Old Republic International Corporation NYSE:ORI

Earnings Call

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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

Matthew John Carletti
JMP Securities LLC, Research Division

Unknown Analyst

ATTENDEES

Joe Calabrese

Presentation

Operator

Ladies and gentlemen, thank you for standing by. My name is Brent, and I will be your conference operator today. At this time I would like to welcome everyone to the Old Republic International First Quarter 2023 Earnings Conference Call. [Operator Instructions] It is now my pleasure to turn today's call over to Mr. Joe Calabrese with the Financial Relations Board. Sir, please go ahead.

Joe Calabrese

Thank you. Good afternoon, everyone, and thank you for joining us for the Old Republic conference call to discuss first 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. 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 April 27, 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'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 First Quarter Earnings Call.

With me today is Frank Sodaro, CFO of ORI and Carolyn Monroe, President and CEO of our Title Insurance segment. Well, despite the headwinds in Title Insurance we're off to a good start to '23 with consolidated pretax operating income of $223 million for the quarter.

General Insurance produced significantly greater income, while Title Insurance produced considerably less income due to the effects of higher mortgage interest rates. Underwriting results, of course, are the cornerstone of how we create value. So we're pleased with our consolidated combined ratio of 92.7%.

Consolidated net premiums and fees earned for the quarter were lower, with General Insurance increasing 6% and Title Insurance decreasing 42%. Our conservative reserving practices are again clearly visible, with the favorable reserve development reported in all 3 segments, led by General Insurance.

And our balance sheet remains strong even as we continued to return capital to shareholders during the quarter through both dividends and share repurchases. So I will now turn the discussion over to Frank, and then Frank will turn things back to me to cover General Insurance, which will be followed by Carolyn, who will discuss Title Insurance. And then we'll open things up for conversation and Q&A. So with that, Frank?

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

Thank you, Craig, and good afternoon, everyone. This morning, we reported net operating income of $179 million for the quarter compared to $192 million last year.

On a per share basis, comparable year-over-year results were $0.61 versus $0.63. Considering the headwinds experienced by the Title Group, our consolidated earnings were solid due to the strong operating results of the General Insurance Group.

Shareholders' equity ended the quarter at over $6.3 billion, resulting in book value per share of $21.91. When adding back dividends, book value increased just over 5% from the prior year end, driven by our operating earnings and higher investment portfolio valuations.

Net investment income increased nearly 30% in the quarter, driven primarily by higher yields, which were most pronounced within the fixed income and short-term investment portfolios. The overall investment portfolio was comprised of approximately 80% in highly rated bonds and short-term investments, with the remaining 20% allocated to large cap dividend-paying stocks.

The average maturity on the bond portfolio is 4.3 years with a book yield of 3.4%, which compares favorable to the book yield of 2.5% at the end of the first quarter last year. The valuation of the fixed income portfolio increased by over $175 million during the quarter, while the stock portfolio was relatively flat, ending the period in an unrealized gain position of nearly $1.3 billion.

Now turning to reserve development. All 3 operating segments recognized favorable loss reserve development. In total, the consolidated loss ratio benefited by 4.5 percentage points for the quarter compared to 2.4 percentage points for the same period 1 year ago.

The mortgage insurance cost -- loss costs continued to be favorable with lower newly reported defaults and higher cure rates on those loans already in default. The group paid a $25 million dividend to the parent holding company in the quarter, and the plan is to return over $100 million this year, subject to regulatory approval.

In the quarter, we paid $70 million in dividends and repurchased over $130 million worth of our shares, for a total of just over $200 million returned to shareholders. Since the end of the quarter, we repurchased another $35 million worth of shares, completing our $450 million 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 General Insurance, pretax operating income rose by 36% to $193 million for the quarter, and the combined ratio was at 89.3% compared to 91.6% in Q1 of '22, reflecting our underwriting discipline and our underwriting excellence efforts. So we commend all of our associates for this continued focus on discipline and excellence.

The loss ratio for the quarter was 61.4%, including 5.5 points of favorable reserve development, and the expense ratio was 27.9%, consistent with a lower loss ratio, a higher commission ratio line of coverage mix relative to a few years ago.

Strong renewal retention ratios and new business production helped drive a 5.5% increase in net premiums written. And we also saw rate increases across most of our book, with the exception of D&O and workers' compensation.

So turning to a few of these larger lines of coverage. Commercial auto, net premiums written grew at a 6% clip. The loss ratio was 73.7% compared to 70.2% in Q1 of '22, with favorable loss development in both of those periods.

Severity continues in the high single-digit range, and our rate increases are consistent with that trend, implying that we continue to cover loss trends. So with these rate increases, we think our rate levels for commercial auto will enable us to achieve our combined ratio targets.

Turning to workers' compensation. Net premiums written came in 3% lower, affected by rate decreases in about the same range. A lower loss ratio of 52.5% compared to 62.5% in Q1 of '22. And here, too, there was favorable reserve development in both of those periods.

Frequency for workers' compensation continues to trend down, approximately commensurate with the rate decrease levels that we're seeing. So even with some rate decrease, we think our rate levels here, too, will enable us to achieve our combined ratio targets.

So for General Insurance, we expect solid growth and profitability to continue through '23 supported by our specialty growth strategy and our operational excellence initiatives.

I'll now turn the discussion over to Carolyn to report on Title Insurance. Carolyn?

Carolyn Jean Monroe
President

Thank you, Craig. The Title Group reported premium and fee revenue for the quarter of $583 million, down 42% from first quarter 2022. Agency premiums were down 42% and direct premiums were down 41%.

Our pretax operating income of $17 million compared to $81 million in the first quarter of 2022 while a combined ratio of 99.3% compared to 92.9% last year. And as noted in the release, the pending recovery of a fourth quarter state sales tax assessment improved the quarter's expense ratio by 3 points.

As we start adjusting to the normal seasonal real estate markets, of which the first quarter has traditionally been the slowest, the continual rapid rise in interest rates, coupled with tight inventory, certainly contributed to the softer market. Based on our agency-focused business model, under current market conditions, we benefit from having a large portion of our overall expenses being variable in nature with our expense ratio highly correlated with our top line revenue.

The fixed portion of our expense ratio is largely personnel-related. We have and will continue to monitor all of our expenses and make the appropriate long-term decisions that allow us to effectively manage our business. We do this, keeping in mind the cyclical nature of our industry and the appropriate balance needed in today's market, while still ensuring we are prepared for and not at a disadvantage in the future.

This aligns with our core value of managing for the long run and will allow us to continue our historical delivery of value to our agents, our shareholders and our employees.

Turning to commercial premiums. Despite this being our second highest first quarter on record, they were down 24% over first quarter 2022 and represented 25% of first quarter premiums compared to 20% in first quarter 2022. As we started to experience a turn in the market last year, we realized that there would be increased pressure on our agents, the cornerstone of our strategic focus.

We wanted to continue to provide industry-leading services that would enable them to focus on their core business and provide opportunities for efficiencies in their operations. To that end, we created our Agency Operations Department. This department's principal goal is to drive agency-focused business priorities, advance innovative initiatives and measure the effectiveness of the strategies deployed to enhance the company's connection in collaboration with its Title agents.

Along with this, we continue our investment in technology services and products. We are excited about our newest production software horizon being launched out of RamQuest, 1 of our Title tech companies. It is a web-based Title and escrow production platform that will serve the agency community in addition to our own direct operations.

Managing for the long run means leading not only in the upcycles of the real estate market, but the down as well. We're prepared to successfully do that with a strong experienced leadership team through retention and recruitment, and a commitment to the continued long-term success of the Title Group. And I'll now turn it back to Craig.

Craig Richard Smiddy
President, CEO & Director

Okay. Thank you, Carolyn. Well, we're a diversified specialty insurance company, and that diversification served us well this quarter, with continued profitable growth in General insurance helping to mitigate the lower profits in Title Insurance.

And as Frank pointed out, while higher mortgage interest rates worked against us on the top and bottom line in Title Insurance, higher interest rates helped produce significant growth in our investment income.

We remain pleased with our recent and long-term track record of capital stewardship and book value growth, including more than $200 million returned to shareholders in the first quarter through dividends and share repurchases, as Frank mentioned, along with the 5% year-to-date growth in book value per share.

For the remainder of '23, we're optimistic for continued profitable growth within General Insurance, where we recently announced our newest underwriting subsidiary, Old Republic Lawyers Specialty Insurance, which follows last year's launch of Old Republic Excess and Surplus. Going into '23, our expectation for Title Insurance was for considerably less revenue and operating income.

And we remain of the view that headwinds will continue as we proceed through 2023. As I mentioned on this call last quarter, 2023 is our 100-year anniversary, which we're celebrating under the banner of 100 years of excellence, honoring our unique culture that has driven our outstanding results.
So that concludes our prepared remarks, and we will now open up the discussion to Q&A, where either I'll answer your question or I'll direct the question to Frank or Carolyn, depending on who's best. Thank you.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

For my first question, I was hoping to just circle back to Carolyn's discussion on Title and kind of maybe start with the environment.

We spoke a little -- I think it was last quarter, about your expectations for the year, and correct me if I'm wrong, but I think you referenced some of the normal seasonality we can see where Q1 is typically a slow quarter and tend to see a little bit of recovery in Q2, but obviously, what we're going through has continued headwinds.

I mean how should we think about kind of that progression? Have you seen anything in, say, the last few weeks in April that see any headwinds lightening up? Should we expect to see some seasonable sequential recovery in revenues? Or is it still pretty stiff headwinds?

Craig Richard Smiddy
President, CEO & Director

Carolyn, I think you're best to answer that. We know a few of the industry reports that we follow seem to indicate some optimism for the remainder of the year relative to 2022. But Carolyn, I'll let you speak more specifically to what you're seeing.

Carolyn Jean Monroe
President

Sure. I think when we reported last quarter, we had hoped that when we got into the second quarter, we'd see more improvement than we're seeing now. The challenges are just consumer confidence, just the uncertainty surrounding the mortgage rates.

And in looking at the MBA and Fannie Mae forecast, they are forecasting, as we get towards the end of the year and then on into 2024, some improvement. I just don't feel like we're going to see a lot of improvement in the second quarter like we had hoped. Just so much of it is just we've got tight inventory in a lot of markets. And people right now don't have a sense of why should they move. And that's just kind of what we're getting out in the field right now.

Matthew John Carletti
JMP Securities LLC, Research Division

That makes sense. And then maybe if I take that kind of 1 step further, if we assume that's the case. And you had $583 million of earned premium Q1. So I mean just pick some numbers here, but if the business would size such that maybe the remainder of the year is, call it, even $600 million to $700 million a quarter or something like that, some small improvement.

I know you've talked some about some expense saving measures you've taken and rightsizing of the business. What sort of expense ratio do you think you can kind of run the business at or the business is set to run at, at that ballpark kind of volume size?

Carolyn Jean Monroe
President

Well, we're kind of targeting a combined ratio for the rest of the year between 96% and 97% range.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Very helpful. And shifting topics, 1 last question. Craig, I guess I'll turn it back to you, and you can direct elsewhere if needed. I caught the commentary in the release about the, kind of the share buyback authorization now being complete with the purchases made post quarter. Can you just update us on capital management thoughts?

Would it be reasonable to assume the Board might re-up an authorization? Or is there something else: thinner excess capital levels, optimism on growth, other uses of capital, that might make that not be the case?

Craig Richard Smiddy
President, CEO & Director

Sure, Matt. So every quarter, we review with our board, our position on adequate liquidity along with our capital position. And when we are in a position where we believe we have excess capital, and we don't have another opportunity to reinvest in the business, then we will make a recommendation and the Board will take into consideration the alternatives for returning capital to shareholders.

And when that is done, it is always done with consideration given to the possibility of special dividends and the possibility of a share buyback. So as we head into this next Board meeting, we are in a position -- in a very strong capital position and a very sufficient liquidity position. And we will, as we do every quarter, have that discussion with them.

Operator

Your next question comes from the line of Greg Peters with Raymond James.

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

And I guess I'm a little bit relieved that we haven't heard the fire trucks run by down Michigan Avenue yet. But with that said, can we pivot to the General Insurance business. I guess 2 areas of questions would be the prior year reserve development, and clearly, you've already talked a little bit about this, but this favorable trend that really began the back half of last year seems to be continuing at least through the first quarter, which is it seems like maybe you're taking some reserves out of or lowering some case reserve assumptions on some of the more recent years' results?

And then secondly, aside from reserves, just when you look across the different business lines, which ones do you think are going to generate, say, the most growth over the next -- and be the most impactful, I should also add -- over the next 2 years?

Craig Richard Smiddy
President, CEO & Director

Okay. So we'll address your reserve question first, and then we'll talk about where we're expecting continued growth. So with regard to our strong reserve position, a nice problem to have for sure.

We had favorable reserve development coming from most years. And for workers' compensation, those years were years that were prior to our -- to the period that we traditionally like to hold, which for workers' compensation is the last 5 years.

On commercial auto, our reserve position is extremely strong. And there too, most of that development came from prior years, but there was a little bit of favorable reserve in the more recent years where we traditionally like to hold those. But as we discussed, Greg, last quarter, a very nice problem to have, but if reserves become too excessive, it creates other issues.

But for the -- like I say, for the most part, it's in those older years. Commercial auto is coming in so favorably that there is a little bit from the more recent years.

On the second question more about growth. As I intend to underscore again our -- we've added 2 new companies in the last year. And one of those companies is writing E&S business. They're not focused on property cat business. They're focused more on Main Street E&S business with limited cat exposure.

So that will help grow our general liability, property lines there. And with regard to the newest entity, we probably won't see premiums come through 'til the latter part of the year, but that will help drive our professional lines cover, listed under the financial indemnity section.

On the other hand, home and auto warranty we expect to turn around a bit as we go forward. So as we try to indicate in some of our communications, we're trying to become more diversified by line of coverage mix. We think we've demonstrated that pretty clearly over the last 4 or 5 years, and some of these newer entities that we have started to have yet to really contribute.

And the lines that we're not looking to grow disproportionately to the overall portfolio would include commercial auto and workers' compensation, where we're heavy. Workers' compensation, as you know, has trended down. And as long as frequency keeps coming down, we don't expect that to grow.

Commercial auto, on the other hand, is growing just -- purely, if you just look at the rate that we continue to get on that. So there's a possibility that commercial auto could continue to grow through rate, although we're not doing anything strategically to try to grow that line of business.

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

Thank you for that thorough response. I guess my second question, I'll pivot to the title business. I certainly can appreciate that the business mix today is a lot different than it was, say, the last time in the great financial crisis, with definitely more, skewing to more commercial-oriented exposures.

But if I do look at the last time the economy was under stress, which would have been the GFC, I did note that the loss ratios, the claim ratio in Title did start to inch up. And I'm just wondering if there's anything in the system that you see that might cause some gradual uplift in your assumptions around loss ratios in Title?

Craig Richard Smiddy
President, CEO & Director

Greg, I'll be happy to start the discussion and then again hand it off to Carolyn, who's closer to the action. But with regard to what we saw in the financial crisis, '07, '08 '09, as you know, mortgages were underwater and it was the case that consumers' attorneys were looking for every possible outlet, which included some pressure on Title Insurance.

This time around we don't believe that the mortgages in the marketplace are underwater to the degree that they were during that period. And I think that's somewhat evidenced as what we're seeing on our mortgage runoff business that Frank commented on.

We're not seeing anything there that is concerning. In fact, it's still very favorable. So our -- even though that is the case, we're not relying on that. And our CFO at Title, Chris Lieser, along with Carolyn and Frank Sodaro and myself, have specifically focused in on your question to make sure, are we seeing anything in the way of losses that would seem to indicate that things might be warming up a bit because of what we're seeing in the housing market, in particular.

And we have not yet seen that. So Carolyn, I'll turn it to you to add any color commentary or more specifics.

Carolyn Jean Monroe
President

Yes. I think the equity that Craig spoke to is 1 of the most important. But the other thing to emphasize is just the difference in the lending practices back then and now. When we had the financial crisis, that was really about them -- loans being made to either people that didn't really exist or shouldn't have had a loan. And that just has really changed.

And we just aren't -- we're not -- we haven't seen that since the financial crisis. So I agree. I just -- I don't think we're going to see the same type of losses like we did then.

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

Yes. Well, I just -- related to that, there's a lot of rhetoric that's in the press around commercial and specifically office properties, whether that portion of the market is going into a recession, if you will. Maybe you could address that as it relates to title, and then step back and then talk about how your investment portfolio is positioned relative to some of the stressors that we might see in the marketplace, whether it's exposure to banks or commercial real estate, et cetera. That's my last question.

Craig Richard Smiddy
President, CEO & Director

Greg, thank you. I'll -- if you don't mind, I'll take the very first part of the commercial title space, then ask Carolyn chime in with anything she has to add. And then after that, we'll have Frank comment on the investment portfolio.

So the only thing that I would say that we've observed and that we're talking about here, is that even though we acknowledge the pressure on commercial properties, the potentially good news for us is that to the extent that, that pressure results in transactions where there is turnover of commercial properties because of this dynamic, that could bode well for us, in that as long as they're -- even though the owners of those commercial properties are not in a good position in having to sell the properties, if there's activity, that's good for us.

So like I say, we're not saying that, that is coming through loud and clear right now. But as we go forward, we're optimistic that the pressures we're seeing on commercial properties will probably result in commercial transactions. Carolyn, I'll turn it to you, and then we'll let Frank chime in.

Carolyn Jean Monroe
President

Okay. Yes, Greg, we're hearing the same thing, just really on office property. But on the bright side, we're seeing still movement in the hospitality sector, the energy sector. And so we're not seeing as much pressure at this time on the other sectors.

It's really more, the chatter we're hearing is about the office sector mainly. But the industrial slowed down a little bit, but some of the other is just -- especially in our local commercial markets, has stayed a little steadier than we had anticipated. So outside of the office, we haven't seen as much negative.

Francis Joseph Sodaro
Senior VP, CFO & Chief Accounting Officer

And from an investment portfolio perspective, it's just -- it's a very easy answer. There's -- we just have insignificant exposure to commercial real estate and to the regional banks that have been in the news. This is a clean portfolio. Just to remind you, it's over 98% investment-grade and high-quality stock. So it's -- there's not much of a story there in that regard.

Operator

[Operator Instructions] Your next question is from the line of Andrew [Lambrecht] with Piper Sandler.

Unknown Analyst

I'm just wondering if there are any strategic areas you'd like to be in that you're not already in? And then sort of how you think about it from an M&A perspective versus doing it yourselves, like you guys did with Lawyer Specialty?

Craig Richard Smiddy
President, CEO & Director

Sure. I'd be happy to comment on that. We are always open and considering the potential for M&A. And just tying it back to the capital discussion we had a little bit ago, I think, as I mentioned, the first order of business is to try to redeploy that capital back into the business if we can. That's the first step. And if we don't see opportunities, then that's when we look to returning the capital to shareholders 1 way or another.

So we're very open-minded about M&A. As I said in my concluding remarks, we are a specialist. We like to call ourselves an inch wide and a mile deep where we think we understand our specialties from an underwriting, pricing, marketing, risk control, claims point of view better than anybody else. That's what we strive for.

So the first thing we look for in an M&A transaction is something specialty. And as I mentioned earlier, we're heavy in workers' compensation, we're heavy in commercial auto. We've seen some opportunities for auto books of business, for workers' compensation books of business. Those don't excite us very much, because we're trying to diversify.

On the other hand, we also see some opportunities that frankly are -- where the prospect is a generalist. And we work hard to try to say, well, is there a specialty play here within that portfolio? And sometimes that's hard to find. And then lastly, sometimes we might find ourselves competing with maybe a specialty book of business that is managed by an MGA that actually looks like it would fit in very well.

However, we're competing against other brokers and other carriers that are willing to pay something that we think would be highly dilutive. So we're -- we try to avoid any kind of acquisition that would be highly dilutive to our shareholders. So it has to get through those filters, but we are open for business to the right specialty opportunity on the General Insurance side of the business.

And when it comes to the Title side, we have made a few small agency acquisitions. We have a few we're talking to right now. We will continue to do that. And when we do that, here, too, there's a filter. We're very careful because we're loyal to our independent Title agent network. And we don't go in and make acquisitions that find us in a position whereby we're now competing with our Title agents in the same geography, for instance.

So we do look at title agency acquisitions when they make sense, because they don't put us in conflict with our agency distribution network. And we have been successful on some small acquisitions. And here, too, we're open for business and would be very eager to look at anything that might be a fit.

And I'll reiterate that our first order of business is to redeploy the capital back into the business, either investing in businesses like the E&S business that we're investing in currently, investing in the lawyers professional that we just announced, investing in agency acquisitions, that's first order of business before we look at returning capital.

Operator

There are no further questions at this time. I will now turn the call back over to management for closing remarks.

Craig Richard Smiddy
President, CEO & Director

Okay. Well, thank you very much. We appreciate all of you that are listening, either on the telephone or online, and we feel good about the start to the year. We'll see how things go as we progress.

And again, we appreciate all of your support and we will hopefully see some of you as we continue to celebrate our 100 years of excellence here at Old Republic. Have a great rest of the afternoon, and thank you again.

Operator
Ladies and gentlemen, thank you for participating. This concludes today's conference call. You may now disconnect.