

STEWART INFORMATION SERVICES CORP

Form 10-Q

November 04, 2009

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**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 September 30, 2009

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

(State or other jurisdiction of
incorporation or organization)

74-1677330

(I.R.S. Employer Identification No.)

1980 Post Oak Blvd., Houston TX

(Address of principal executive offices)

77056

(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 ☐
(Do not check if a smaller reporting
company)

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 November 3, 2009, the following shares of each of the issuer's classes of common stock were outstanding:

Common 17,188,698

Class B	
Common	1,050,012

FORM 10-Q QUARTERLY REPORT
QUARTER ENDED SEPTEMBER 30, 2009
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As used in this report, we, us, our, the Company and Stewart mean Stewart Information Services Corporation and its subsidiaries, unless the context indicates otherwise.

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STEWART INFORMATION SERVICES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE EARNINGS

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(\$000 omitted, except per share)			
Revenues				
Title insurance:				
Direct operations	176,795	176,713	502,915	557,988
Agency operations	263,822	208,558	648,015	613,124
Real estate information	15,394	10,210	44,532	36,228
Investment income	4,952	7,016	15,763	22,550
Investment and other losses net	(972)	(5,832)	(7,013)	(10,541)
	459,991	396,665	1,204,212	1,219,349
Expenses				
Amounts retained by agencies	216,798	169,333	534,254	499,457
Employee costs	124,968	140,006	362,108	438,045
Other operating expenses	76,616	87,541	213,889	260,787
Title losses and related claims	55,462	29,644	141,325	108,961
Depreciation and amortization	6,962	8,360	21,823	32,413
Interest	756	1,433	2,847	4,369
	481,562	436,317	1,276,246	1,344,032
Loss before taxes and noncontrolling interests	(21,571)	(39,652)	(72,034)	(124,683)
Income tax expense (benefit)	249	(11,269)	3,786	(45,557)
Net loss	(21,820)	(28,383)	(75,820)	(79,126)
Less net earnings attributable to noncontrolling interests	1,876	1,592	6,121	4,730
Net loss attributable to Stewart	(23,696)	(29,975)	(81,941)	(83,856)
Comprehensive loss:				
Net loss	(21,820)	(28,383)	(75,820)	(79,126)
Other comprehensive earnings (loss) attributable to Stewart, net of taxes of \$7,165, (\$3,729), \$8,162 and (\$8,222)	10,291	(10,331)	19,450	(17,827)
Comprehensive loss	(11,529)	(38,714)	(56,370)	(96,953)
Less comprehensive earnings attributable to noncontrolling interests	1,876	1,592	6,121	4,730

Comprehensive loss attributable to Stewart	(13,405)	(40,306)	(62,491)	(101,683)
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Basic and dilutive loss per share attributable to Stewart	(1.30)	(1.66)	(4.51)	(4.64)
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Basic and dilutive average shares outstanding	18,196	18,109	18,177	18,082
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See notes to condensed consolidated financial statements.

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STEWART INFORMATION SERVICES CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

September 30 and December 31,	2009	2008
	(\$000 omitted)	
Assets		
Cash and cash equivalents	96,445	76,558
Cash and cash equivalents statutory reserve funds	12,276	9,688
	108,721	86,246
Short-term investments	30,519	37,120
Investments in debt and equity securities available-for-sale, at fair value:		
Statutory reserve funds	391,530	374,508
Other	78,717	156,267
	470,247	530,775
Receivables:		
Notes	10,133	11,694
Premiums from agencies	31,778	35,707
Income taxes	19,419	38,936
Other	51,842	37,265
Allowance for uncollectible amounts	(19,675)	(17,504)
	93,497	106,098
Property and equipment, at cost		
Land	8,468	8,468
Buildings	23,267	22,629
Furniture and equipment	276,212	281,949
Accumulated depreciation	(236,813)	(229,413)
	71,134	83,633
Title plants, at cost	78,428	78,363
Real estate, at lower of cost or net realizable value	3,430	3,947
Investments in investees, on an equity method basis	12,322	13,685
Goodwill	212,763	210,901
Intangible assets, net of amortization	6,711	8,448
Other assets	51,181	66,473
Investments pledged, at fair value	221,405	222,684
	1,360,358	1,448,373
Liabilities		
Notes payable	82,475	135,276

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Line of credit, at fair value	221,405	222,684
Accounts payable and accrued liabilities	96,394	112,306
Estimated title losses	499,274	463,084
Deferred income taxes	20,612	13,837
	920,160	947,187
Contingent liabilities and commitments		
Stockholders' equity		
Common and Class B Common Stock and additional paid-in capital	145,439	143,811
Retained earnings	266,011	347,952
Accumulated other comprehensive earnings	19,743	293
Treasury stock 476,227 and 330,407 Common shares, at cost	(4,330)	(4,097)
Stockholders' equity attributable to Stewart	426,863	487,959
Noncontrolling interests	13,335	13,227
Total stockholders' equity (18,238,710 and 18,141,787 shares outstanding)	440,198	501,186
	1,360,358	1,448,373

See notes to condensed consolidated financial statements.

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STEWART INFORMATION SERVICES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30,	2009	2008
	(\$000 omitted)	
Reconciliation of net loss to cash used by operating activities:		
Net loss	(75,820)	(79,126)
Add (deduct):		
Depreciation and amortization	21,823	32,413
Provision for bad debt	5,293	4,345
Realized investment losses net	7,013	10,541
Provisions for title losses in excess of payments	31,135	8,690
Decrease (increase) in receivables net	5,899	(7,467)
Decrease in other assets net	7,852	6,316
Decrease in payables and accrued liabilities net	(16,087)	(15,844)
Decrease in net deferred income taxes	(1,387)	(34,561)
Net earnings from equity investees	(2,526)	(1,108)
Dividends received from equity investees	2,408	1,918
Other net	3,683	2,177
Cash used by operating activities	(10,714)	(71,706)
Investing activities:		
Proceeds from investments available-for-sale matured and sold	242,764	602,975
Purchases of investments available-for-sale	(144,808)	(410,934)
Purchases of investments pledged		(241,525)
Purchases of property and equipment and title plants net	(6,932)	(13,690)
Increases in notes receivable	(838)	(945)
Collections on notes receivable	494	4,564
Cash paid for acquisitions of subsidiaries net (see below)	(1,165)	(514)
Cash paid for cost-basis investments, equity investees and related intangibles net	(1)	(1,493)
Cash received for the sale of real estate		333
Cash provided (used) by investing activities	89,514	(61,229)
Financing activities:		
Distributions to noncontrolling interests	(5,807)	(6,142)
Proceeds from line of credit		199,325
Proceeds from notes payable	1,206	45,756
Payments on notes payable	(56,386)	(13,898)
Proceeds from exercise of stock options and grants	57	569
Cash (used) provided by financing activities	(60,930)	225,610
Effects of changes in foreign currency exchange rates	4,605	(2,753)
Increase in cash and cash equivalents	22,475	89,922

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Cash and cash equivalents at beginning of period	86,246	109,239
Cash and cash equivalents at end of period	108,721	199,161

Supplemental information:

Assets acquired:

Goodwill	1,862	1,178
Title plants	577	
Property and equipment	13	
Other		189
Liabilities assumed	(187)	
Debt issued	(1,100)	(853)

Cash paid for acquisitions of subsidiaries net	1,165	514
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See notes to condensed consolidated financial statements.

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STEWART INFORMATION SERVICES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1

Interim financial statements. The financial information contained in this report for the three and nine months ended September 30, 2009 and 2008, and as of September 30, 2009, 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, 2008.

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 from those estimates.

B. Consolidation. The condensed consolidated financial statements include all subsidiaries in which the Company owns more than 50% voting rights in electing directors and variable interest entities when required by FASB Accounting Standards Codification (ASC) 810-10-05. 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 2008 interim financial statements have been reclassified for comparative purposes. Net losses, as previously reported, were not affected. However, stockholders' equity changed due to the application of FASB ASC 810-10-45-16, which provides guidance for the nature and classification of the noncontrolling interests in the consolidated statement of financial position. Noncontrolling interests, formerly presented as minority interests outside of stockholders' equity, are now included in stockholders' equity.

D. Subsequent events. The Company has reviewed subsequent events through November 4, 2009, the date of issuance of these financial statements, and determined there were no subsequent events except as follows. On October 8, 2009, we entered into an agreement providing for the sale by us of \$60.0 million aggregate principal amount of 6.0% Convertible Senior Notes due 2014 (Notes) to an initial purchaser for resale to certain qualified institutional buyers in compliance with Rule 144A under the Securities Act of 1933, as amended. The Company also granted the initial purchaser an option to purchase up to an additional \$5.0 million aggregate principal amount of Notes to cover over-allotments, which option was exercised in full on October 9, 2009. The closing of the sale of the \$65.0 million aggregate principal amount of Notes occurred on October 15, 2009. The net proceeds to the Company, after deducting discounts, commissions and estimated offering expenses payable by the Company, were approximately \$62.0 million. The Company is currently evaluating the accounting impact any embedded derivatives will have on the consolidated financial statements.

E. Immaterial correction of prior period misstatement. In June 2009, the Company identified several immaterial misstatements primarily related to tax benefits from foreign operations and book versus tax goodwill differences, policy loss reserves and municipal tax accruals. In accordance with FASB ASC 250-10-S99-1, *Assessing Materiality*, and FASB ASC 250-10-S99-2, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, management evaluated the materiality of the errors from qualitative and quantitative perspectives and concluded that the errors were immaterial to the prior periods. Consequently, the Company will revise its historical financial statements for the year 2008 and the first quarter of 2009 when they are published in future filings.

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The immaterial misstatement corrections had no effect on the results of operations for the nine months ended September 30, 2008 and the accompanying condensed consolidated statements of operations and comprehensive earnings have accordingly not been adjusted. The summary of the effects of the immaterial corrections on the condensed consolidated statement of operations and comprehensive earnings follows:

	Three Months Ended March 31, 2009		
	As previously	Adjustments	Adjusted
	reported		
(\$000 omitted, except per share)			
Other operating expenses	68,046	(1,272)	66,774
Title losses and related claims	21,572	(1,552)	20,020
Depreciation and amortization	7,864	(166)	7,698
Total expenses	350,784	(2,990)	347,794
Loss before taxes and noncontrolling interests	(37,325)	2,990	(34,335)
Income tax expense	3,223	(1,424)	1,799
Net loss	(40,548)	4,414	(36,134)
Net loss attributable to Stewart	(42,019)	4,414	(37,605)
Comprehensive loss	(40,548)	4,414	(36,134)
Comprehensive loss attributable to Stewart	(46,088)	4,414	(41,674)
Basic and dilutive loss per share attributable to Stewart	(2.31)	.24	(2.07)

The summary of the effects of the immaterial corrections on the condensed consolidated balance sheets follows:

	As of March 31, 2009			As of December 31, 2008		
	As previously	Adjustments	Adjusted	As previously	Adjustments	Adjusted
	reported			reported		
(\$000 omitted)						
Income taxes receivable	23,319		23,319	40,406	(1,470)	38,936
Furniture and equipment	278,716		278,716	281,683	266	281,949
Accumulated depreciation	(231,990)		(231,990)	(229,247)	(166)	(229,413)
Other assets	58,416		58,416	65,956	517	66,473
Total assets	1,342,214		1,342,214	1,449,226	(853)	1,448,373
Accounts payable and accrued liabilities	92,376		92,376	110,769	1,537	112,306
Estimated title losses	445,619		445,619	461,532	1,552	463,084
Deferred income taxes	12,957	1,468	14,425	11,896	1,941	13,837
Total liabilities	880,892	1,468	882,360	942,157	5,030	947,187
Retained earnings	311,527	(1,180)	310,347	353,547	(5,595)	347,952
Accumulated other comprehensive earnings	(3,488)	(288)	(3,776)	581	(288)	293
Stockholders' equity attributable to Stewart	448,254	(1,468)	446,786	493,842	(5,883)	487,959
Total stockholders' equity	461,321	(1,468)	459,853	507,069	(5,883)	501,186

Total liabilities and stockholders equity	1,342,214	1,342,214	1,449,226	(853)	1,448,373
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The summary of the effects of the immaterial corrections on the condensed consolidated statement of cash flows follows:

	Three Months Ended March 31, 2009		
	As previously reported	Adjustments (\$000 omitted)	Adjusted
Cash used by operating activities	(27,799)	(264)	(28,063)
Cash provided by investing activities	41,228	265	41,493
Effects of changes in foreign currency exchange rates	(585)	(1)	(586)

NOTE 2

Recent significant accounting pronouncements. In June 2009, the Transfers and Servicing Topic and the Consolidation Topic of the FASB ASC were amended. The amendments change the way entities account for securitizations and other transfers of financial instruments. In addition to increased disclosure, these amendments eliminate the concept of qualifying special purpose entities and change the test for consolidation of variable interest entities. The amendments are effective as of the beginning of the first annual and interim reporting periods that begin after November 15, 2009. The Company does not believe the adoption of these amendments will have a material effect on its financial statements.

NOTE 3

Investments in debt and equity securities. The amortized costs and fair values follow:

	September 30, 2009		December 31, 2008	
	Amortized costs	Fair values (\$000 omitted)	Amortized costs	Fair values
Debt securities:				
Municipal	65,837	69,203	89,172	90,118
Corporate and utilities	227,590	237,785	181,172	175,244
Foreign	130,381	136,563	114,050	122,360
U.S. Government	23,428	25,200	122,712	126,871
Mortgage-backed securities	113	86	114	85
Equity securities	976	1,410	16,974	16,097
	448,325	470,247	524,194	530,775

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Gross unrealized gains and losses were:

	September 30, 2009		December 31, 2008	
	Gains	Losses	Gains	Losses
	(\$000 omitted)			
Debt securities:				
Municipal	3,398	32	1,753	807
Corporate and utilities	11,012	818	1,531	7,459
Foreign	6,233	50	8,310	
U.S. Government	1,780	8	4,159	
Mortgage-backed securities		27		29
Equity securities	434		258	1,135
	22,857	935	16,011	9,430

Debt securities as of September 30, 2009 mature, according to their contractual terms, as follows (actual maturities may differ because of call or prepayment rights):

	Amortized costs	Fair values
In one year or less	21,695	22,166
After one year through five years	186,090	194,751
After five years through ten years	156,224	163,708
After ten years	83,227	88,126
Mortgage-backed securities	113	86
	447,349	468,837

As of September 30, 2009, 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, were: