S&P Global
Market Intelligence

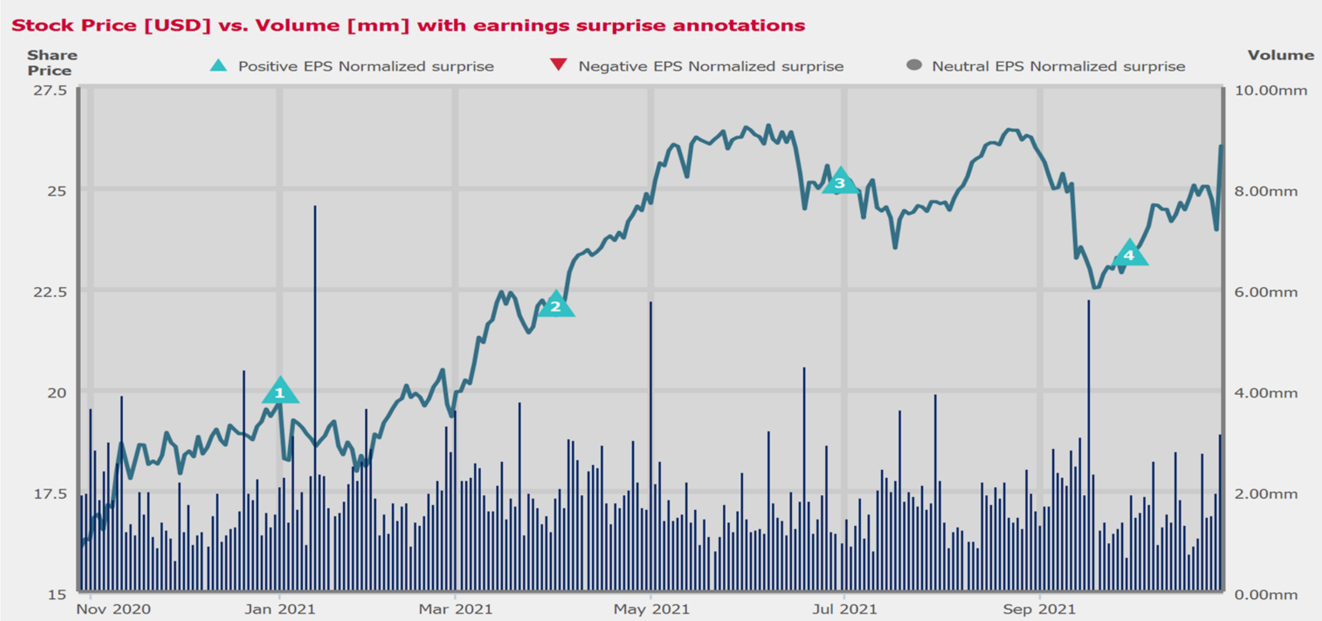
Old Republic International Corporation
NYSE:ORI
FQ3 2021 Earnings Call Transcripts

Thursday, October 28, 2021 7:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.63	0.79	▲25.40	0.61	2.65	NA
Revenue (mm)	1857.00	2204.90	▲18.73	1984.00	8449.00	NA

Currency: USD
Consensus as of Oct-15-2021 6:52 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	0.44	0.75	▲66.67 %
FQ1 2021	0.45	0.69	▲53.33 %
FQ2 2021	0.52	0.73	▲40.38 %
FQ3 2021	0.63	0.79	▲25.40 %

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

Alexander Bolton
Raymond James & Associates, Inc., Research Division

Boris Kuzmin
Crawford Investment Counsel Inc.

Matthew John Carletti
JMP Securities LLC, Research Division

ATTENDEES

Joe Calabrese

Presentation

Operator

Good afternoon. My name is Emma, and I will be your conference operator today. At this time, I would like to welcome everyone to the Old Republic International Third Quarter Earnings Conference Call. [Operator Instructions]

Joe Calabrese with the Financial Relations Board, you may now begin your conference.

Joe Calabrese

Thank you. Good afternoon, everyone, and thank you for joining us for the Old Republic conference call to discuss third quarter 2021 results. This morning, we distributed a copy of the press release and posted a separate statistical supplement, which we assume you have seen and 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 that this call may involve forward-looking statements as discussed in the press release and statistical supplements dated October 28, 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 would 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 third quarter earnings call. With me today, we have our CFO, Frank Sodaro, and we also have Carolyn Monroe, the President of our Title Insurance Group.

Well, our hard work is paying off, and we're very pleased to again report that ORI produced another terrific quarter with General Insurance and Title Insurance each posting exceptional results that drove the strong, record-setting consolidated results that you saw.

Compared to the third quarter of '20, total net premium and fees earned increased to just over $2 billion, up almost 19%. At the same time, our pretax operating income increased to just under $300 million, up almost 32%. And the consolidated combined ratio improved to 89.8%. That's a 2.5 percentage point improvement.

Still comparing to the third quarter of '20, General Insurance saw net written premium increased by 4.3%. And in Title Insurance, we saw net premiums and fees earned increased by over 33%. So our diverse portfolio of specialty products in both General Insurance and Title Insurance continue to deliver growth and profitability.

And with that, I will now turn the discussion over to Frank to discuss some of the per share figures, our investment portfolio and briefly touch upon our runoff mortgage business. Then he'll turn things back to me to cover General Insurance, followed by Carolyn, who will discuss Title Insurance, and we will follow those discussions by opening up to Q&A.

So Frank, take it away.

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Thank you, Craig, and good afternoon, everyone. This morning, we reported a 32% year-over-year increase in third quarter net income, excluding investment gains and losses of $240 million or $0.79 per share. For the first 9 months of this year, this figure was $668 million, up nearly 50%. Results for both periods were driven by substantial growth in underwriting profitability within our General and Title Insurance segments, which you'll hear more about shortly.

Shareholders' equity ended at $6.3 billion, resulting in book value per share of just under $21. Adding back dividends, including the $1.50 special dividend paid in the quarter, book value increased 11% from year-end 2020, driven by our strong earnings.

Net investment income increased for the quarter, however, it was down slightly year-to-date. The increased investment base, inclusive of proceeds from last quarter's debt issuance and lower yields on new investment purchases, affected both periods. The investment portfolio consisted of approximately 71% in highly rated bonds and short-term investments, with the remaining 29% allocated to large-cap dividend paying stocks. The average maturity on the bond portfolio is approximately 4.5 years with both book and market yields of about 2.5%. The fair value of the equity portfolio did decrease by about $200 million during the quarter due to normal market fluctuations. However, we ended the period with unrealized gains on these investments of nearly $1.1 billion.

I'll now turn to claim reserves, which ended the period at just under $11.5 billion. All 3 operating segments recognized favorable claim reserve development for all periods presented. In total, the consolidated claim ratio benefited by 2.3 and 2 percentage points for this year's third quarter and first 9 months, respectively, compared to 1.4 and 0.9 percentage points for the same period a year ago.

Finally, premiums and risk in force of our runoff mortgage operations continued to decline in line with our expectations while generating a modest operating profit. Claim costs reflect a significant reduction in newly reported defaults compared to 2020 and lower claims severity resulting from increasing home values. The group paid another $25 million dividend to parent, bringing the total to $75 million for the year. And we expect to pay another $25 million dividend in the fourth quarter, but that will be subject to regulatory approval. Total GAAP shareholders' equity for the mortgage companies ended the quarter at just under $400 million.

I'll now turn the call back to Craig for a discussion of General Insurance.

Craig Richard Smiddy
President, CEO & Director

Okay. Frank, thanks.

So in General Insurance, net written and net earned premiums each increased by just under 5%. We continue to achieve strong rate increases on most lines of coverage other than workers' comp. Compared to the third quarter of 2020, pretax operating income rose almost 33%, and that's primarily from improved claim ratios. The overall combined ratio improved 4.2 percentage points from 95.5% to 91.3%. The claim ratios we reported were, of course, inclusive of favorable prior period development, and that came in at 3.2 percentage points in the quarter.

Net premiums written in commercial auto grew by 5.4%. Our third quarter commercial auto claim ratio improved to 73.1%, compared to 80.4% in the third quarter of last year. Claim frequency is not quite back to prepandemic levels, but it is higher than 2020. Severity trends continue to increase although at a slightly lower pace than what we had seen in previous years.

Rate increases in auto liability are continuing in the 15% range. So we think we're staying ahead of the overall loss trends that we're seeing, but we also recognize that we still need to achieve a lower claim ratio for auto.

Turning to workers' comp. Net premiums written were lower by about 1% compared to the third quarter of 2020, somewhat reflecting our ongoing underwriting discipline to maintain rate levels. The workers' comp third quarter claim ratio came in at 59% compared to 54.1% in the third quarter of 2020.

Claim frequencies now just slightly below prepandemic levels, while severity is slightly up, mostly driven by indemnity severity. So for workers' comp, we think our rate levels are adequate, and we'll continue to maintain our underwriting discipline as we move forward with this line.

Our aggregated commercial auto, workers' comp and general liability claim ratio came in at 65.9% compared to 72% in last year's third quarter. In financial indemnity, property and other coverages, we continue to experience favorable steady claim ratios and strong rate increases, all contributing to the improved combined ratio we're seeing in General Insurance.

So we continue with our underwriting excellence initiative that focuses on better segmentation, improved risk selection and pricing precision, all aided by increased use of analytics. And we think these efforts will continue to facilitate strong underwriting profitability, adequate rate levels and continued high retention levels.

So I'll now turn the discussion over to you, Carolyn, who you, along with your team, have put together yet another terrific quarter. So Carolyn?

Carolyn Jean Monroe
President

Thank you, Craig.

As reported this morning, the Title Group posted an all-time high for quarterly premium and fee revenue, while operating profits were just slightly below the record-setting results reported in the second quarter of 2021. Total revenue for the quarter of $1.1 billion was up 33% from the prior year third quarter. Year-to-date, revenue has already surpassed $3 billion, a 43% increase from the comparable period last year.

Our pretax operating income was $136 million for the quarter compared to $103 million in last year's third quarter, an increase of $33 million or 32%. Year-to-date, our pretax operating income of $378 million exceeds pretax operating income for the same period last year by $166 million or approximately 79%.

Commercial premiums were up 73% over third quarter 2020 and represented 15.3% of our total premiums versus 13.6% in third quarter 2020. While we have seen a drop in order counts, this is mostly a result of the slowdown in the refinance sector. Purchase transactions, which generate a higher fee per order, are expected to remain strong as we close out the year.

In our technology portfolio, Pavaso remains the market leader in the number of digital closings completed. We have seen an increase in digital closings, although at this time, less than 5% of all closings in the industry are done digitally. We are constantly investing in the platform, planning for the future expansion and greater adoption of digital closings across the industry.

Another part of our digital road map recognizes and addresses the need to optimally service our agents with an interconnected ecosystem of external partners and technologies that interact and exchange information throughout the entire business workflow. The number of choices, partners and technologies has rapidly grown and will accelerate in the future. With a vision to integrate with anything, we have developed an integration platform built with the latest technology, architecture and security that will connect our applications and services with internal and external data service providers with standardized integrations that streamline onboarding and promote rapid adoption.

We continue to execute on our plan of blending 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 fourth quarter, we are so appreciative of 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 we do.

And with that, I will turn the call back over to Craig. Thank you.

Craig Richard Smiddy
President, CEO & Director

All right. Carolyn, congratulations again.

While we're extremely pleased with another quarter of exceptional operating results and we also continue to be very pleased with our specialty strategy, providing a wide range of specialty insurance and products to core industries served by both General Insurance and Title Insurance, which we believe continues to produce value for our shareholders.

As you may have also seen, we announced this morning in an 8-K that Al Zucaro has resigned from the Board and as Chairman of the Board. We want to thank Al, of course, for his more than 45 years of service and the enormous contributions he's made to the company, and we wish Al all the best in the future.

In that announcement, we also indicated that Spencer LeRoy (sic) [Spencer LeRoy III] has been elected as Chairman of the Board. And that the Board size has been reduced to 13 members.
So that concludes our prepared remarks, and we'll now open up the discussion to Q&A where I will 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 Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Craig, I'll start with GI. I was hoping you could unpack 2 numbers for us. Yes, the first being the favorable development, just kind of which of the major line items kind of drove that the most and what you're seeing there that drove it? And kind of a similar question on the current accident year ratio look quite good and what you're seeing there that -- as you're bringing that down? I mean from the supplement, it looks like while small, general liability moved a lot, so it seems like some of that's there. But any more color you could provide would be great.

Craig Richard Smiddy
President, CEO & Director

Sure. I'll address the latter first, and then I'll ask Frank to maybe comment on the favorable development. So on the accident year loss ratio that we have, that is reflective of years of compounding rate increases and also reflective of the line of business mix. So as you see in the release, the third quarter of '21, we had a claim ratio of 68%, excluding prior year development, which is an improvement from the third quarter of '20, but less of an improvement if you look at the full year of '20, where we were at 70.7%. So in our opinion, nothing dramatic there. And again, reflective of the rate increases that we've been achieving, in some lines, quite extraordinary rate increases as well as a line of business mix changes.

Frank, could you comment briefly on the developments that we're seeing?

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Sure. Yes. So for the quarter, most of that favorable development is coming from the years of 2015 through '18. And most of the development coming through for General Insurance is on workers' comp. Although our major lines, workers' comp, commercial auto and GL, all had favorable development in the quarter. Year-to-date, it's pretty much the same story on -- the majority of our development is coming from workers' comp.

Matthew John Carletti
JMP Securities LLC, Research Division

Great. Very helpful. And then my other question, I just wanted to shift to Title and hope that maybe you can help us just trying to get a feel for just how things earn through. I caught the commentary on the -- I guess, not to read too deep into kind of the order flow in terms of because there's a difference between, obviously, refi and purchase transactions. But just trying to get an understanding of as that slows down, the timing and pattern by which that might hit the earned premium numbers for the Title business. I mean do you feel like we're at kind of peak volume levels? Or are there reasons that you believe that we can stay in this general area for a while?

Craig Richard Smiddy
President, CEO & Director

Carolyn, would you like to respond to that?

Carolyn Jean Monroe
President

Sure. So I think we've -- we feel like we've peaked definitely in the recent net sector. Although it -- the last couple of years have showed us, we -- it's really hard to predict any of this. But the purchase were like -- I don't think repeat. They feel like they're staying strong. The -- even if the interest rates climb slightly, that -- it's -- I -- we just don't feel like it's going to affect the purchase volumes that much. And because of our mix of agency and direct, we will have a lag with our revenue coming from our agents by about a quarter. So we'll be able to stay strong in the fourth quarter and I think on into the first part of the year.

Matthew John Carletti
JMP Securities LLC, Research Division

Great. Congrats on a nice quarter.

Craig Richard Smiddy
President, CEO & Director

Thank you, Matt. We appreciate your questions.

Operator

[Operator Instructions] Your next question comes from the line of Greg Peters with Raymond James & Associates.

Alexander Bolton
Raymond James & Associates, Inc., Research Division

This is Alex Bolton calling in on behalf of Greg Peters. I was wondering if you could touch on renewal retention within GI. Any numbers around that?

Craig Richard Smiddy
President, CEO & Director

Could you repeat your question? I'm sorry. You broke up a little bit.

Alexander Bolton
Raymond James & Associates, Inc., Research Division

Yes. If you could touch on renewal retention within GI?

Craig Richard Smiddy
President, CEO & Director

Sure. Sure. Yes. So as you see, I'll start with commercial auto. And you can see there if we're obtaining 15% rate increases but the premium is only growing by about 5% that there is some leakage in retention. We still have very high retention ratios in the mid-80s. But we are very focused on disciplined underwriting and achieving the appropriate rates. And right now, we think the appropriate rate increase that we need on auto liability is 15% range. Of course, that isn't across the board, but on average. And we have to do that because, as we indicated, severity is still increasing, frequency is coming back, and we still are working to drive down our auto loss ratio. So we're not afraid to let some business flow out if we can't achieve what we believe to be adequate rates.

On workers' compensation, similar story but a few different dynamics. In the marketplace, some workers' comp rates have been generally declining year after year. And we have been doing our very best to hold our rates that we have. Generally speaking, quarter-to-quarter, we've been either plus or minus 1 point or 2 in rate on workers' compensation. So as I mentioned in my prepared remarks, here, too, if we don't think we can achieve adequate rate, we have let business go. But overall, we think our portfolio is priced adequately at this point on comp to achieve our target loss ratios.

On our other lines of business, GL, similar story where pricing discipline in the marketplace may not be quite as robust as it should be. We think some of the social inflation dynamics are working its way into GL, and therefore, we believe we need GL rate increases. And right now, we're achieving rate increases in the high single digits. And again, we think those are necessary. And if we're not able to achieve those, we're, again, willing to let the top line drop off a bit.

On all of our other business, I would say that we are -- our retention ratios are extremely strong and that even is on lines of business where we're getting substantial rate increases on, for instance, aviation still getting rate increases in the mid-teens, D&O still getting rate increases in the mid-teens, as examples, and extremely high retention ratios even at those kind of rate levels.

Alexander Bolton
Raymond James & Associates, Inc., Research Division

Okay. Great. And then I guess within -- I guess, talking to your customers, I guess, what's their perspective on the labor market and the struggles that they may have with hiring. And even with yourself, what -- how's -- how are you handling the labor market situation and maybe wage inflation?

Craig Richard Smiddy
President, CEO & Director

Right. So I'll first just speak to what we're seeing in the way of what it means to our financials. And as I mentioned in my earlier comments, where we are seeing some increase in severity on workers' comp is on the indemnity side, and that's being driven mostly by wages.

As far as our customers are concerned, there is the newly coined phrase out there, the Great Resignation with people leaving the labor force, including early retirements, and that is certainly, in the short term, placing pressure on compensation costs and employee retention with strong demand and lower supply throughout the labor market. So when you look at, for instance, our trucking business, it's -- all those dynamics are at work there. And our customers are struggling to get people in place that they need to drive trucks and they're having to pay them more. And so it is -- this dynamic is alive and well.

And then -- and for us, here, in running our business, we're seeing the same thing. We're seeing many of our competitors offering extremely robust compensation packages and trying to lure away some of our folks. So it -- we're seeing the pressure ourselves. Without any question, there is a dynamic out there, again, where there's strong demand and lower supply throughout the labor market.

Alexander Bolton
Raymond James & Associates, Inc., Research Division

I guess any expectation -- I know you don't give guidance, but impact on expenses?

Craig Richard Smiddy
President, CEO & Director

Yes. We're very disciplined in our approach, and we're focused on the long term, as you well know. So there certainly will be pressure somewhat on labor costs, but I wouldn't expect that to impact our overall expense ratio in a dramatic way. But on the other hand, we're cognizant that there's an added headwind out there that hasn't been there for many years.

Alexander Bolton
Raymond James & Associates, Inc., Research Division

Okay. And then on the Title Insurance, I'm not sure, Carolyn, if you gave the breakout between refi and purchase transaction. But I guess is there any data that you can provide that would show that maybe there's new purchases from people refinancing and buying additional homes?

Carolyn Jean Monroe
President

I mean I don't think we have any data that shows that they're refinancing and buying additional homes. I -- we don't have data that follows that. Do I understand your question, right?

Alexander Bolton
Raymond James & Associates, Inc., Research Division

Yes, yes. No. I appreciate that. And then maybe, finally, just on the Board changes. Maybe you can provide some color around decision-making on reducing the Board and the new Chairman.

Craig Richard Smiddy
President, CEO & Director

Sure. Well, we remain very committed to Board refreshment. And we've outlined in our letter to shareholders of August 13, some of the things that we've taken. We've added several new Board members. We've had retirements. And we're in discussions with potential new Board members. So -- and we've also stated that we ideally would like to have the Board at 11 in the long term. So I would say that we're on track, doing the right things.

And with regard to Spencer LeRoy coming on to the Board, Spencer has a very deep history of our company. He was our General Counsel before he was on the Board. He's now an Independent Member of the Board. And Spencer and I have worked very closely together for many years. So we expect that to work out very, very well. And so I would say all things considered with regard to the Board, things are on track and heading in the right direction.

Alexander Bolton
Raymond James & Associates, Inc., Research Division

Great. And congrats on the quarter.

Craig Richard Smiddy
President, CEO & Director

Thank you very much. Thanks for your questions.

Operator

Your next question comes from the line of Boris Kuzmin with Crawford Investments.

Boris Kuzmin
Crawford Investment Counsel Inc.

A question on investment income. It was positive this quarter, which I think somewhat contrast your prior commentary that it's going to be on somewhat of a downward trajectory. So I was just kind of thinking, is this kind of a turning point? And should we expect maybe small, positive increases going forward? Or this is just a step up from a higher asset base and then it's going to start trailing back down again?

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Boris, this is Frank Sodaro. So the quarter had some favorable base happening there because of the debt issuance we did. Now we've then subsequently made a special dividend payment, which will bring that back in line. So I would not expect investment income to continue to trail up.

Boris Kuzmin
Crawford Investment Counsel Inc.

Okay. And one more quick question on Title segment. The expense ratio is obviously declining with higher premiums, but what would be kind of a more of a sustainable expense ratio in the long run for that segment?

Carolyn Jean Monroe
President

Well, I would think that where -- we should be able to maintain where we are right now. It's always going to be based on the volume, a higher volume would always help us.

Boris Kuzmin
Crawford Investment Counsel Inc.

Yes. But I mean, historically, it's been probably closer maybe in the low 90s, maybe?

Carolyn Jean Monroe
President

Right.

Boris Kuzmin
Crawford Investment Counsel Inc.

So yes.

Carolyn Jean Monroe
President

So right now, I mean, we're at -- I think, it's, what, 89 right now.

Boris Kuzmin
Crawford Investment Counsel Inc.

It was 86 in this quarter, I think, right, on the expense ratio?

Craig Richard Smiddy
President, CEO & Director

Yes, yes, it's 86. The -- and I think if you look back at 9 months ended 2020, we were at 89. So as Carolyn says, I think -- I don't have the other years in front of me. But as Carolyn said, I think depending upon the volume and how much volume we're able to continue with, we -- even if volume stays relatively flat with the new purchases, driving more revenue into the equation, staying around the 86 mark would be reasonable. However, if volumes fall off and end up back to where they were a few years ago, we would expect that to emerge maybe in the low 90s.

Operator

[Operator Instructions] At this time, there are no further questions. Mr. Smiddy, I turn the call back over to you.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, again, thank you to everyone on the call for participating and listening. And we will keep up the hard work to keep delivering value to our shareholders and all of our stakeholders. And things continue to move along, as we have said, in a very favorable direction. And we look forward to reporting next on how things look for the next quarter. And hopefully, we will be reporting yet again similar positive results. So thank you all very much, and we wish you all a good afternoon.

Operator
This concludes today's conference call. Thank you for attending. You may now disconnect.