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Old Republic International Corporation NYSE:ORI

Earnings Call

Thursday, October 26, 2023 8:00 PM GMT

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

Jon Paul Newsome
Piper Sandler & Co., Research Division

Unknown Analyst

ATTENDEES

Joe Calabrese

Presentation

Operator

Good afternoon. My name is Audra, and I will be your conference operator today. At this time, I would like to welcome everyone to the Old Republic International Third Quarter 2023 Earnings Conference Call. Today's conference is being recorded. [Operator Instructions]. At this time, I would like to turn the conference over to Joe Calabrese with Financial Relations Board. Please go ahead.

Joe Calabrese

Thank you. Good afternoon, everyone. Thank you for joining us for the Old Republic conference call, Third quarter 2023 results. This morning, we distributed a copy of the press release and posted a separate financial supplement which we assume you have seen and/or otherwise have access to during the call. All 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 October 26, 2023. 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. 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 is Frank Sodaro, our CFO of ORI; and Carolyn Monroe, our President and CEO of Title Insurance.

Well, during the third quarter, General Insurance continued to produce strong underwriting results, which drove a 28.6% increase in pretax operating income for the quarter and a 32.3% increase year-to-date. The decline we saw in Title insurance pretax operating income continues to reflect what we're seeing from the effects of mortgage interest rates.

However, our focus on specialization and diversification across Title and P&C segments allowed us to produce $251 million of consolidated pretax operating income in the third quarter compared to $257 million in the third quarter of '22, alongside of a consolidated combined ratio of 91.9% for the quarter and 92.4% year-to-date. So our conservative reserving practices continue to produce favorable reserve development, and we saw that in all 3 segments, led by strong favorable reserve development in general insurance.

Our balance sheet remains solid even as we continue to return capital to shareholders through both dividends and share repurchases and as we continue to invest in the long term, including our September announcement of yet another new underwriting venture Old Republic Accident and Health.

So I'll now turn the discussion over to Frank, and then Frank will turn things back to me to go into some details on general insurance, followed by Carolyn, who will discuss some details on Title insurance. And then we'll open up, as we always do, for conversation and Q&A. So Frank, I hand it to you.

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Thank you, Craig, and good afternoon, everyone. This morning, we reported net operating income of $200 million for the third quarter compared to $206 million last year. On a per share basis, comparable year-over-year results was $0.72, up from $0.68.

Net investment income increased over 26% for the quarter, driven primarily by higher yields on the fixed income and short-term investment portfolios. Our average reinvestment rate and corporate bonds during the year was 5.3%, while the comparable book yield on bonds disposed of was just under 2.8%.

The bond and short-term investment portfolios increased to 83% of the total, with the remaining 17% allocated to large cap dividend paying stocks. We continue to evaluate this allocation in light of current interest rate environment. The quality of the bond portfolio remains high with 99% in investment-grade securities with an average maturity of 4.3 years and an overall book yield of nearly 3.8% compared to 3.1% at the end of the third quarter last year.

The valuation of our fixed income securities decreased by approximately $180 million during the quarter, driven by higher interest rates, while the value of the stock portfolio declined nearly $106 million, but ended the period in an unrealized gain position of just under $1.1 billion.

Now moving to the other side of the balance sheet. Our strong reserve position once again led to all 3 operating segments, recognizing favorable loss reserve development for all periods presented. The consolidated loss ratio benefited by 4.5 percentage points for the quarter compared to 3.4 points for the same period a year ago.

The Mortgage Insurance group paid a $25 million dividend at the parent holding company in the quarter, bringing the year-to-date total to $85 million, with plans to return another $25 million in the fourth quarter subject to regulatory approval.

We ended the quarter with book value per share of $21.37. When adding back dividends, book value increased just under 5% from the prior year-end driven by our strong operating earnings, partially offset by unrealized investment losses. In the quarter, we paid $68 million in dividends and repurchased nearly $125 million worth of our shares for a total of just over $190 million returned to shareholders.

Since the end of the quarter, we repurchased another $52 million worth of shares, leaving us with about $90 million remaining in our current repurchase program. I'll now turn the call back over to Craig for a discussion of General Insurance.

Craig Richard Smiddy
President, CEO & Director

Okay. Thanks, Frank. In the third quarter, General Insurance net written premiums were up a hefty 12% and pretax operating income increased to $216 million, up from $168 million in the third quarter of 2022. Our combined ratio was 89% compared to 90% in the third quarter of 2022.

So thanks all the hard work of our associates, along with our underwriting excellence efforts. We continue to produce overall very profitable results. The loss ratio for the quarter in General Insurance was 60.4%, which included 6 points of favorable reserve development and the expense ratio was higher at 28.6%, but that's in line with our line of coverage mix trending toward lower loss ratio, higher commission ratio lines over the last few years

We had strong renewal retention ratios and new business growth, including new business produced through our new underwriting ventures that helped drive that 12% increase in net premiums written and we're continuing to achieve rate increases across the portfolio with the exception of D&O in our financial [lines] and workers' compensation.

So turning specifically to our 2 largest lines of coverage. First, commercial auto, net premiums written grew at a 19% clip while the loss ratio came in at 66.3% compared to 64.8% in the third quarter of '22. And in both of those periods, we had favorable loss development, although there was somewhat less favorable development in the third quarter of this year compared to last year.

Severity trends holding around 10% with frequency trend relatively stable. And our rate increases are commensurate with these trends we're observing which implies that we continue to cover our loss cost trend on commercial auto.

Workers' compensation net premiums written declined 6% and while the loss ratio came in at 33.2% compared to 35.8% in the third quarter of '22. And here too, both of these periods saw a favorable reserve development. Frequency for workers' compensation continues to trend down, while severity trend is relatively stable. So we think our rate levels remain adequate even with rate decreases in the low to mid-single digits.

We overall expect solid growth and profitability and General Insurance to continue for the rest of the year and into '24, reflecting again our specialty strategy and our excellence initiatives. So I'll turn it now over to Carolyn to report on Title Insurance. Carolyn?

Carolyn Jean Monroe
President

Thank you, Craig. For the third quarter, the Title group reported premium and fee revenue of $684 million. This represents an improvement of around $35 million from last quarter, but it was down 29% from third quarter of 2022. Our agency premiums were down 31% and direct premium and fees were down 22% from last year's third quarter. And our pretax operating income of $37 million compared to $73 million in the third quarter of 2022. We had a combined ratio of 96.7%, which compared to 93.7% in the third quarter of 2022.

As the challenging market continues, our approach is cost management with a long-term view of focused on our strategic initiatives. This approach helped to maintain an incremental improvement and our pretax operating income this quarter as compared to second quarter 2023 results.

Since the end of 2022, interest rates have been the headline story in our market. And as interest rates continue to rise, housing affordability dropped to its lowest level in more than 30 years. This issue impacts the availability of existing homes for sale, pushing buyers towards new homes. Low levels of inventory will continue to affect the volume of transactions in our markets. The commercial market remains an important focus for us. Our transformed nationwide footprint has allowed us to grow market share in this segment.

Our commercial premiums in the third quarter increased from last quarter, but were down 32% over third quarter of 2022. Commercial premiums represented 22% of our earned premiums this quarter compared to 21% in the third quarter of 2022.

The cornerstone of our business is our independent agents. 88% of our 2023 premiums came from independent agents. Over 60% of U.S. title insurance premiums are written by independent agents. So our strategy is to utilize bundling of technology solutions to optimize the business processes of our agents and internal productivity, resulting in better customer and employee engagement. We believe these strategies will position us to take advantage of market opportunities in the future.

And with that, I will turn it back to Craig.

Craig Richard Smiddy
President, CEO & Director

Okay. Carolyn, thank you. Well, we remain pleased with our profitable growth in General Insurance, which is helping to mitigate the lower revenue and lower profit levels and Title Insurance. And we also remain pleased with our capital management efforts, including the $684 million we've returned to shareholders through dividends and share repurchases in the first 9 months of this year.

For the remainder of '23 and into '24, we're optimistic for continued profitable growth within General Insurance, as I commented on earlier. While we remain of the view that Title Insurance will continue to face mortgage interest rate and real estate market headwinds through '24.
So that concludes our prepared remarks, and we'll now open up the discussion to Q&A and either I'll take your questions or ask Frank or Carolyn to respond.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Greg Peters at Raymond James.

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

I guess I had a couple of questions for you. First of all, from a written premium standpoint, it seems like things have accelerated a little bit in the third quarter relative to the rest of the year. Perhaps you can give us sort of a perspective on how the third quarter is really going to shape the cadence of what we should think about for next year? Specifically, as we look at the strong top line results, I guess, general expectation is we'd expect growth to moderate into next year. But with pricing and exposure growth maybe an expectation of elevated growth going through '24 might be reasonable. Any comments on that?

Craig Richard Smiddy
President, CEO & Director

Sure, Greg. I'd be happy to comment. So the strong net written premium growth we saw in commercial auto is somewhat of a reflection on the fact that it became very clear that our pricing for commercial auto was appropriate and that we could be competitive in that space at the pricing levels that we were at as long as we kept up with severity trends. So again, we saw not only the lift that we got from, say, 10% rate increases on commercial auto on average, but also a lift from some new business there as well.

And I would -- we feel very good about where we sit with commercial auto, and we had favorable development again on that line of business. So we're very well positioned relative to the marketplace to continue to be competitive on commercial auto into '24.

The other thing that I commented on, we had 4 out of 6 new underwriting ventures that have been in recent years, more recent years, and they are starting to produce premium and I anticipate that we will start to see some considerable lift from those new underwriting ventures as we get into '24 and '25 based on the pro forma that we have now.

On the other end of the spectrum is workers' comp. I think the rest of the year, certainly, it does not look like rate increases are going to be the case. I think rate decreases continue there. Again, we're -- while on the surface, we don't like giving up rate and we do our very best to hold on to rate. The frequency trends continue to go down and consequently, the marketplace is reducing rates. So that creates a bit of drag on our net premiums written. And I would hope that as we get into '24 that at least it flattens out, and we're not continuing to see rate decreases there.

So fairly optimistic about top line as we move into '24, our portfolio is at a very good place profitability-wise. And it's not as though we're having to take underwriting actions, reducing large portions or even small portions of our portfolio. We're in a very good place, and we're able to grow the business.

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

Just as a follow-up on the workers' comp, I mean, the loss ratios that you're reporting are clearly reflecting the prior year development. Can you give us a sense of where you're [pegging] the current accident or loss pick with inside workers' comp?

Craig Richard Smiddy
President, CEO & Director

Yes. Well, we're holding it fairly consistent with where we had it in the past. As a matter of fact, it might even be about 1 point higher. So the current accident year on work comp is around 64, and that compares to around 63 last year. So we're being conservative there. We're not reducing the loss pick and we would expect that as we get into our planning sessions and set our picks for '24, we'll take a close look at what's happening with severity and frequency again and take both of those things into consideration, along with anticipated rate changes in '24 when we look to reset that lost bit.

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

And then I just pivot real quickly to the Title business. I know the expense ratio has popped up as revenues have come in. Do you think we're sort of nearing the peak in terms of where the expense ratio is? And I know you commented a little bit in your prepared remarks, but is it expected that that's going to gradually come down over time?

Craig Richard Smiddy
President, CEO & Director

Well, I'll start off and then I'll hand it over to Carolyn to give a little more detail. So we have been very consistent in what we've communicated the last several quarters on this call, and that is that we were anticipating that '23 would have a combined ratio around 97. And we're still looking at that as where we likely think the year will end.

And of course, I'm speaking about combined ratio because that's what we talked about previously and, of course, 95 points of that combined ratio or expense ratio. So as Carolyn mentioned in her comments, we're managing expenses, and as is also very clear, it's -- the top line has a heck of a lot to do with where we end up on those ratios. And so we're being cautious, but Carolyn, I'll turn it to you more specifically to respond to Greg's questions about where that expense ratio might be for the year and into next year.

Carolyn Jean Monroe
President

Yes. I think that where we are is pretty consistent with where we think it will stay. We were able to although slightly, I mean, we did improve our combined ratio from the second quarter to the third quarter. And I just think that's just because of some of the things that we have been doing throughout the year. And I just expect it to stay right around this for at least the rest of this year on into 2024.

Operator

[Operator Instructions] We'll go next to Paul Newsome at Piper Sandler. Mr. Newsome your line is open, please go ahead.

Jon Paul Newsome
Piper Sandler & Co., Research Division

I had a couple of Title questions. I wanted to ask if the change in the -- if there's really -- if we're seeing anything that affects the mix between Title Insurance sold through independent agents versus Title through the direct channel. And I was just curious if that has -- the downturn has had any effect on sort of where customers go? And does that change your positioning in the Title business as you see those changes? If at all.

Craig Richard Smiddy
President, CEO & Director

Carolyn, I'll just chime in real briefly and then turn it to you. But our observations on direct and independent are based, of course, on our portfolio. And just to give you a sense, our direct operations are mostly West Coast, California. So the real estate market there has had more headwind than we've seen in other places in the country. So for us, we have a view of direct business that is mostly California-centric and then of course, the rest of our view is nationwide. But Carolyn, I'll turn it to you now to comment on what you think about any shifts in direct and agency and where things are.

Carolyn Jean Monroe
President

Sure. We've tracked for years. We're able to look at numbers of how much business is written by independent agents compared to directly owned operations. And at least for the last 10 years, it has stayed in the 60%, low 60%. There just hasn't been much shift. And I don't see it changing because really [direct and agency] is also like a lot of market driven. On the East Coast, you see mainly independent agents. And in some of the bigger states, it's about a 50-50 split. So as long as we are able to keep our independent agents in business, I don't see that changing much.

Jon Paul Newsome
Piper Sandler & Co., Research Division

That makes sense. Does it matter -- you've seen this shift within the housing business to new sales of new homes versus old homes, existing homes, does that make any difference to you as a Title insurer from a marketing perspective?

Craig Richard Smiddy
President, CEO & Director

Go ahead, Carolyn.

Carolyn Jean Monroe
President

No. I mean it's just -- for an agent, they market to someone different. They're marketing to a builder rather than to a real estate client, that type of thing. And it just depends on what market you're in, whether an underwriter or a direct operation has a relationship with a builder. It's a -- our business is always relationship driven. So it's really just about who has the relationship with the builder and who has the relationship with the realtor.

Jon Paul Newsome
Piper Sandler & Co., Research Division

A question about reserves, perhaps because I always want to put Frank in the hot seat. A lot of the companies are today and recently are reporting issues with accident years sort of in the casualty reserves for accidents or sort of 2016 to 2019. Obviously, you folks have had a great track record overall. I'm just curious if in some of your books, you're seeing some of that? Or is that some of the differentiation amongst your book versus others that they're seeing these problems during casualty lines in those years.

Craig Richard Smiddy
President, CEO & Director

Yes. And the years where you say others are experiencing problems with unfavorable development are in accident years did you say '16 to '19, Paul?

Jon Paul Newsome
Piper Sandler & Co., Research Division

Yes. They're sort of all the pre-pandemic years. Seems to be where the source of some problems are for a lot of companies.

Craig Richard Smiddy
President, CEO & Director

Yes. Well, I think we are very different, certainly on commercial auto. We have been very successful at identifying trends early, responding quickly, and that started well before the pandemic, 5, 6, 7, 8 years ago. And achieving the necessary rate to offset those trends we were seeing. So while I know I've observed in the marketplace, some of the -- our competitors that are experiencing unfavorable development on commercial auto in those years. That is not the case for us, we're actually -- we have favorable development.

And on general liability, it's a little bit different. We are seeing some unfavorable development on general liability. And we're -- just like we did on auto, we're responding to that and some of the general liability growth in premium you're seeing is because of increases in rates on a general liability to respond to any social inflation severity trend that's leaking from auto into general liability.

Operator

We'll take our next question from Evan Tindell at Bireme Capital.

Unknown Analyst

My question has to do with interest rates and competition in really all lines of insurance that involve flows. So I'm just generally you can obviously get much higher yield on insurance flow these days. Do you guys expect various lines to become more competitive over the next few years in terms of pricing? And relatedly, do you guys still think that 90% to 95% combined ratio in the General Insurance business is a good sort of range because you guys have been at 90 for a few years now? Or do you think you guys could start to push into the 80s. Thank you.

Craig Richard Smiddy
President, CEO & Director

Sure. I'd be happy to address both of those. And actually, I think your questions are related. In my 37-year career, I've experienced hard and soft markets, some of them that have been driven by the issue of underwriting float and investment income that was given too much attention relative to underwriting income. So I understand your question.

I think where we sit in this cycle, there is a far greater concern in the marketplace about social inflation, about general inflation, the need to continue with and rate increases that are commensurate with those trends that I don't believe. And certainly, we here are not adjusting our target combined ratios because we're achieving greater levels of investment income. We think that is important to continue to target combined ratios between 90% and 95%, depending on the line of business.

And we say between 90% and 95% because there is a little bit of difference if it's shorter tail or if you're receiving investment income on the longer tail business, so you can write it to a few points higher combined ratio. But generally speaking about competitiveness in the marketplace. I think there's far greater concerns that outweigh the potential advantages of greater investment income. Of course, you could always have new entrants that come in and are disruptive and and underpriced business. But generally speaking, the P&C marketplace is remaining very disciplined and more concerned about achieving appropriate levels of rate relative to inflationary trends.

And so therefore, like I said, I think the second part of your question was related because that involves where do we set target combined ratios. And I can tell you that our target combined ratios will not change as we go into planning for the 2024 year, and we'll still be targeting combined ratios in the low 90s to 95%. It's -- will we be able to move into the '80s and target something in the 80s.

I think that is very difficult to do because, again, there is some pressure that will inevitably come in the marketplace from the greater investment income. And typically, when there's greater investment income, combined ratios go up. So being able to drive that down in general insurance much further is unlikely.

And then you also have to remember that a good portion of that is coming from favorable development. And as we said on the earnings call last couple of quarters, but the current level of favorable development that we're experiencing is not sustainable over the long term, 6 points is extremely robust. We try to err on the side of having favorable development ideally in the 2% range.

But right now, that overall calendar year combined ratio is reflective of some very strong favorable development that won't continue. So we're going to continue to target and the combined ratios that we currently are targeting on an accident year basis.

Unknown Analyst

And one other question. Do you guys have an internal forecast for when you think autonomous vehicles might start to impact the commercial auto insurance market? Or do you guys think it's so far off that it's not worth worrying about right now?

Craig Richard Smiddy
President, CEO & Director

Well, we certainly keep an eye on it. We don't have any type of internal forecast. But we think it's a long way off before the public gets comfortable with autonomous driving.

And for us, you really have to think about long-haul trucking and commercial vehicles. And because that's the majority of our commercial auto exposure. We don't have the personal lines, commercial exposure -- ours is commercial, not personal lines.

So when it comes to commercial, the idea of an 80,000-pound truck running down a highway, without a driver is probably a long way off before the public is going to accept that kind of catastrophic potential. And then if you look at the other commercial auto business that we write across our companies, it's commercial auto business that's transporting workers and goods and those vehicles will always have drivers because they are the workers that we're insuring.

So for us, the autonomous question is not perhaps as relevant as it may be if you're a personal auto carrier because, again, I think it's a long way off for the type of exposures that we underwrite.

Operator

And that does conclude the question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, we, again, I appreciate everyone that has join the call and listen in and those that have asked questions, we are appreciative of that as well, and I appreciate the support, and we feel good about the third quarter and looking forward to reporting to you on our fourth quarter results. And until then, thank you very much, and have a good day.

Operator
And that does conclude today's conference call. Thank you for your participation. You may now disconnect.