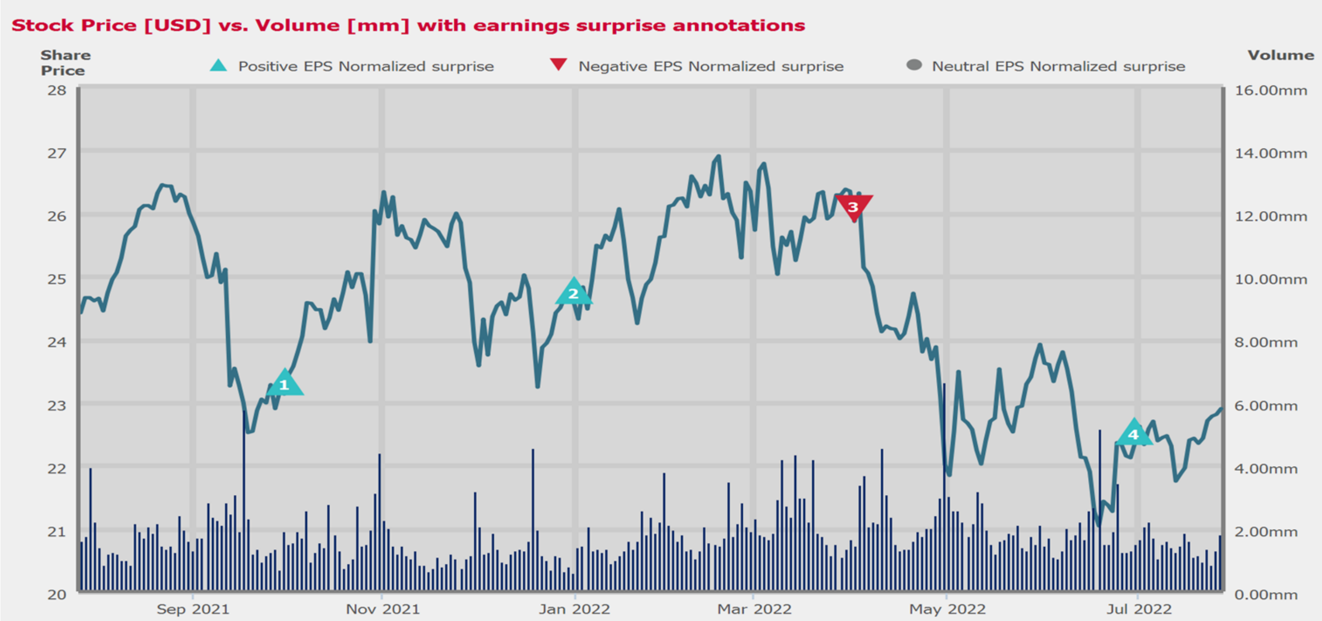
S&P Global
Market Intelligence

Old Republic International Corporation
NYSE:ORI
FQ2 2022 Earnings Call Transcripts
Thursday, July 28, 2022 7:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.60	0.69	13.11	0.66	2.65	NA
Revenue (mm)	2012.00	2127.80	5.76	1853.00	7813.00	NA

Currency: USD
Consensus as of Jul-28-2022 10:57 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	0.63	0.79	1 25.40 %
FQ4 2021	0.74	0.88	2 18.92 %
FQ1 2022	0.68	0.63	3 (8.70 %)
FQ2 2022	0.60	0.69	4 13.11 %

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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 afternoon. My name is Joanne, and I'll be the conference operator today. At this time, I would like to welcome everyone to the Old Republic International Second Quarter 2022 Earnings Conference Call. [Operator Instructions]

I would now like to turn the call over to Joe Calabrese with the Financial Relations Board. Sir, you may begin your conference.

Joe Calabrese

Thank you. Good afternoon, everyone, and thank you for joining us for the Old Republic conference call to discuss second quarter 2022 results. This morning, we distributed a copy of the press release and posted a separate financial supplement which we assume you have seen and are 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 financial supplement dated July 28, 2022. 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, and good afternoon, everyone, and welcome again to Old Republic's second quarter earnings call. With me today, I have Frank Sodaro, our CFO of Old Republic International; and Carolyn Monroe, the President of our Title Insurance business. .

Well, Old Republic produced another highly profitable quarter in both General Insurance and Title Insurance, even though Title Insurance revenues and operating income were less than the record setting 2021 results due to the increasing mortgage rate environment.

Net premiums and fees earned were just below $2 billion, while pretax operating income was $263 million. And our consolidated combined ratio continues to come in at a strong level, just under 91% for the quarter. In General Insurance, net premiums earned increased over the prior year by almost 9%. And in line with what we expected, Title Insurance net premium and fees decreased by 7% from that prior record-setting year. Both General Insurance and Title Insurance continue to produce excellent underwriting results reflected in those combined ratios and both are poised to continue to deliver strong profits throughout the remainder of the year.

So I'll now turn the discussion over to Frank and then he'll turn things back to me to cover General Insurance, followed by Carolyn, who will discuss Title Insurance, and then we'll open it up to the Q&A. So Frank?

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Thank you, Craig, and good afternoon, everyone. This morning, we reported second quarter net income, excluding investment gains and losses, of $210 million, a 5% decline from last year. On a per share basis, comparable year-over-year income was $0.69 versus $0.73.

For the first half of this year, operating profit was $402 million, a decline of 6%. Although both periods were down when compared to the record set last year, operating profits were very strong by historical standards with considerably higher levels coming from General Insurance, along with healthy levels of operating profit from Title.

Shareholders' equity ended the quarter at $6.4 billion, resulting in book value per share of just under $21. When adding back dividends, book value decreased by 5.8% from the prior year-end as a result of interest rates, the effect of that on our bond portfolio and lower valuation in our stock portfolio were partially -- were partially offset by the stronger operating earnings.

Net investment income was relatively flat for the quarter as an increase in the invested asset base was partially offset by slightly lower yields earned. Given our current bond reinvestment rate of just over 4% versus a bond portfolio rate of 2.7%, we believe we are at an inflection point and expect higher overall yields on a comparative basis sometime in the next few quarters.

During the quarter, we continued to rebalance our portfolio by reducing our stockholdings and increasing our investment in bonds, benefiting from the materially higher reinvestment rates. As a result of that process, we realized $53 million in net investment gains on sales and our investment portfolio ended the quarter with 74% in bonds and short-term investments and 26% in stocks.

During the quarter, the total fair value of bonds declined by $315 million, while stock decreased by $280 million. The overall credit quality of our bond portfolio remains strong with approximately 98% of the portfolio in investment-grade securities. We are pleased with how well our stock portfolio has performed during this market downturn. During the year, we significantly outperformed the S&P 500 as a result of our strategy to reduce volatility and by investing in large cap dividend paying stocks, which ended the quarter in an unrealized gain position of over $1.2 billion.

Now switching to loss reserves. All 3 operating segments recognized favorable loss reserve development. In total, the consolidated loss ratio benefited by 1.9 percentage points for the quarter compared to 1.8 percentage points for the same period a year ago.

Mortgage insurance losses continued with a favorable trend of lower newly reported defaults and higher cure rates on loans already in default. The group paid another $35 million dividend to the parent holding company in the quarter, bringing the total to $70 million year-to-date. Total shareholders' equity for the mortgage companies ended the quarter at $325 million.

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

Craig Richard Smiddy
President, CEO & Director

Okay. Thanks, Frank. So for General Insurance, net premiums written increased by almost 12%, and we continue to achieve rate increases on most lines of coverage with renewal retentions remaining strong and new business production also coming in strong.

Pretax operating income also rose by almost 12% to $138 million. And the loss ratio we reported for the quarter was 65% compared to the 68% we saw in the second quarter of '21. And of course, this included favorable development, which came in at 1.9 percentage points in the quarter.

The expense ratio came in at 27% with growth in lower loss ratio, higher expense ratio lines continuing to contribute about 1 additional point to our expense ratio relative to our historical line of coverage mix. The overall combined ratio was 92.5 points compared to 94% in the second quarter of last year.

Turning to some line of coverage specifics, starting with commercial auto. Net premiums in commercial auto grew by 10%, while net premiums earned grew by 6.5% and the loss ratio improved to 66% from 75% we saw in the second quarter last year. Claim frequency appears to be working its way back to pre-pandemic levels in auto, but we're still not there in our estimation. And claims severity continues to increase, but nowhere near the pace we saw in previous years. Our rate increases continue in auto in the high single-digit range, which implies that we continue to stay ahead of our overall frequency and severity trends.

Looking at workers' compensation line of coverage, net premiums written rebounded in the quarter and grew by 9%, while net premiums earned increased by nearly 7%. And the loss ratio improved 52% from 60% in the second quarter last year. Here, claim frequency appears to be returning to pre-pandemic levels as well and claim severity trends are slightly up. Rate decreases in workers' comp continue in the low single-digit range. But as we've stated in prior quarters, we still feel comfortable that our rate levels remain adequate relative to our combined ratio targets for this line of coverage.

In the financial indemnity line of coverage, more specifically, the public company D&O component of that, we experienced unfavorable loss development during the quarter stemming from some large security class action claims in accident years

2018 and 2019. Additionally, in the same line of coverage, it appears new market entrants are driving down rates. So we're no longer seeing the very hefty rate increases we saw in 2019, '20 and '21 and there is considerable pressure on rates as we go forward.

Those rate increases on public company D&O, in our opinion, were necessary as evidenced by the security class action activity we saw this quarter. So we're keeping a very close eye on the public company D&O line, and we will exercise underwriting discipline and our underwriters won't write accounts that aren't priced adequately. It's that simple.

As always, we follow loss trends very closely. That's what we do, and we'll continue to adjust our rates for inflationary trends that ultimately drive the severity trends. And that includes both general inflation and social inflation. We'll also keep a close eye on reserve levels relative to our observations and expectations surrounding inflation and adjust our reserves accordingly.

So overall, General Insurance growth strategy and underwriting excellence initiative continues to produce solid growth and profitability with new business production, high retention ratios, generally increasing rate levels, all contributing to those results.

So I'll now turn the discussion over to Carolyn, who will report on what's happening in our Title Insurance segment. Carolyn?

Carolyn Jean Monroe
President

Thank you, Craig. The Title group reported premium and fee revenue for the quarter of just over $1 billion, down 7% from prior year second quarter. Our pretax operating income of $110 million compared to $139 million in second quarter 2021, a decrease of 21.1%.

Agency premiums were down $46 million or 5.4% over second quarter 2021, and direct premiums and fees were down $33 million or 12.9%. Our commercial activity remained strong this quarter, with commercial premiums up [45%] over second quarter 2021 and made up 22% of our premium total this quarter. Our expense ratio for the second quarter of 2022 was 87.6% compared to 85.4% in second quarter of 2021. This increase is primarily driven by the decrease noted in directly produced revenue, which have higher fixed expenses, along with a greater proportion of agency produced revenues that have a higher expense ratio.

Agency commissions were down 5.8% for the quarter, roughly in line with the decrease in agency premiums. We believe that continuing with our strategic focus on serving our agents which accounted for 79% of our revenue this quarter, creates a sustainable competitive advantage. The expense structure associated with this model has a relatively high degree of variable expenses, which will enable us to navigate current market conditions.

All other expenses were down by 2% second quarter 2022 over second quarter 2021, with personnel expenses comprising almost half of that decrease. We will continue to manage and align our expense structure accordingly as rising interest rates are expected to soften commercial activity as well as residential markets.

While we are reporting decreases in revenue and pretax operating income for this quarter, it is important to keep in perspective that these comparisons are to a year that saw record-setting demand for housing and investments in the real estate market. Our reported second quarter results for both revenue and pretax operating income ranked fifth in terms of all-time highs, trailing only the fourth quarter of 2020 and the second, third and fourth quarter of 2021. The accomplishments of our employees and agents continue to be significant and drive positive results to the company.

While strong underwriting support is paramount in our value-add to our agents, we also recognize the importance of technology and we'll continue to offer in advance our portfolio of technology services and solutions. This includes, but is not limited to, the recently launched enhanced easy jacket application that I spoke about on our last earnings call, an in-progress project to enhance the StarsLink portal that allows agents quick access to documents and applications. Also continuing to invest in and enhance the integration platform supermarket that will allow our agents a standardized connection to an ecosystem of applications they need, including our closing software platforms, RamQuest and E-Closing, our e-recording service provider, EPN, which allows for an electronic document recording with a counties and also our digital signing solution, Pavaso.

We remain committed to combining Old Republic's Title solid business practices, procedures and expertise in the industry with our growing portfolio of technology to deliver measurable benefits and success for the industry, company and our shareholders. Thank you, and I'll now turn it back to Craig.

Craig Richard Smiddy
President, CEO & Director

Okay. Carolyn, thank you very much. So we remain very pleased with our strong levels of profitability in both General Insurance and Title Insurance, and our diversified specialty strategy should continue to produce stable, profitable results and value for our shareholders.
So this concludes our prepared remarks, and we'll now open up the discussion to Q&A, where I'll answer your questions or I'll ask Frank or Carolyn to respond.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Greg Peters with Raymond James.

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

Through the years, some things never change, and the Chicago's finest seem like they're coming back from lunch because I can hear the sirens in the background. Craig, I think it's been decades that, that's been going on. It's kind of ironic. So I realize there's other people who are going to ask questions. So I'm going to just -- I mean, let's start with the General Insurance business. And I think you adjusted the financial indemnity thing. But the growth is pretty stunning for your company to generate 10% top line growth.

And then in particular, workers' comp, which is almost 10%, which you acknowledged, which is a dirty word in the investment community right now because of the presumption of it being a soft market. So give us some perspective on where you're getting the growth? Is it -- is it new business with unit counts? And tell me what your perspective is about that new business you're writing?

Craig Richard Smiddy
President, CEO & Director

Sure, Greg. I'd be happy to. So I think one thing to start is keeping perspective on where we were at a few years ago pre-pandemic work comp. And if you look back, you could refer to the financial supplement as well. And you can see that we had really reduced our premiums quite significantly over the course of the years in the supplement, if you look at year '17 through '21.

So as we reported during the quarters at the beginning of the pandemic and through last year, premiums were coming down, exposure growth was coming down and we've seen a rebound there. So we're really getting a lift from exposure growth within our existing policies and adding new business and at the same time, trying to hold as much rate as we can. So we would not be growing that line if we didn't think it was at a profitable level. And you can see the reported combined ratios, of course, are very strong, but include favorable development, as you know.

But even on a current accident year basis, we feel very good about where those loss ratios are projected to come in at, given our target combined ratios for that line of business. So hopefully, that provides some of the color and history, I think, is necessary when thinking about that bump up in comp and comparing it to those prior years.

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

Yes. The other thing that is -- the other thing that's probably worth you commenting on as it relates to General Insurance is just this whole concept of what the right inflation factor is to use in your loss pick assumptions. We've observed, and I know you have as well, companies that have already reported raising -- Chubb, I think, raised their loss picks. Cincinnati was out with some issues. And just curious, from your perspective, for your book of business, how you're thinking about those inflation factors?

Craig Richard Smiddy
President, CEO & Director

Definitely. And I know some of our peers, including those you mentioned, talk about a very general inflation factor. We don't really talk about it in a general fashion because you really need to look at the severity and the frequency by line of coverage in our opinion. So for instance, on comp, you look at, well, what's happening with the frequency first and then you take a look at the severity. And their medical inflation is not running anywhere near general inflation.

And the decreases that are still happening in rates and comp are -- have happened over many years because of the frequency. So I don't like to generalize when we're talking about what kind of severity trend or -- that we're building in or inflationary trends. It really depends on the line. Now on the other side of the coin, if you look at our auto physical damage, it's quite the opposite story where the inflationary trends we're seeing there that ultimately end up in the severity trends are really high right now with labor increases, parts increases, used vehicle price increases, the list goes on.

So on auto physical damage or the trends we're seeing there are probably double digit. So you really have to look at it by a line of coverage in our opinion. And with regard to your point about current accident year loss ratios there, when we look at those picks, it's all -- it all depends on what kind of rates we're getting. And as I commented on auto, where we believe that we're actually getting rate that implies we're ahead of the inflationary trends, including social inflation that we're seeing still on auto, there would be no reason to go back and adjust our auto accident year loss picks for this year because we're getting rate that is, in our view, ahead of the trends that we're seeing.

So again, it would depend on line of coverage. We'll look at what we're seeing. And if those inflationary severity trends are coming in with more than we're getting in rate, we got -- we have to go back and look at things. But we're doing our very best to on all lines of coverage to reinforce with all of our underwriters the necessity of getting rates that is at least commensurate with trend and preferably some cushion to allow us to absorb the unexpected.

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

That's a thorough answer. I'm going to pivot to the Title segment is my final question. And there's a lot of headlines about the fact that there's very little activity happening in the marketplace today as a result of the higher rates. And you clearly still produced a strong result. I assume some of that's the lagging nature of your business. I look at the direct orders, Carolyn, I think they were down second quarter to second quarter, 24% or so. .

When things settle out in your judgments, what kind of revenue base do you think is normal? And obviously, we have to take -- if we have to set aside what happened last year and maybe the last couple of years, what's the right level of revenue to think about how this business looks once things settle out?

Craig Richard Smiddy
President, CEO & Director

Carolyn?

Carolyn Jean Monroe
President

Sure. I think if we -- if we try to go back and -- when we've been trying to do planning, trying to take out the last 2 years, we start with a baseline of what we saw in 2019. And then you factor in that there's been home price increases. And since our revenue is always based on a sales price. That's what the premiums are based on. We take that into consideration. So we just look at that as a baseline for us. And even this quarter was -- I think we were at 60-something percent ahead of 2019. So we're seeing somewhat of a slowdown, but what we're reading about isn't exactly what we're seeing out in our agents and in our offices. So I think some of that could take a little longer to catch up with sales.

I mean home prices are still holding strong. And even though interest rates are going up, they're still not so bad that people aren't still wanting to buy homes. So it slowed, but it slowed based on some really great years, and it hasn't slowed when we look at what happened in 2019. And that's really as we're trying to manage what we're looking at.

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

And so if I look at -- just trying to take it a step further, the 24% down in direct orders. If that's a leading indicator, is that fair to say that revenue might be down 24% in the third quarter? Or I hate to -- I'm not trying to get you [$0.01] down in a quarterly number. Just directionally, it feels like it's -- things are going to accelerate in the slowdown as we move through the year? And just based on your answer, it's kind of confusing because you're saying we're not necessarily seeing it yet. So just clarification on that, and that will be it.

Carolyn Jean Monroe
President

Well, yes, the 24%, it seems like a high percentage going forward. But it's -- Greg, it's just -- the real estate is just really a hard market to predict. And I honestly, coming into this year, I don't know that I would have thought we were going to do as well as we did in the second quarter, just with everything we're reading. And I think that's what I'm basing my comment on is that based on what we were reading at the beginning of the year and seeing all the NBA reports, I honestly thought second quarter would not have been as good as it was.

So that's why it's all -- it's just rough to predict. In our commercial, the 82% of our commercial business comes from our agents and that business is up. So it's -- that's helped us along this last quarter as well.

Operator

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

Craig Richard Smiddy
President, CEO & Director

Okay. Well, we thank everyone very much for participating, and we will continue to work hard here to keep on top of things as the macroeconomic environment continues to change and we, as I said earlier, have every expectation that we will continue to produce very strong profitability in both General Insurance and Title Insurance as the year continues. So we look forward to seeing you next quarter. And again, appreciate your interest and participation.

Operator
This concludes today's conference call. You may now disconnect.