

STEWART INFORMATION SERVICES CORP

Form 10-Q

July 29, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-02658

STEWART INFORMATION SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 74-1677330

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

1980 Post Oak Blvd., Houston TX 77056

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (713) 625-8100

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

(Do not check if a smaller reporting
company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

On July 27, 2016, there were 23,371,297 shares of the issuer's Common Stock, \$1 par value per share, outstanding.

FORM 10-Q QUARTERLY REPORT
 QUARTER ENDED JUNE 30, 2016
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As used in this report, “we,” “us,” “our,” “Registrant,” the “Company” and “Stewart” mean Stewart Information Services Corporation and our subsidiaries, unless the context indicates otherwise.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

	For the Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(\$000 omitted, except per share)			
Revenues				
Title insurance:				
Direct operations	237,017	243,209	423,018	433,020
Agency operations	225,416	249,461	450,051	462,650
Ancillary services	21,182	34,182	43,217	74,954
Investment income	4,856	4,665	9,926	8,614
Investment and other gains – net	966	389	1,454	1,540
	489,437	531,906	927,666	980,778
Expenses				
Amounts retained by agencies	183,485	204,437	367,329	380,237
Employee costs	152,427	171,078	302,636	333,574
Other operating expenses	86,458	98,022	174,168	186,796
Title losses and related claims	17,153	19,577	40,247	52,711
Depreciation and amortization	7,340	7,274	15,646	14,379
Interest	661	486	1,440	924
	447,524	500,874	901,466	968,621
Income before taxes and noncontrolling interests	41,913	31,032	26,200	12,157
Income tax expense	14,386	10,407	7,738	2,876
Net income	27,527	20,625	18,462	9,281
Less net income attributable to noncontrolling interests	3,928	3,519	6,058	4,623
Net income attributable to Stewart	23,599	17,106	12,404	4,658
Net income	27,527	20,625	18,462	9,281
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustments	(1,703)	2,243	1,592	(4,256)
Change in net unrealized gains on investments	6,182	(6,700)	11,971	(3,941)
Reclassification of adjustment for gains included in net loss	(115)	(131)	(179)	(782)
Other comprehensive income (loss), net of taxes:	4,364	(4,588)	13,384	(8,979)
Comprehensive income	31,891	16,037	31,846	302
Less net income attributable to noncontrolling interests	3,928	3,519	6,058	4,623
Comprehensive income (loss) attributable to Stewart	27,963	12,518	25,788	(4,321)
Basic average shares outstanding (000)	23,365	23,624	23,357	23,806
Basic earnings per share attributable to Stewart	0.50	0.72	0.02	0.20
Diluted average shares outstanding (000)	23,559	23,795	23,542	23,975
Diluted earnings per share attributable to Stewart	0.49	0.72	0.02	0.19
See notes to condensed consolidated financial statements.				

CONDENSED CONSOLIDATED BALANCE SHEETS

	As of June 30, 2016 (Unaudited) (\$000 omitted)	As of December 31, 2015
Assets		
Cash and cash equivalents	137,266	179,067
Short-term investments	42,032	39,707
Investments in debt and equity securities available-for-sale, at fair value:		
Statutory reserve funds	488,399	483,312
Other	147,649	96,537
	636,048	579,849
Receivables:		
Notes	2,702	3,744
Premiums from agencies	34,390	36,393
Income taxes	2,516	1,914
Trade and other	47,451	49,453
Allowance for uncollectible amounts	(8,981)	(9,833)
	78,078	81,671
Property and equipment, at cost		
Land	3,991	3,991
Buildings	22,681	22,898
Furniture and equipment	225,643	214,350
Accumulated depreciation	(176,778)	(169,870)
	75,537	71,369
Title plants, at cost	75,743	75,743
Real estate, at lower of cost or net realizable value	517	570
Investments in investees, on an equity method basis	9,518	9,628
Goodwill	217,722	217,722
Intangible assets, net of amortization	15,209	18,075
Deferred tax assets	2,768	4,949
Other assets	46,147	43,237
	1,336,585	1,321,587
Liabilities		
Notes payable	127,690	102,399
Accounts payable and accrued liabilities	94,788	118,082
Estimated title losses	463,238	462,622
Deferred tax liabilities	9,893	1,356
	695,609	684,459
Contingent liabilities and commitments		
Stockholders' equity		
Common and Class B Common Stock and additional paid-in capital	183,853	180,385
Retained earnings	442,163	455,519
Accumulated other comprehensive income (loss):		
Unrealized investment gains on investments - net	21,195	9,403
Foreign currency translation adjustments	(11,768)	(13,360)
Treasury stock – 352,161 common shares, at cost	(2,666)	(2,666)
Stockholders' equity attributable to Stewart	632,777	629,281
Noncontrolling interests	8,199	7,847

Total stockholders' equity (23,371,297 and 23,341,106 shares outstanding)	640,976	637,128
	1,336,585	1,321,587

See notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30,	
	2016	2015
	(\$000 omitted)	
Reconciliation of net income to cash used by operating activities:		
Net income	18,462	9,281
Add (deduct):		
Depreciation and amortization	15,646	14,379
Provision for bad debt	1,098	1,261
Investment and other gains – net	(1,454)	(1,540)
Payments for title losses in excess of provisions	(2,615)	(9,217)
Insurance recoveries of title losses	538	313
Decrease (increase) in receivables – net	1,076	(563)
Increase in other assets – net	(2,936)	(2,154)
Decrease in payables and accrued liabilities – net	(20,768)	(10,543)
Change in net deferred income taxes	2,017	656
Net income from equity investees	(1,069)	(2,114)
Dividends received from equity investees	1,172	2,099
Stock based compensation expense	3,723	3,606
Other – net	3,569	108
Cash provided by operating activities	18,459	5,572
Investing activities:		
Proceeds from investments available-for-sale sold	32,827	45,936
Proceeds from investments available-for-sale matured	7,782	12,469
Purchases of investments available-for-sale	(75,771)	(59,593)
Net (purchases) sales of short-term investments	(2,325)	2,377
Purchases of property and equipment, title plants and real estate – net	(11,494)	(11,772)
Cash paid for acquisition of subsidiaries	—	(3,958)
Other – net	592	1,223
Cash used by investing activities	(48,389)	(13,318)
Financing activities:		
Payments on notes payable	(15,101)	(17,736)
Proceeds from notes payable	34,578	29,267
Distributions to noncontrolling interests	(5,660)	(3,638)
Repurchases of common stock	—	(27,793)
Cash dividends paid	(13,760)	(5,671)
Cash paid on Class B Common Shares conversion	(12,000)	—
Payment of contingent consideration related to an acquisition	(2,002)	—
Other – net	(301)	78
Cash used by financing activities	(14,246)	(25,493)
Effects of changes in foreign currency exchange rates	2,375	(2,718)
Decrease in cash and cash equivalents	(41,801)	(35,957)
Cash and cash equivalents at beginning of period	179,067	200,558
Cash and cash equivalents at end of period	137,266	164,601

See notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF EQUITY (UNAUDITED)

	Common and Class B Common Stock (\$1 par value) (\$000 omitted)	Additional paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock	Noncontrolling interests	Total
Balances at December 31, 2015	23,693	156,692	455,519	(3,957)	(2,666)	7,847	637,128
Net income attributable to Stewart	—	—	12,404	—	—	—	12,404
Cash dividends on Common Stock (\$0.60 per share)	—	—	(13,760)	—	—	—	(13,760)
Cash paid on Class B Common Shares conversion	—	—	(12,000)	—	—	—	(12,000)
Stock based compensation and other	30	3,693	—	—	—	—	3,723
Purchase of remaining interest in consolidated subsidiary	—	(255)	—	—	—	—	(255)
Net change in unrealized gains and losses on investments	—	—	—	11,971	—	—	11,971
Net realized gain reclassification	—	—	—	(179)	—	—	(179)
Foreign currency translation adjustments	—	—	—	1,592	—	—	1,592
Net income attributable to noncontrolling interests	—	—	—	—	—	6,058	6,058
Subsidiary dividends paid to noncontrolling interests	—	—	—	—	—	(5,660)	(5,660)
Net effect of changes in ownership and other	—	—	—	—	—	(46)	(46)
Balances at June 30, 2016	23,723	160,130	442,163	9,427	(2,666)	8,199	640,976
See notes to condensed consolidated financial statements.							

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1

Interim financial statements. The financial information contained in this report for the three and six months ended June 30, 2016 and 2015, and as of June 30, 2016, is unaudited. This report should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

A. Management's responsibility. The accompanying interim financial statements were prepared by management, who is responsible for their integrity and objectivity. These financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP), including management's best judgments and estimates. In the opinion of management, all adjustments necessary for a fair presentation of this information for all interim periods, consisting only of normal recurring accruals, have been made. The Company's results of operations for interim periods are not necessarily indicative of results for a full year and actual results could differ.

B. Consolidation. The condensed consolidated financial statements include all subsidiaries in which the Company owns more than 50% voting rights in electing directors. All significant intercompany amounts and transactions have been eliminated and provisions have been made for noncontrolling interests. Unconsolidated investees, in which the Company typically owns 20% through 50% of the equity, are accounted for by the equity method.

C. Reclassifications. Certain amounts in the 2015 interim financial statements have been reclassified for comparative purposes. Net income attributable to Stewart, as previously reported, was not affected.

D. Restrictions on cash and investments. The Company maintains investments in accordance with certain statutory requirements for the funding of statutory premium reserves. Statutory reserve funds, which approximated \$488.4 million and \$483.3 million at June 30, 2016 and December 31, 2015, respectively, are required to be fully funded and invested in high-quality securities and short-term investments. In addition, included within cash and cash equivalents are statutory reserve funds of approximately \$17.8 million and \$17.2 million at June 30, 2016 and December 31, 2015, respectively. Although these cash statutory reserve funds are not restricted or segregated in depository accounts, they are required to be held pursuant to state statutes. If the Company fails to maintain minimum investments or cash and cash equivalents to meet statutory requirements, the Company may be subject to fines or other penalties, including potential revocation of its business license. These funds are not available for any other purpose. In the event that insurance regulators adjust the determination of the statutory premium reserves of the Company's title insurers, these restricted funds as well as statutory surplus would correspondingly increase or decrease.

NOTE 2

Investments in debt and equity securities available-for-sale. The amortized costs and fair values follow:

	June 30, 2016		December 31, 2015	
	Amortized costs	Fair values	Amortized costs	Fair values
	(\$000 omitted)			
Debt securities:				
Municipal	70,253	73,492	70,300	72,008
Corporate	334,085	351,069	303,870	309,461
Foreign	158,265	164,255	149,914	153,221
U.S. Treasury Bonds	12,793	12,946	13,803	13,906
Equity securities	28,046	34,286	27,497	31,253
	603,442	636,048	565,384	579,849

Foreign debt securities consist primarily of Canadian government and corporate bonds, United Kingdom treasury bonds, and Mexican government bonds. Equity securities consist of common stocks and master limited partnerships.

Gross unrealized gains and losses were:

	June 30, 2016		December 31, 2015	
	Gains	Losses	Gains	Losses
	(\$000 omitted)			
Debt securities:				
Municipal	3,239	—	1,720	12
Corporate	16,994	10	7,700	2,109
Foreign	6,032	42	3,789	482
U.S. Treasury Bonds	153	—	128	25
Equity securities	7,024	784	4,842	1,086
	33,442	836	18,179	3,714

Debt securities as of June 30, 2016 mature, according to their contractual terms, as follows (actual maturities may differ due to call or prepayment rights):

	Amortized costs	Fair values
	(\$000 omitted)	
In one year or less	45,817	45,949
After one year through five years	246,846	256,384
After five years through ten years	214,939	225,377
After ten years	67,794	74,052
	575,396	601,762

Gross unrealized losses on investments and the fair values of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2016, were:

	Less than 12 months		More than 12 months		Total	
	Losses	Fair values	Losses	Fair values	Losses	Fair values
	(\$000 omitted)					
Debt securities:						
Corporate	10	3,901	—	—	10	3,901
Foreign	42	32,547	—	—	42	32,547
Equity securities	454	2,671	330	2,217	784	4,888
	506	39,119	330	2,217	836	41,336

The number of investment securities in an unrealized loss position as of June 30, 2016 was 44, 3 securities of which were in unrealized loss positions for more than 12 months. Since the Company does not intend to sell and will more-likely-than-not maintain each investment security until its maturity or anticipated recovery, and no significant credit risk is deemed to exist, these investments are not considered other-than-temporarily impaired.

Gross unrealized losses on investments and the fair values of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2015, were:

	Less than 12 months		More than 12 months		Total	
	Losses	Fair values	Losses	Fair values	Losses	Fair values
	(\$000 omitted)					
Debt securities:						
Municipal	9	2,230	3	1,615	12	3,845
Corporate	1,461	83,565	648	32,871	2,109	116,436
Foreign	322	35,008	160	3,155	482	38,163
U.S. Treasury Bonds	6	1,195	19	3,583	25	4,778
Equity securities	720	4,440	366	3,224	1,086	7,664
	2,518	126,438	1,196	44,448	3,714	170,886

The Company believes its investment portfolio is diversified and expects no material loss to result from the failure to perform by issuers of the debt securities it holds. Investments made by the Company are not collateralized.

NOTE 3

Fair value measurements. The Fair Value Measurements and Disclosures Topic (Topic 820) of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal, or most advantageous, market for the asset or liability in an orderly transaction between market participants at the measurement date. Topic 820 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs when possible. The three levels of inputs used to measure fair value are as follows:

Level 1 – quoted prices in active markets for identical assets or liabilities;

Level 2 – observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data; and

Level 3 – unobservable inputs that are supported by little or no market activity and that are significant to the fair values of the assets or liabilities, including certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

As of June 30, 2016, financial instruments measured at fair value on a recurring basis are summarized below:

	Level 1	Level 2	Fair value measurements
	(\$000 omitted)		
Investments available-for-sale:			
Debt securities:			
Municipal	—	73,492	73,492
Corporate	—	351,069	351,069
Foreign	—	164,255	164,255
U.S. Treasury Bonds	—	12,946	12,946
Equity securities	34,286	—	34,286
	34,286	601,762	636,048

As of December 31, 2015, financial instruments measured at fair value on a recurring basis are summarized below:

	Level 1	Level 2	Fair value measurements
	1		
	(\$000 omitted)		
Investments available-for-sale:			
Debt securities:			
Municipal	—	72,008	72,008
Corporate	—	309,461	309,461
Foreign	—	153,221	153,221
U.S. Treasury Bonds	—	13,906	13,906
Equity securities	31,253	—	31,253
	31,253	548,596	579,849

As of June 30, 2016, Level 1 financial instruments consist of equity securities. Level 2 financial instruments consist of municipal, governmental and corporate bonds, both U.S. and foreign. In accordance with the Company's policies and guidelines which incorporate relevant statutory requirements, the Company's third-party registered investment manager invests only in securities rated as investment grade or higher by the major rating services, where observable valuation inputs are significant. All municipal, foreign, and U.S. Treasury bonds are valued using a third-party pricing service, and the corporate bonds are valued using the market approach, which includes three to ten inputs from relevant market sources, including Financial Industry Regulatory Authority's (FINRA) Trade Reporting and Compliance Engine (TRACE) and independent broker/dealer quotes, bids and offerings, as well as other relevant market data, such as securities with similar characteristics (i.e. sector, rating, maturity, etc.). Broker/dealer quotes, bids and offerings mentioned above are gathered (typically three to ten) and a consensus risk premium spread (credit spread) over risk-free Treasury yields is developed from the inputs obtained, which is then used to calculate the resulting fair value.

There were no transfers of investments between Level 1 and Level 2 during the six months ended June 30, 2016 and 2015.

NOTE 4

Investment income. Gross realized investment and other gains and losses follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
	(\$000 omitted)			
Realized gains	1,139	674	5,076	2,228
Realized losses	(173)	(285)	(3,622)	(688)
	966	389		