the premium collected. That's in spite of what I said earlier about the long-term expectation that it will run-off positively.

As we noted in the earnings release, this outcome of 8 to 10 quarters of negative performance could exhaust the capital that's committed to this business line in short order. As we have also maintained in the release -- indicated in the release, we do maintain a long-term interest in resuming production of this business under the right risk management construct in a re-capitalized entity other than the flagship carrier, but certainly at this point in time we have little if any idea of the timing of that possible resumption in the business.

That being said about the Mortgage Guaranty business, let me take a minute and transition to a brief review of our Title operations for the quarter. Our Title business results continue to improve from all the previous period comparisons. The business continues to build on some of the positive momentum that we've seen throughout this year and at the very end of last year. In the third quarter of 2010 we posted a positive pre-tax profit of $9.6 million, which was in comparison to about $5.7 million in the same quarter of 2010. The year-to-date comparison looks much better with the 2011 year-to-date profit of almost $18 million, compared to a profit in the first 9 months of 2010 of $1.1 million.

If you look at the premium and fees collected in the Title Insurance business, comparatively they were up about 6% over last year's third quarter, and we continue to attribute these gains to our growth in market share that's occurred over the last several years. As we look at that business, the company's market share in the first half of the year, which was the most recent period in which we have an estimate, was about 13%, which was up from the 10.4% estimate that we had for the same period in 2010.

On the expense ratio side, we were down slightly in the third quarter at 91%, in comparison to the same quarter last year where the ratio was about 92%. On the claim ratio side as well, we were down slightly. We were 7.8% for the quarter, third quarter of 2011 that is, versus a slightly higher 8.3% in the third quarter of 2010.

All that being said, we continue to be encouraged with the progress we're seeing in this segment, particularly given the uneven recovery at best that we've been seeing in the housing markets across the country.

With that I will turn it over to Al Zucaro. Back to Al.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Okay, so let's see. Before we turn this session to your questions, I think it would be appropriate to address, perhaps reiterate, a couple of issues that are probably on the minds of many that follow our company and have an interest in it. First of all, as Chris just mentioned, our objectives in dealing with the run-off of our Mortgage Guarantee book of business. It bears repeating that our 3 Mortgage Guaranty carriers and we have 3: Republic Mortgage Insurance Company, which Chris mentioned, we have something, a second tier company called Republic Mortgage Insurance Company of North Carolina, and a third tier company, Republic Mortgage Insurance Company of Florida. All 3 companies are licensed in all, or substantially all, of the jurisdictions in this country, and are able to do business therefore in most, if not all, states.

But and as we speak, each of those 3 companies are very much solvent and to our knowledge there are no imminent threats, nor is there any basis for a regulatory authority to take over one or more of them. We have always had, and continue to have, very open and clearly transparent communications with the North Carolina regulator of our two most significant Mortgage Guaranty insurers. And that department knows exactly the proposal we have in mind for achieving a run-off of the business which is to be concentrated in our flagship carrier in such a fashion, as Chris again says, that it achieves a soft landing as opposed to a thud of the operation, and minimizes disarray for all interested parties. And most importantly, the policyholders that are to whom we owe the most important fiduciary obligation in all of our companies. We do not as yet have an agreement with the insurance department on all the elements of the run-off plan we are organizing. But we are confident that a mutually satisfactory resolution will come to pass within the next couple of months.

Having said that, on the chance, however remote it may be, that we do not prevail and that we have to give up control of our flagship mortgage insurer, the Old Republic Holding Company, which is our publically-held company owned by shareholders, that company would be exposed potentially to a principal payment acceleration for two, for its two publicly held debt instruments.

One of these with a principal balance of about $316 million has a May 12 contractual due date of next year, about 7 months from now, thereabouts. The other is a more recent issuance, or specifically an issuance in February of this year, early March, I forget now, for $550 million which is contractually due in 2018. Both issues incidentally are convertible into Old Republic stock and given what's happened to our share price both issues would not at this point in time by any stretch of the imagination convert into common stock.

So in these regards, we believe that with respect to the first issue, given the fact that it has a 9% coupon, which is eminently safe, that the holders of that debt issue can bank on that coupon being paid every 6 months until May of next year. We're not under the gun by any stretch of the imagination with respect to an early redemption of that $316 million issue.

As to the $550 million issue we also think we've got quite a bit of time before we need to address a possible early redemption of it. However, now in the event that the timeframes we're banking on are short circuited for one reason or another, we have got quite a bit of a cash cushion in the Old Republic Holding Company system, not only in the parent but elsewhere among various midstream holding companies and service companies of one sort or another who are not regulated and therefore have free access to cash.

And we have a cushion of about $600 million. Most of that money is there and came to us from the $550 million issuance that we did earlier this year, as I said before. And certainly that would leave therefore, some couple hundred million dollars, maybe $270 million, if both issues were precipitated into immediate redemption. We think that we could easily raise that extra $270 million by a combination of floating an

additional new debt issue and/or using what we consider to be sufficient intra-system dividend paying capacity to make up the shortfall. So, while nothing is ever guaranteed in this world, we do believe that Old Republic as a holding company is in very good position today to honor those 2 obligations if, as I say, they should come due before their due date.
On that note, we'll turn it to your questions.

Question and Answer

Operator

[Operator Instructions] All right, we just had a caller queue up. We will go to Geoffrey Dunn with Dowling & Partners.

Geoffrey Murray Dunn
Dowling & Partners Securities, LLC

Al, can you give us an indication which way North Carolina is leaning? We've seen 2 different approaches from 2 different states on implementing a DPO and whether or not they need to seize control. Has there been precedent in the past with North Carolina or is there any kind of preliminary indication that you can talk about?

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Well, generally speaking, Geoff, there have been, as you know, very few run-off situations in the Mortgage Guaranty business. First of all because it's a small relatively small industry. And to boot they have only been to, as I recollect, 2 companies, now 3 if you include Triad, and 4 if you include PMI which is just a budding type of situation as you know. So the point of this is that whatever you end up doing you are really breaking new ground, but the precedents are there, you know for running-off these types of long duration types of contracts.

And as you are, as I am sure others also are aware, a good precedent was set with respect to the Triad Corporation, which is an Illinois based company, and it has been able to meet a portion of its obligations since what, 2008, as I recall. And it has been done through what's referred to as a deferred payment obligation type of approach to the business meaning that, in its case at least, as we understand it, it pays 60% of whatever claims it honors and then issues a note with respect to the remaining 40%. The 40% note being payable sometimes in the future, when, if and when, cash becomes available.

So now with respect to our dealings with the North Carolina department we cannot speak for it. But as we tried to say before, we believe we have a very good transparent relationship with that department. They are fully aware of what we are trying to do, to achieve, as I described before, a soft landing which minimizes the impact on our policyholders and claimants. And that we sense that they are very much inclined to see their way to working with us to achieve that objective. So as to where we end up, only time will tell. We think that in the next couple of months certainly by -- hopefully by the end of this year, we should have our situation resolved one way or the other.

Operator

[Operator Instructions] And there are no further questions at this time.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Well, I think we must have done a great job of addressing whatever questions were out there if there are no questions from our audience. As always, we appreciate your visiting with us, and as always, we hope that the next time around we'll have somewhat better news than we have been delivering now for just too many quarters. So on that note, we'll bid you farewell until the next time. You all have a good day.

Operator
Great, thank you very much. Well, again ladies and gentlemen, that does conclude today's conference.