S&P Global
Market Intelligence

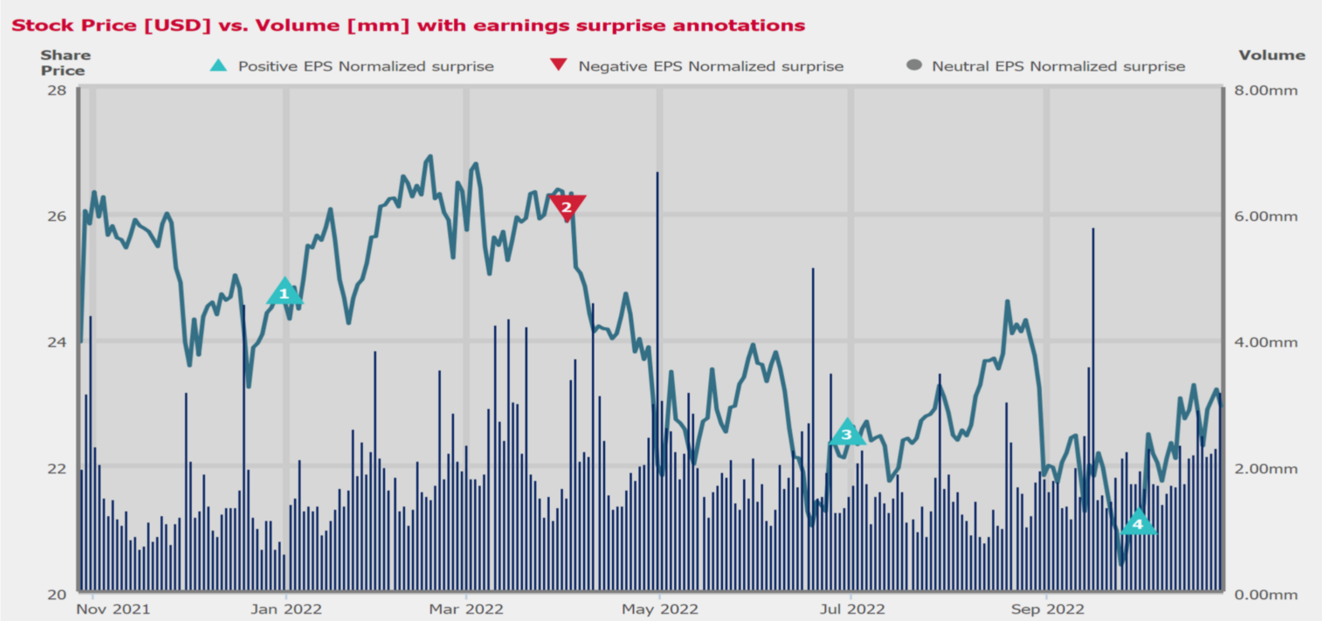
# Old Republic International Corporation
# NYSE:ORI
# FQ3 2022 Earnings Call Transcripts

## Thursday, October 27, 2022 7:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ3 2022- | | | -FQ4 2022- | -FY 2022- | -FY 2023- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.60 | 0.68 | ▲11.48 | 0.57 | 2.50 | NA |
| **Revenue (mm)** | 1790.00 | 2098.20 | ▲17.22 | 1714.00 | 7692.00 | NA |

Currency: USD
Consensus as of Oct-18-2022 7:02 AM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2021** | 0.74 | 0.88 | ▲1 18.92 % |
| **FQ1 2022** | 0.68 | 0.63 | ▼2 (8.70 %) |
| **FQ2 2022** | 0.60 | 0.69 | ▲3 13.11 % |
| **FQ3 2022** | 0.60 | 0.68 | ▲4 11.48 % |

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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*

### ATTENDEES

**Joe Calabrese**

# Presentation

**Operator**

Good afternoon. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Old Republic International Third Quarter 2022 Earnings Conference Call. [Operator Instructions] Thank you. Joe Calabrese with the Financial Relations Board, you may begin.

**Joe Calabrese**

Thank you. Good afternoon, everyone, and thank you for joining us for the Old Republic conference call to discuss third 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 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 October 27, 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 Corporation -- Old Republic International Corporation and several other senior executives.

At this time, I would like to turn the call over to Craig Smiddy. Please go ahead, sir.

**Craig Richard Smiddy**
*President, CEO & Director*

Okay. Thank you, Joe. Good afternoon, everyone, and welcome again to Old Republic's third quarter earnings call. With me today, I have Frank Sodaro, our CFO of ORI; and Carolyn Monroe, President of our Title Insurance business.

Well, as you've seen in this morning's release, ORI had another strong quarter, with General Insurance producing significantly greater pretax operating income, while our Title Insurance business pretax operating income was considerably less than the record-setting 2021 results due, of course, to the effects of the increasing mortgage interest rate environment.

Our reserve position remains very healthy in all 3 of our segments with a very high level of favorable reserve releases for General Insurance in the quarter.

Our balance sheet remains strong. We returned considerable amount of capital to shareholders during the quarter, which we'll talk about in a little bit. And we've reduced balance sheet volatility by reducing our exposure to equities by nearly $2 billion since the beginning of the year, reinvesting in fixed income securities at yields, quite frankly, we haven't seen in over a decade.

Consolidated net premiums and fees earned were just below $2 billion for the quarter and just below $6 billion year-to-date. Consolidated pretax operating income was $258 million for the quarter and stands at $758 million year-to-date. And our consolidated combined ratio came in at a healthy 91.4% for both the quarter and the year-to-date periods.

Both General Insurance and Title Insurance continue to produce excellent underwriting results as demonstrated in their respective combined ratios. General Insurance net premiums earned increased by over 7% for both the quarter and year-to-date periods. While in the third quarter, Title Insurance net premiums and fees earned decreased by 15% alongside a decrease of 7% year-to-date.

As we've commented over the course of the last 12 months, our 2022 expectations for Title Insurance were considerably less than those expectations of the record-setting 2021 year. We think this downturn in Title Insurance and the continuing upturn in General Insurance reinforces the benefits of our long-standing diversification strategy anchored in the non-correlated P&C in Title Insurance segments, which provides for steadier earnings and shareholder returns over the long run.

So with those opening comments, I'll now turn the discussion over to Frank, and then Frank will turn things back to me to cover General Insurance, followed by Carolyn who will discuss Title Insurance. And then as always, we'll open up the conversation to Q&A. So Frank, do you want to take it from here?

**Francis Joseph Sodaro**
*Senior VP, CFO & Chief Accounting Officer*

Sure. Thank you, Craig, and good afternoon, everyone. This morning, we reported third quarter net income, excluding investment gains and losses, of $206 million compared to $240 million last year. On a per share basis, comparable year-over-year income was $0.68 versus $0.79.

For the first 9 months of this year, operating profit was $608 million compared to $668 million last year. Although both periods were down when compared to the record set last year, our earnings were very strong by historical standards.

Book value per share ended the quarter at just under $19. When adding back dividends, this was a decrease of 9.4% from the prior year-end as the declines in the values of our bond and stock portfolios were partially offset by our strong operating earnings.

Net investment income increased for the quarter as we have turned the corner on yields earned and experienced continued growth in our invested asset base. Our current bond reinvestment rate was just under 4.8%, and our ending bond portfolio yield improved to 3.1%.

During the quarter, we continued to rebalance our investment portfolio by reducing our stockholdings and increasing our investments in bonds. As a result, we realized $181 million of net investment gains on sales of common stock. However, we also recognized $207 million of losses on bonds we either sold or intend to sell as part of our tax planning efforts. Our investment portfolio currently stands at about 80% in bonds and short-term investments, and 20% in stocks, a level with which we are comfortable given the more favorable interest rate environment.

During the quarter, the total fair value of bonds declined by $385 million, while stocks decreased by $170 million. The overall credit quality of our bond portfolio remains strong with approximately 98% of the portfolio in investment-grade securities.

Switching to loss reserves. All 3 operating segments recognized favorable loss reserve development. In total, the consolidated loss ratio benefited by 3.4 percentage points for the quarter compared to 2.3 percentage points for the same period a year ago. Hurricane Ian had a nominal effect on the current period loss costs.

Mortgage insurance loss costs 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 in dividends to the parent holding company in the quarter, bringing the total returns to $105 million year-to-date.

I'll wrap up my remarks with a discussion about the capital we have returned since we last spoke. We paid $375 million in dividends, which included a $1 per share special dividend. In addition, up through yesterday, we repurchased about another $225 million worth of our shares. This puts us about halfway through our repurchase authorization, which we will continue to execute on opportunistically.

I'll now turn the call back over to Craig for a discussion of General Insurance.

**Craig Richard Smiddy**
*President, CEO & Director*

Okay. Frank, thanks. So for General Insurance, net premiums written increased by almost 10% in the quarter, and we continue to achieve rate increases on many lines of coverage with renewal retention ratios and new business production, both remaining very strong.

Pretax operating income for us rose by 15% to $168 million, and the loss ratio for the quarter was 63% compared to 65% in the third quarter of last year. That's inclusive of 4.7 percentage points of favorable development this quarter for the General Insurance group. The expense ratio was 27% with continued growth in lower loss ratio, higher commission ratio lines of coverage, driving approximately 1 percentage point of additional commission within that expense ratio. The combined ratio was a strong 90% compared to 91% in the third quarter of '21.

So now I'll turn to specifically commercial auto. Net premiums written grew by 10%, while net premiums earned grew by 7%, and the loss ratio improved to 64% from 73% in the third quarter last year. Loss frequency for auto remains below pre-pandemic levels, while auto liability severity continues to increase at the same high single-digit pace that we've seen over the last year or so.

On auto physical damage, severity is increasing at mid-double-digit rates. So we're seeing greater severity on the auto physical damage side. Our rate increases are in the high single-digit range, which implies that we continue to cover overall frequency and severity trends. So we think our rate levels on this line remain adequate relative to the targets we've set for combined ratios.

Looking now at workers' compensation. Net premiums written there continued to rebound, growing 11%, while net premiums earned grew 7%. And the loss ratio improved to 36% from 59% in the third quarter last year. Loss frequency for work comp continues to trend favorably, while severity is slightly up. Rate decreases in workers' comp continue in the low single-digit range for us. So here, too, we think our rate levels remain adequate relative to our target combined ratios.

In financial indemnity, more specifically the D&O line of coverage, we saw unfavorable loss development stemming from large security class action claims occurring in accident years 2018 and 2019. And we're no longer seeing the robust rate increases we saw in policy for 2019, 2020 and '21 as new D&O market entrants are driving down rates. So we continue to keep a very close eye on the D&O line of coverage, and we'll exercise underwriting discipline, declining accounts that aren't priced adequately while aggressively managing our attachment points and limits on public company D&O.

More generally, while we continue to follow loss frequency and severity trends very closely and adjust our rates for inflationary trends that drive severity, including both general inflation and social inflation, and we also continue to keep a close eye on case and IBNR reserves relative to these trends and adjust accordingly.

So we believe our growth strategy and operational excellence initiatives in General Insurance will continue to produce solid growth and profitability with new business production, high renewal retention ratios and generally increasing rate levels all contributing.

So I'll now turn the discussion over to you, Carolyn, to report on Title Insurance.

**Carolyn Jean Monroe**
*President*

Thank you, Craig. The Title group reported premium and fee revenue for the quarter of $968 million, down 15% from prior year third quarter. Our pretax operating income of $73 million compared to $136 million in third quarter 2021. Agency premiums were down $103 million or 12% over third quarter 2021, and direct premiums and fees were down $71 million or 28%.

Increasing mortgage interest rates impacted third quarter and year-to-date comparisons, most notably with a steep decline in refinance activity that has continued throughout the year. While purchase activity has also dropped off, it has been to a much lesser extent, tempering the overall impact. Commercial activity remained strong this quarter with commercial premiums up 29% over third quarter 2021 and made up 21% of our premium total for this quarter.

Our combined ratio for third quarter 2022 was 93.7% compared to 89% in third quarter 2021. This increase is primarily driven by the decreased loaded and directly produced revenue, which have higher fixed expenses. Agency commissions were down 12.6% for the quarter, roughly in line with the decrease in agency premiums. All other expenses were down by 5.2% in third quarter 2022 over third quarter '21 with personnel expenses representing the vast majority of this decrease.

We believe that continuing with our strategic focus on serving our agents, which account for 81% 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 is beneficial as we continue to navigate current market conditions.

We'll continue to deliver on our technology road map and digital business plan with a focus on optimization by looking for improvements in productivity and existing revenue with better customer engagement with an automation focus. This balances between improvements in our current business portfolio and workflow while preparing for future changes in transformations.

An important achievement at RamQuest, our closing software entity, is the upcoming launch of Horizon, our new web-based and modern title and escrow platform. We see this as a key piece of our technology delivery strategy for our agents as well as our own internal modernization program for our direct operations.

A recent addition to our integration platform supermarket is a verification service that will help combat wire fraud, which is an ever-present focus in the industry. We will continue with the addition of value-added services to our agents utilizing our title and escrow platforms as well as our internal operations.

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 over to Craig.

**Craig Richard Smiddy**
*President, CEO & Director*

Okay. Carolyn. Thank you very much. Well, we think we had a good quarter with strong levels of profitability in both General Insurance and Title Insurance, while our diversification and specialty strategy should continue to produce stable, profitable results going forward and long-term value for our shareholders.

So that 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. So we'll open up to Q&A.

# Question and Answer

**Operator**

[Operator Instructions] Our first question is from Matt Carletti with JMP.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

I have a couple of questions. One, just a numbers question and one is a little higher level. On the numbers question, as I look at Page 3 of your supplement that shows the loss ratios by -- I'm looking at the major coverage lines. There was a pretty good uptick in the quarter in general liability. Can you just give a little bit of color there on what might be driving that?

**Craig Richard Smiddy**
*President, CEO & Director*

Sure, Matt. Over the quarters, we see this loss ratio move rather significantly in some quarters because as you can tell by the level of premium, we don't have the scale that we have in some of the other lines like commercial auto and workers' comp. So I know in many quarters, I've commented that loss ratio is volatile. And we did look at it and tried to identify anything in particular, and there isn't anything specifically that I can point you to, except to say that it's a small line of coverage for us and has a more volatile loss ratio. But over -- once you -- if you look back over the years, it evens out.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

Okay. Perfect. And then just circling back on -- you guys touched there a little bit on some of the kind of the title tech, I'm looking at your slide deck, and you mentioned RamQuest. I was hoping you could give us a little color on -- is it Pavaso, which seems to be more -- if I'm understanding you right, kind of customer-facing and kind of making a better experience for customers in the title process with digital and hybrid closings. Can you -- am I understanding that right? And if that is so, is that rolled out across your entire footprint? Is it in its early stages? Kind of maybe just a little bit of color on where that stands.

**Craig Richard Smiddy**
*President, CEO & Director*

Carolyn, I know you're very passionate about what we're doing in the way of technology in our Title business and specifically the platforms that Matt referenced. So do you want to comment on that, please?

**Carolyn Jean Monroe**
*President*

Sure. So Pavaso is our -- would be more of a customer-focused facing platform. But Pavaso is generally used by our lenders. It's -- Pavaso has been around, and it's ready to use any time, any of our lenders, our realtor customers want to use it. All of our agents have access to it. But it does provide a much better closing experience for the end user, for the buyer, the seller. But it all has to be initiated through the lender because it's all their documents that would come through that would allow signing through that platform.

And so while Pavaso is there and it's ready, Pavaso got a lot of use during the refinance boom because the lenders control that transaction 100%. And so that's where we saw a really uptick of use in that platform. But if the lender isn't controlling the whole closing, the whole process, then only pieces of it can be used. So if we're ready, we just continue to wait for the industry to be ready to just totally go with the E-Closing.

**Matthew John Carletti**
*JMP Securities LLC, Research Division*

Great. And congrats on a nice quarter.

**Craig Richard Smiddy**
*President, CEO & Director*

Thank you, Matt.

**Operator**

[Operator Instructions] Our next question is from Greg Peters with Raymond James.

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

I guess a follow-up. I'd like to start off with a couple of questions on your General Insurance operations. And I think a good place to start might be the expense ratio. And Craig, I know you've commented on this in the past as it relates to changing business mix, et cetera. But if we look at the 9-month results, let's take away the quarter number. You're still -- you're running about 140 basis points higher in terms of your expense ratio on a year-over-year basis. So I was hoping maybe you could sort of bridge the gap because that looks like it's more than just business mix. It looks like there's some other issues there. So maybe you can help fill in the blanks there.

**Craig Richard Smiddy**
*President, CEO & Director*

Yes. Well, as I indicated in my opening comments, Greg, there is -- about a point of that is the additional commission that is being driven by the line of business mix relative to the first 9 months of '21. So the majority of it is that. And then there's other expenses as well, of course, that are slightly higher.

The comment that I would make is we've been pretty consistent that our target combined ratios are between 90% and 95%. And I know we continue to say that our target is 25% for the expense ratio but that's based upon the historical line of coverage mix. And we were somewhat hesitant to want to change that expense ratio target if this wasn't going to be more of a permanent thing.

And as we continue to move through the quarters, that line of business mix is starting to show us that it's going to stick. So we'll have to look at that more closely in the next few quarters and consider what we want to say about that expense ratio. But again, the majority of it is indeed 1 point of additional commission expense because of the line of business mix.

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

Okay. And then I guess the other question, it speaks to reserves and what's going on, on an underlying basis. But paid loss ratio continues to trend down versus what any 5- or 10-year average might look like. And your reserve development, prior year development, is trending up. So these look to be good trends.

Can you talk to some of the underlying movements in those 2 components? And is it conceivable that the paid loss ratio continues to track down? Or are we hitting an inflection point where it sort of levels out at this point?

**Craig Richard Smiddy**
*President, CEO & Director*

Well, I would say that we don't really know whether we're at an inflection point. It's -- as you asked, it's conceivable that it continues to trend down. Certainly, what we're seeing in the way of our reserves in total, including IBNR, we can see that those loss ratios continue to trend down. So it would make sense that both the paid loss ratio and the overall loss ratio trends, including IBNR, are both trending down commensurately.

So I think that this is probably representative of all of the work we've done through our operational excellence initiatives, our pricing initiatives, underwriting initiatives. And of course, the compounding of the rate increases that we've had year-over-year. It's not surprising to us that our paid loss ratios are coming down. Our accident year -- current accident year loss ratios are coming down. And our reported loss ratios, including development, are coming down.

So frankly, it would all be exactly what we were trying to achieve, which is improving how we price the business, improving underwriting selection, claims, risk control, distribution, production, it all is paying dividends as far as we're concerned.

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

Yes, it does look like that. Maybe pivot to the balance sheet. And I think I understand what's going on with the sale of your equity portfolio and going into -- or part of the equity portfolio and reinvesting in bonds, but maybe you could provide more color on where you think the relative percentages of your portfolio are going to balance out at, considering what's available to you in the marketplace today. And what I'm thinking about is just what's -- where do you see the mix of equities versus bonds in the near term, considering all the moving parts that you're looking at?

**Craig Richard Smiddy**
*President, CEO & Director*

Yes. I'll respond initially and then let Frank get into the details a little bit more. But we're comfortable with that 80-20 mix that Frank referenced, 80% fixed income and 20% equities. And even after we sold, as I mentioned, approximately $2 billion of equities this year, and by the way, we didn't sell those equities at lows, we actually sold them within a very nice window within the highs. So after selling those and getting to that 20% level, we're comfortable there.

We don't have anything underway to try to reduce that further. But we will always continue to take a look at what kind of yields are we earning on those equities. Because as we said when we became overweight in equities, the reason we were doing that several years ago, we said, was because we could invest in a blue-chip equity that was paying a yield on that stock that was 100 or 200 basis points higher than we could achieve if we invested in that same blue-chip bond.

So we have to keep ourselves intellectually honest here. And as things flip the other direction, we will look at what kind of yields we're achieving on those equities. And if we can instead invest in the bonds and achieve a rate of 5%, 6%, 7% return on bonds, well, we -- that could result in us in taking another look at it.

But we don't have any initiative underway to reduce that holding further. And we're fine holding what we have now as long as it's achieving that investment income outcome that was really at the beginning of our strategy when we started to, again, invest in equities in a bigger way several years ago. Frank, do you have anything to add to that?

**Francis Joseph Sodaro**
*Senior VP, CFO & Chief Accounting Officer*

You didn't leave too much to add, but I'll just put a number around -- so 11% of the stocks we sold were within their 52% -- 52-week high. So we're pretty happy with that. As far as the sales of the bond portfolio, the tax planning, I mean we found a sweet spot on a little bit of the longer end of the maturity curve there. And we're basically replacing to the point where we're staying about where we were on a maturity. Our average maturity has been hovering around 4.4 years, and we've kind of replaced that. So just a little extra color for you. But we're staying at 98% investment grade, so that's very high-quality portfolio.

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

Great. Congratulations on the quarter.

**Craig Richard Smiddy**
*President, CEO & Director*

Thank you, Greg.

**Operator**

We have no further questions at this time. I'll turn it over to management for any closing remarks.

**Craig Richard Smiddy**
*President, CEO & Director*

Okay. Well, thank you, everyone, for your interest and for the conversation this afternoon. As we said, we think we had another successful quarter. And we know that we have headwinds when it comes to real estate markets and the interest rate environment, but those were expected headwinds, and we're planning accordingly. And likewise, we have some very favorable things happening in the General Insurance group as those trends in loss ratio, combined ratio and income continue to improve and are at very strong levels.

So thank you all again, and we will see you again next quarter. Have a good afternoon.

**Operator**
Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.