S&P Capital IQ

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Old Republic International Corporation

NYSE:ORI

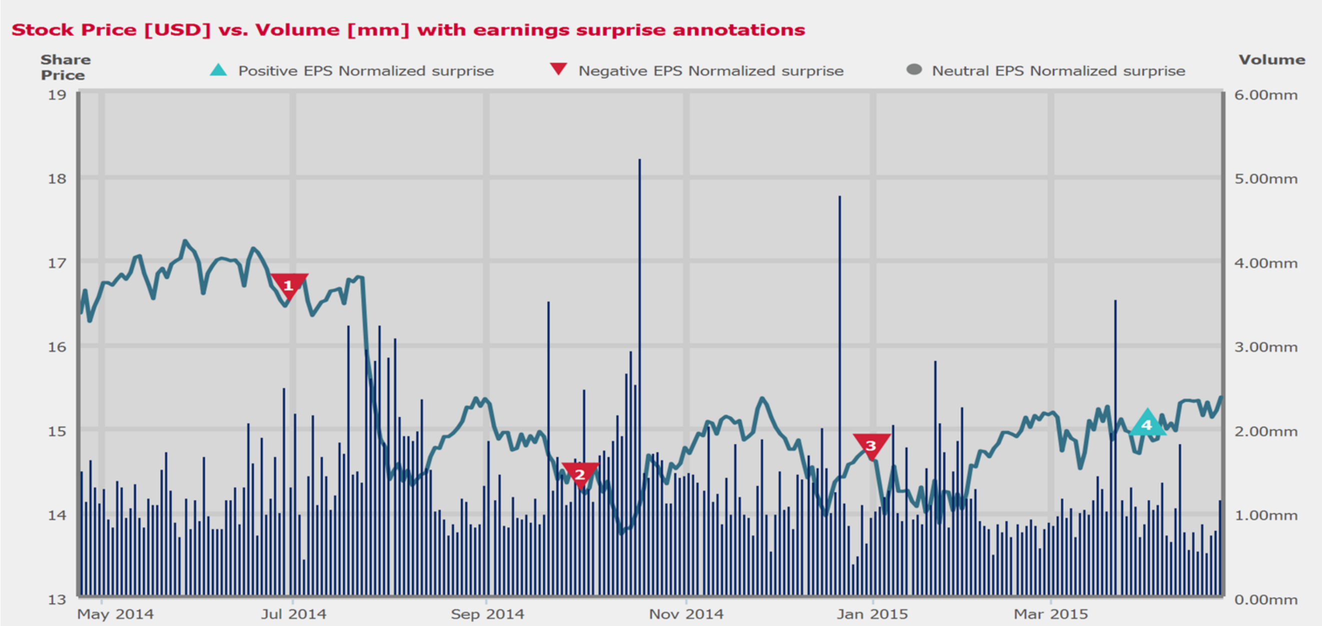
FQ2 2015 Earnings Call Transcripts

Thursday, July 23, 2015 7:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2015-			-FQ3 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.24	0.32	28.00	0.26	1.06	1.08
Revenue (mm)	1300.00	1410.00	8.46	1394.00	5420.00	5443.00

Currency: USD
Consensus as of Jul-20-2015 5:20 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2014	0.26	0.13	(50.00 %)
FQ3 2014	0.26	0.25	(3.85 %)
FQ4 2014	0.24	0.21	(12.50 %)
FQ1 2015	0.24	0.32	33.33 %

Call Participants

EXECUTIVES

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Karl W. Mueller
Chief Financial Officer and Senior Vice President

Marilynn Meek

R. Scott Rager
President and Chief Operating Officer

Rande K. Yeager
Chief Executive Officer and President

ANALYSTS

Christine Amanda Worley
JMP Securities LLC, Research Division

Presentation

Operator

Good day, and welcome to the Old Republic International Second Quarter 2015 Earnings Conference Call. [Operator Instructions] I would like to remind everyone that this conference is being recorded.

I would now like to turn the conference over to Marilynn Meek with MWW Group. Please go ahead.

Marilynn Meek

Thank you, operator. Good afternoon, everyone, and thank you for joining us for Old Republic's conference call to discuss second quarter 2015 results.

This morning, we distributed a copy of the press release. If there's 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 July 23, 2015.

Risks associated with these statements can be found in the company's latest SEC filings.

Participating in the call, we have: Scott Rager, President and Chief Operating Officer; Rande Yeager, Chairman and Chief Executive Officer of Old Republic Title Insurance Company; Karl Mueller, Senior Vice President and Chief Financial Officer; and Al Zucaro, Chairman and Chief Executive Officer.

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

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Okay. Well, thank you, and welcome again to this discussion of our company's latest results. And as was just indicated, after the remarks, we'll open up the session to field any questions that are -- or that may be left unanswered by either the press release itself or the discussion we're about to have.

We'll handle this visit as we have in the past by covering matters specific to each of our operating segments. And we'll do so in the same order as the discussion appears in the news release.

So that said, why don't we start with you, Scott, and take up the general insurance business discussion, okay?

R. Scott Rager
President and Chief Operating Officer

Thanks, Al. The general insurance group experienced 5.6% growth in net premiums earned for the quarter year-over-year and an increase of 6.4% for 2015 year-to-date.

We currently believe that this growth rate should hold at or near those levels through the remainder of the year. This growth rate, obviously, varies among the various coverages and product lines. While rate increases should begin to moderate going forward, we still expect organic growth and stable retention rates to continue on existing accounts.

We also have reasonable opportunities -- or should have reasonable opportunities for new business such that most of our operations should experience steady growth for the foreseeable future.

Addressing rate trends, and with the understanding that we operate in several specific marketplaces with varying product mixes, we are seeing rate levels moderating in an increasing, more stable, economic but still very competitive environment.

Some of our operations are achieving low to mid-single-digit production growth in other parts of the business that have bolstered less than acceptable performance in the past couple of years or more, we're having to retrench some in order to reorient the business mix from both geographical and product-type standpoints.

As we have noted before, we have different markets, different products, and no one size fits all.

Year-to-date, the composite ratio declined from 98.2% in second quarter of 2014 to 97.1% this year. Loss ratio was down a bit and the expense ratio ticked up, but overall, a better composite for the quarter and year-to-date.

Commercial auto performance improved over the first quarter, resulting in a year-to-date loss ratio of 77.5%, more in line with our expectations.

The worker's compensation loss ratio is down a couple of points year-to-date from 2014 to 81%, and we continue our efforts to return that ratio to more historic levels in the 70s.

General liability is performing much better year-over-year. With these smaller lines, severity and claim development are the usual performance drivers, as we have noted before.

Trends are both better thus far. The lines posted a loss ratio of 67.1% versus 81% in 2014 year-to-date. Remaining product lines have performed well through midyear as well, thus resulting in an improved composite ratio for the group.

We continue our efforts where appropriate in our several markets to emphasize more loss-sensitive product offerings versus guaranteed cost products.

As we've explained before, our results tend to improve as the insured share is in the risk of loss and has a real incentive to observe good loss control practices.

Looking ahead in the near term, we believe our respective markets will maintain their present competitive environments as they have to-date for the remainder of the year.

Our focus remains on favorable underwriting results and achieving the objectives outlined in the 5-year plan we established as 2012 came to an end.

And with that, I'll turn the meeting over to Rande Yeager for a Title Group update.

Rande K. Yeager
Chief Executive Officer and President

Thank you, Scott. Well, we're very happy with the latest report we were able to get here on the Old Republic Title Insurance business. Title Group recorded its best quarterly profit ever. Previous record dates all the way back to the third quarter of 2003. Our record performance in the latest quarter is even more remarkable when you consider that 2003 third quarter mortgage origination market totaled nearly $1.2 trillion, while 2015 second quarter originations were only about $400 billion, about 1/3 of what they had been recorded in 2003.

As we reported this [indiscernible], title segment registered a $47.7 million pretax profit in comparison to 2014 second quarter profit of $26 million or up 83.3%.

Year-to-date, pretax operating income was up about $33 million compared to 2014, rising from $30.8 million to $63.7 million. This represents year-to-date growth of about 106%.

As we can see in the release, premiums and fees were up a little more than 19% from $421 million to $503 million. And so far this year, premiums and fees are approximately 14% -- or approximately 14.3% from $815 million to $931 million in the latest quarter.

Closed orders from our direct operations increased 22%, while independent agency production was up about $58 million or close to 20%.

Commercial operations continued to exceed our expectations. Revenue from commercial orders was up almost 20% relative to comparable quarters and now accounts for over 16% of our total premium revenue.

Our national market share has exceeded 15% early in the year -- so far anyway.

Taking a look at the factors that drive profit margins, we note that claims trends continue to improve. If you look at the table on Page 3 of the release, you can see the claims ratio dropped from 6% to 5% in the quarter and 5.3% year-to-date.

The expense ratio has also declined as we obtain significant benefits from operating leverage.

Our results are benefiting from a number of things: low interest rates; an improving economy; and more purchase transactions relative to refinances. We have a little reason to believe that much of change in the near-term interest rates, seasonal fluctuations, regulatory issues seem to be stable. Consumer Financial Protection Bureau was to release new rules in -- next month in August, but that's now been delayed till October. It was supposed to be the hiccups that many predicted would affect the third quarter money market, and it probably won't have much impact this year.

Sum total all the factors we've cited leaves us to be optimistic about our potential for growth and the title segment's contributions to the Old Republic families -- family of companies. And with that very good thought, I'll turn the meeting back to Al Zucaro.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Okay. So let's see. Let's take a look at Pages 3 and 4, [indiscernible] if you have it there. And looking at those numbers, with respect to the RFIG runoff, it's obviously clear that we're not yet out of the woods with regard to the litigation matters we've been dealing with since the Great Recession started in 2007 or thereabouts. Periodically, as you might expect and as is expected of us, we do revisit the trends in the mortgage insurance and CCI litigation. As you know, we have 2 separate cases, even though they're both with the same major banking institution. But we do look at those case trends in terms of the litigation costs, as I say. And as a result, we tend to respond as necessary in the light of changing circumstances and, more importantly, the advancing fees, legal fees, that we incur in order to assess the estimable costs of these ongoing cases.

In last year's second quarter, for instance, that period reflected a substantial charge for the settlement of a CCI case in an amount that exceeded what we had earlier felt were well-founded cost expectations.

On the other hand, in this year's second quarter, we once again took pencil to paper, so to speak, and concluded that we needed to put up some more money in what we refer to in the trade as unallocated loss adjustment expense reserves. Those are reserves set aside to pay expenses of litigation in this case or even indemnity as it might occur.

We still believe that with respect to these cases that we are reasonably well reserved to address the ongoing litigation. And we still have every expectation of resolving these matters in the, I would suspect, the intermediate term, which would imply, hopefully, that we can get this done within the next 12 months as quickly as we can.

The results of the -- on the other hand, the results of the runoff book, ex the litigation aspects of it that I just referred to, are coming in pretty much as we've expected quarter end and quarter out for the last several years.

As is generally known, obviously, housing values are perking up in many markets throughout the nation. And of course, the job situation, which is always important to most people's ability to make good on their debt obligations, those keep improving fairly consistently. So it is -- this is having a continuing beneficial effect on both the emergence of new mortgage defaults as well as the ability to cure previously reported and sometimes languishing defaults. So these are the major reasons that previously established claim reserves have fairly regularly worked out positively and have produced the types of current claim cost relief and the lowered claim ratios that you can readily see in the statistics that we have in the first paragraph on Page 4 of this morning's release.

So the bottom line for this runoff book is this, as we see it today. And that is that as quickly as we can rid ourselves of this persisting litigation that we've noted, we should be able to achieve the soft, easy landing that we've contemplated for these 2 runoff books of business in the so-called RFIG runoff segment.

And when we do that, we should be able to move our concentration, our intention to more productive efforts in the interest of all of our stakeholders, whether they be in among the RFIG runoff or elsewhere in our enterprise.

So maybe, Karl, you can pick up and speak to some financial matters as we planned.

Karl W. Mueller
Chief Financial Officer and Senior Vice President

Very good. Thank you. Today's press release reflects very little change of significance in Old Republic's financial condition as of June 30. That cash and invested asset balance of $11.3 billion remained largely consistent with amounts reported at the end of December and is down slightly from March 31 levels.

As shown on the table, on Page 5 of the release, the cost basis of the investment portfolio increased by approximately $209 million during the first 6 months of this year. This growth in the invested asset base was substantially offset by a general decline in the fair value of the portfolio during the second quarter of this year in particular.

The portfolio composition remains steady at June 30, with approximately 82% allocated to fixed maturity and short-term investments and the remaining 18% was equity securities.

Investment income rose by a little more than 9% in this year's second quarter to $93 million and by 9.7% to $184 million in the first half of 2015. This higher level of investment income is due primarily to the greater invested asset balances, accompanied by an increase in the overall portfolio.

The fixed income portfolio's credit quality retained its overall A rating at the end of June, and the average life of the fixed income portfolio remains at approximately 5 years.

Consolidated claim reserves were essentially flat at the end of June compared to both the March and prior year-end balance sheets. For the first 6 months of 2015 and 2014, consolidated claim costs have developed slightly favorable.

Comparative reserve development percentages for the general insurance group are included in this morning's release. As we noted, the reserve development was slightly deficient in the second quarter and first 6 months of both years.

I would say, consistent with the past several quarters, we experienced favorable development in the mortgage insurance prior year reserves, as Al referred to in his earlier comments.

Finally, the title reserves developed favorably during the quarter, resulting from the recovery of losses paid in prior years. Absent this, the second quarter loss ratio would remain largely consistent with the loss ratio reported during the first quarter of this year.

Shareholders' equity, as of June 30, was $3.9 billion or $15.16 per share, which was essentially unchanged from December 31, and down $0.32 per share for the second quarter.

As we've shown in the book value per share table that's on Page 6 of the release, we continue to add to book value by virtue of the net operating income and realized gains that are in excess of the quarterly cash dividends that we pay to our shareholders.

As the table readily shows, the volatility in reported book value per share is driven largely by changes to the unrealized gains and losses on the investment portfolio.

And finally, the capitalization ratios shown at the bottom of Page 6 are relatively unchanged at the end of June by comparison to the higher P&L[indiscernible].

So that's the financial highlights that I wanted to cover. So let me turn this call back to Al Zucaro for his closing remarks before we go to the Q&A.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Great. So when you wrap up all these comments from the 4 of us here, we do conclude that we had a very good start on the year. In general insurance, as Scott Rager mentioned before, premium growth should pretty much track the trends that we are seeing in the first half of this year. And underwriting and investment income, that should also continue to trend higher.

A great deal of the underwriting improvement for the remainder of this year should most likely be driven by the much stronger claim reserve base that we closed 2014 with. And therefore, we should not have the level of adverse development that we contended with in last year's second half and much more accentuated, as some of you who follow us may have noted in last year's fourth quarter. So I think we're going to have an easier time in terms of loss ratio expectations for the rest of this year.

Rande Yeager, of course, gave a good basis for our optimism in the title business. And then finally, absent, maybe, unexpectedly adverse resolution of the litigation situation in our runoff business, that business also should produce moderately positive, though declining, results. Again, this could be expected in a runoff book premium. The premium base continues to decline as the in-force gets lopped off. And as a result, particularly in light of the better economy, better housing and so forth, the remaining book should produce some sound positive results.

So when you -- when we wrap up all this together, it does make us confident that we are likely to post a good set of operating numbers for all of 2015.
So with these thoughts, why don't we open up the meeting to any questions that you may have. Why don't you -- anybody with questions direct them to me? And I'll bounce them off Rande or Scott or Karl or myself as necessary.

Question and Answer

Operator

[Operator Instructions] And we'll take our first question from Christine Worley of JMP Securities.

Christine Amanda Worley
JMP Securities LLC, Research Division

I was wondering if you could talk about the competitive landscape in the workers' compensation line and how you feel about the rates that you're getting there versus the loss trends that you're currently seeing.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Well, Scott, do you want to address that? I think you tried to make a few comments about it before but go ahead.

R. Scott Rager
President and Chief Operating Officer

Yes. In terms of the competitive arena, Christine, it varies marketplace to marketplace in the several specialty operations we have. It's -- I think you can say though that no matter what arena you're in, it is -- it's always a competitive marketplace. In terms of the rates we're at right now, obviously, we're running about 81% as I indicated on loss cost. We'd like to see that into the 70s. So by and large, when you look at the rates line-to-line, geographically, product line, specialty line, there's a lot of moving parts on all this and nothing is the same. But in general, we'd like to see rate increases and -- in the operations from the low to mid-single-digit increases for the remainder of the year, if we could. And our retention rates are good, so that should play well for us. Obviously, the performing books may be less than that, and the books with a higher claim cost would be more. But typically, we would say low to mid-single digits.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Does that answer your question?

Christine Amanda Worley
JMP Securities LLC, Research Division

It does, it does. And then just looking at the general liability line, was there any favorable development in that line in this quarter?

R. Scott Rager
President and Chief Operating Officer

Generally, that line is Karl is looking actually at the development, which is on that. But I would say generally, as I indicated, that line is typically driven by severity. And because of its size, it doesn't take many severe occurrences to run that up to where it has been over the last 2 or 3 years. Typically, that line will run about where it is. If you look at it historically on the exhibit we provided through 2012, it runs in the mid-60s. And so we really see this as the normal loss ratio placement that we'd like to see on this, as opposed to the results that we posted the last 2 to 3 years. So it is less -- go ahead.

Christine Amanda Worley
JMP Securities LLC, Research Division

I guess you don't view the 70% then. If I look at the 10-year weighted average that you gave in the supplement, the 70% then you feel is a bit above where the line should be running?

R. Scott Rager
President and Chief Operating Officer

Where we see it running is -- go ahead answer it Al.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

No, you go.

Rande K. Yeager
Chief Executive Officer and President

Okay. I just -- I didn't want to step on anybody in the conversation. If you look at those ratios, yes, the 10-year average is 70%. But if you look at the last 2 or 3 years, they've been in the 80s, the upper 70s and 80s. Historically, that line is along in the mid-60s for us, and that's where -- that's kind of where the target is that we would like that to be is in the upper 60s.

Operator

[Operator Instructions] It appears there are no further questions at this time. Mr. Zucaro, I'd like to turn the conference back to you for any additional or closing remarks.

Aldo Charles Zucaro
Chairman and Chief Executive Officer

Okay. Thank you. Well, I guess we must be doing a pretty good job of explaining what's happening to our business since there are no further questions. And so therefore, we'll bring the meeting to a conclusion. And as always, we appreciate everyone's participation in it and look forward to our next visit sometime in October, following the third quarter release of our earnings. On that note, we'll bid you a good afternoon.

Operator
And that does conclude today's conference. Thank you for joining us.