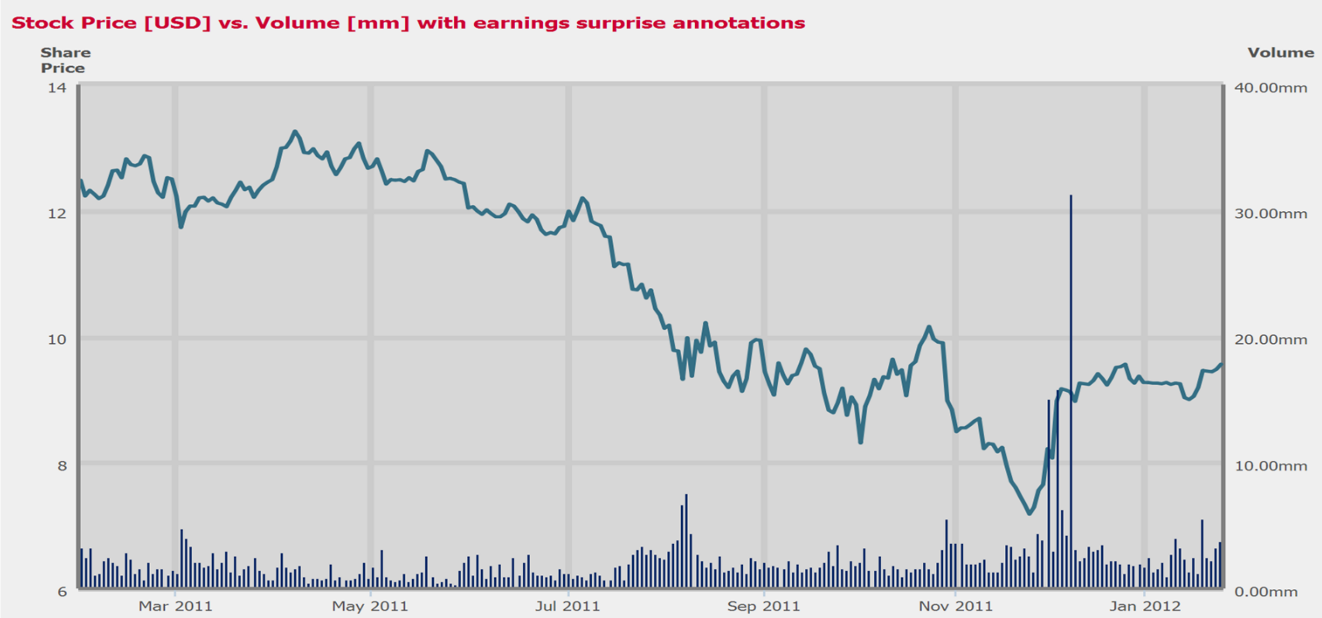
S&P Global
Market Intelligence

Old Republic International Corporation
NYSE:ORI
FQ1 2012 Earnings Call Transcripts
Thursday, April 26, 2012 7:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ1 2012-			-FQ2 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.21	(0.01)	NM	0.20	0.90	0.85
Revenue (mm)	1001.32	1155.10	▲15.36	1003.22	4173.11	5631.50

Currency: USD
Consensus as of Apr-26-2012 4:26 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	(0.04)	(0.07)	NM
FQ2 2011	0.02	(0.25)	NM
FQ3 2011	(0.16)	(0.43)	NM
FQ4 2011	(0.16)	(0.11)	NM

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Call Participants

EXECUTIVES

Aldo Charles Zucaro
Chairman & CEO

Christopher Stephen Nard
President & COO

Scott Eckstein
Director of Account Services

ANALYSTS

Jim Ryan
Morningstar Inc., Research Division

William Dunloy Laemmel
Divine Capital Markets LLC

Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Old Republic International First Quarter 2012 Earnings Conference Call. Today's call is being recorded. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue in for questions.

I would now like to turn the call over to Mr. 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 first quarter 2012 result. This morning, we distributed a copy of the press release. If there is anyone online who did not receive a copy, you can 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 April 26, 2012. Risks associated with these statements can be found in the 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 Mr. Al Zucaro for his opening remarks. Please go ahead.

Aldo Charles Zucaro
Chairman & CEO

Thank you very much and good afternoon to everyone, and welcome once again to this quarterly update of ours. As we have done for a while, I'll speak to General Insurance and then the consolidated business. And Chris will speak to our mortgage guarantee and title insurance, again, as he has done on many past occasions.

Just to go back a little bit, a little more than 1 month or so ago, we put out the news that we would on the one hand, mailed the consumer credit indemnity, or CCI, insurance division that's been part of our General Insurance since the 1950s, when it was first started. And that would meld that business with our mortgage guarantee segment, which incidentally we have renamed the Republic Financial Indemnity Group Inc. or RFIG.

As we speak, we have not -- as we indicated in the release this morning, we have not as yet completed this inter-segment transfer. So we're still reporting the CC line -- CCI line as part of the General Insurance segment.

However, if you -- if you -- as you read this morning's earnings release, you'll see that we have shown the most important effects of the CC line -- CCI line on the General Insurance results. And of course, these are mostly shown in terms of the all-important impact that that coverage has on the overall underwriting results of our General Insurance Group.

So when you look at what we have written in the supplemental table on the pages 3 and 4 of the release this morning, you can really see that the CCI line has been having a progressively less onerous impact on the segments underwriting account, and that's, of course, a positive outcome.

In that line we still had as we discussed in our risk exposures and litigation exposures, portion of the 10-K that we issued in late February. We still have to deal with a couple of, call them trans-agent situations, being litigated within that line, but I think we are beginning to see the end game in so far as normal claims activity is concerned in CCI.

After we move that line into our mortgage guarantee segment, we should have, again, which is our intention, a better opportunity to possibly re-capitalize that business and then to reactivate it in a more rational fashion in the next couple of years or so. At least, that’s our objective long-term.

In other regards, the General Insurance business is performing reasonably well. In the release we noted that we are beginning to benefit from some of the rate improvements we’ve got in the past several quarters, as well as from the relatively slow uptick in economic activity.

Safe to say, however, that we’re looking mostly to a better economy to generate greater demand for our General Insurance products and therefore to grow the top line of that segment down the road.

We are taking, I might say, that we’re taking the benefits of rate increases that we’ve got so far with a fair degree of hesitancy as to how much of them will in fact fall to the bottom line.

We think that most, if not all, of the improved rate situation is going to be needed to offset some inflatio-driven claim cost accretion that we’ve been experiencing, particularly in the-- relative to the medical cost portion of workers comp and the liability claims generally.

On the expense side of the income statement, i.e. our production, our general operating expenses other than claims. We noted in this morning’s release an adjustment of about $10.5 million to take down our deferred sales expenses or what we refer to in the trade as DAC, Deferred Acquisition Costs.

And in that regard we took the opportunity of a new Financial Accounting Standards Board, FASB guidance for the calculation of DAC to take another look at what we had been doing for many years.

With the end result being that the -- we placed starting the early -- starting at January 1st of this year, we placed greater weight on hard fixed costs such as commissions and premium taxes, and much less weight on the variable costs or those that are assigned to the production side of the business, by way of salaries and rent, and what have you.

I might add that the FASB guidance does allow us to alternatively address this change either by restating prior periods or charging the entire difference to the current year. We obviously adopted the second approach, because we didn’t want to rewrite history, so to speak, and we prefer to address the change in the circumstances and the methodology in one fell swoop this year. So the entire effect will be charged during each quarter of 2012 in tandem with the unearned premium and earned premium trends of each quarter as they develop.

As we noted in the portion of the release, which speaks to this, the entire effect was to increase the expense ratio for the first quarter by 1.9 percentage points and therefore, without it, this year’s expense ratio would have been 24.2% versus the 26.1% we booked or reported, and versus the 24.9% posted in the first quarter of 2011. So, on apples-to-apples basis, where our expense ratio this quarter is little bit down from the level it was at in the first quarter last year.

Moving along, as you see in the table of key indicators for our General Insurance business on Page 3 of the release, the General Insurance bottom line is getting still very little help from the investment side of the business.

And even though General Insurance continues to be a reasonably steady source of positive operating cash flow, the low yield environment we’ve been dealing with and will most likely continue to face in the foreseeable future, if you are to believe what is coming out of the fed. It’s not going to provide much upside to the investment income line

I might add as other commentaries on General Insurance that the segment is operating reasonably well from a cash flow standpoint. And as a matter of fact, for this latest quarter, it was about -- it’s just about double the amount for the first quarter of 2011. And this of course is largely due to the higher, roughly 8% increase in net premiums written that we have achieved so far this year.

We should also add that the overall General Insurance claim reserve levels in General Insurance remain very sound. And that the first quarter 2012 developed at prior year reserves has remained solidly positive as it usually does for us quarter-in quarter-out and in most of the years in the past decade.

So bottom line wise, the General Insurance business segment is starting the year in very good shape. And hopefully, we should be able to achieve somewhat better results than last year, but one quarter, as you know, does not tell the story for the full year. But as I say, things are looking pretty positive right now.

I'll turn it over to Chris and the discussion of mortgage guarantee and title insurance.

Christopher Stephen Nard
President & COO

Good afternoon, everybody. As we've mentioned in our last 2 calls, the Old Republic primary mortgage guaranty subsidiary, which is Republic Mortgage Insurance company, has been in run off status since the end of August, in 2011.

And since mid January of this year, the business has been operating under an order of supervision from the North Carolina Department of Insurance. That order instituted a deferred payment obligation construct at the company, which resulted in us limiting the cash portion of the claim payment under any policy issued by the flagship to a 50% cash payment. The remaining 50% of the claim is deferred. And it's credited to a temporary surplus account on the books at Republic Mortgage Insurance company.

In recognition of the current status of Republic Mortgage insurance company, our focus has been and continues to be on achieving an effective run-off of that existing book of business. As we have said in the past, the goal remains to limit that run-off within the constraints of the capital that's committed to that segment, while assuring at the same time the absolutely fairest treatment to all the policy holders of the company.

Take a second and let me switch to the operating side of the business for the first quarter. On the operating side, the mortgage guarantee sub, the trends present in the first quarter of the year compared to the first quarter of 2011 were favorable and benefited largely from what we've continued to see as a downward trend in newly reported delinquents, some welcome stability in the tier ratios and in the quarter, first quarter-to-first quarter comparisons, a significantly lower claims paid component.

The earned premium line, on the other hand, continues its negative trends, and was down about 90.5% in that first quarter-to-first quarter comparison. And obviously, that's related to the book being in a run-off status and no new production being added.

As we have talked about for the last year or so, the changes in the reserve provisions, continue to be impacted by our expectations of a reduced rescission rate component as we go forward. And that's really driven off of our expectations as we work through the claims from the particularly difficult years of 2005 -- late '05, '06, '07 and early '08, into the more claims with less misrepresentation embedded in the books.

I mentioned that we are working hard to successfully run off that book, a big component of that has been to essentially structure the expense side of the business in relation to the run-off capacity. And we've seen good progress in that.

In the quarter-to-quarter comparison, I think in the first quarter of 2011, we had about a 15% expense ratio. We reported in the first quarter of 2012 about 13.5% expense ratio. But embedded in that was about $2 million worth of severance and similar one-time costs.

As we continue to look at the expectations for the book as it runs off over its life, our standard premium deficiency model continues to show that the book should run off positively over its life. As we've talked about throughout this cycle, there are timing issues related to the collection of premium and the payment of claims.

Obviously, the payment of claims are very much front-loaded in this process. And we've seen an extensive extension in the premium cycle as these low rates, the refinance activity, and the anemic home price appreciation have contributed to what we would deem to be very high persistency rates in the book.

We continue to believe, again, that it's likely in the next quarter or two that that timing will result in depletion of the capital in the primary operating subsidiary, Republic Mortgage Insurance Company. But under the order of supervision by the North Carolina department, the results of that would be mitigated.

Let me take a second and segue to our title insurance results for the quarter. The results for the title insurance company continue to improve. And we're pleased to see the progress that they made in the first quarter of the year. I think it was the best first quarter that we've produced in the title segment since 2005.

That looked like, for the first quarter of 2012, a pretax profit of about $9.4 million in comparison to a $2.6 million pretax profit in the first quarter of 2012. We continue to see positive trends in the premium and fees earned line. On a comparative basis, they were up almost 7% comparison to last year's first quarter.

I mean-- that could trend for our title insurance subsidiary continues to be driven largely by increases in market share that we've seen over the last 2 years or so now as we've operated the business. Companies market share are reported numbers lag, so the most recent quarter we have is the fourth quarter of 2011, and our share for that period was 13.2%, which if you look back to the same period in 2010, it was about 11.5% in that same period.

Title expense ratio for this year's first quarter was 91.5, which again compares favorably to the 93% that we saw in the first quarter of 2011. And again, a positive trend in the first quarter-to-first quarter comparison in the claim ratio, category and we were down about a 0.5 to 7.2 for this period in the first quarter of 2012.

We continue to be very encouraged by the progress that the title insurance subsidiary is making. And we look forward to continue to improvements throughout the year for the title insurance company.

With that, I'll turn it back over to Al Zucaro.

Aldo Charles Zucaro
Chairman & CEO

Okay. There isn't much that we can add to what we have said. I'll just say that from a consolidated financial standpoint and the Old Republic level, there's very little change in between year end '11, and the end of the first quarter of 2012 on our balance sheet.

We have plenty of liquidity, specifically plenty of liquidity to certainly pay off the $316 million of convertible debt that's coming due around mid May in a couple – 2 or 3 weeks from now. The investment portfolio is as clean as it's ever been. We've got good market appreciation built into the balance sheet, on the bond portfolio in particular.

The cash flow of the entire business in the first quarter was very positive. With both general insurance and title insurance, positive cash flow more than offsetting the mortgage guarantee negative cash flow, but on the other hand, that itself was in much better shape this year.

We had about a $73 million negative cash flow and mortgage guarantee versus almost 130 in the first quarter of last year. So things are looking a little better from a cash flow standpoint there.

And then I might to say again, our loss reserves not just in general insurance but throughout the system, are still playing out very well and for each of our segments and in the totality of our business. So, as we like to say, we don't have to pay the piper for yesterday's claims. The reserves are standing up very well.

We're moving ahead with the previously announced separation of the CCI and mortgage guarantee lines, which as we said before, we are in process of melting together. And we should be able to execute on that separation of that part of the business in the next couple of months or so. Certainly, it will come late mid year, July or so, we should have that objective met.
Let's see. I think that's about the extents of the notes that I have here. Also, as was announced initially, we'll open it up to your questions.

Question and Answer

Operator

[Operator Instructions] And we'll take our first question from Jim Ryan with Morningstar.

Jim Ryan
Morningstar Inc., Research Division

Just a quick question regarding the change with the mortgage insurer and the CCI. Do you anticipate any changes in how you report for example, would it be considered discontinued operations or is there anything that would affect the way the income statement would look?

Aldo Charles Zucaro
Chairman & CEO

Yes. The general rule is that you start reporting only business as a discontinued operation the moment you have, in fact, effectively separated the equity ownership. So you have to sell the business or dispose of it in some fashion before you can do that.

So we have every expectation that with the separation of the business, then we would report it as a discontinued operation, as well as any remnants of the business that may stay behind following that separation.

So the best we could do at this point in time was to -- was to do what we did back in mid March, which was to telegraph what the company would look like, both in terms of the segments as well as the consolidation when we-- the separation takes place. And we will continue to update those schedules. But until the separation actually occurs, we have to report on a historical consolidated basis.

Jim Ryan
Morningstar Inc., Research Division

Okay. And secondly, it appears the title industry is starting to turn around. You are doing well. Your competitors have all reported very good earnings. Do you see any opportunities going forward that you might be able to take advantage of?

Christopher Stephen Nard
President & COO

Well, I think on the positive note, what you are seeing in the title business, is a lot of refinance activity. I mean, we see rates-- historically low rates and as Al mentioned ,when we think about the investment portfolio, we don't really see that changed any time soon that's obviously a big boom to refinancing. On top of that, you've got this government program called HARP that allows people to take advantage of the low rates, even though they may not have any equity in the property. That's been a huge plus to the title business and also to the mortgage guarantee business. It allows some of these higher rated loans to refinance to much lower rates. And then on the title insurance side, our West Coast operations we run largely an agent-focused title business. But we do have a large direct operation on the West Coast, particularly in the San Francisco area. And the San Francisco housing market has been very good. So we think the big plus for us is been the growth in share over the last few years, and to be able to essentially garner the benefit of the increased share now that the market seems to have recovered some in these few quarters.

Operator

[Operator Instructions] And we will take our next question from Bill Laemmel with Divine Capital Markets.

William Dunloy Laemmel
Divine Capital Markets LLC

With all those trucks out there, in the past that's benefited your property operations, has that occurred-- this so far?

Aldo Charles Zucaro
Chairman & CEO

Frequency seems to be under control. Severity is up a little bit, again, as I said before, pretty much across the board. Not just in the trucking area, when it comes to health-related types of claim costs. But other than that, our claim costs are pretty stable and we don't have as yet as many accidents. As you know, though, as economic activity picks up and as more trucks on the road for longer periods of time, et cetera, you are bound to ultimately get some more claims, activity. But so far we haven't seen anything of significance yet.

William Dunloy Laemmel
Divine Capital Markets LLC

Thank you. And one other item on the class action suit -- that really puzzled me, since you've always been very timely on your liabilities. I just wonder, are there any comments there?

Aldo Charles Zucaro
Chairman & CEO

Well, the thing we've done, Bill, is to state as best we can, the nature of those -- of that litigation in our 10-K. And I would just point you to that, as being the latest -- bit of information that we have on claimed activity I mean, being in the insurance business, we're natural recipients of claims. And I guess we have our share like everybody else.

Operator

And we have no further questions in the queue. I would like to turn the call back over to management for any additional or closing remarks.

Aldo Charles Zucaro
Chairman & CEO

So as excited are we -- we made all the comments that we were think -- we thought were worthy of attention. So as always, we appreciate your interest in our company and look forward to our next visit following the second quarter release. So you all have a good afternoon.

Operator
That does conclude today's conference. Thank you for your participation.