

STEWART INFORMATION SERVICES CORP
Form 10-Q
July 28, 2017
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, 2017

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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company (Do not check if smaller reporting
company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 25, 2017, there were 23,741,722 shares of the issuer's Common Stock, \$1 par value per share, outstanding.

FORM 10-Q QUARTERLY REPORT
QUARTER ENDED JUNE 30, 2017
TABLE OF CONTENTS

Item	Page
PART I – FINANCIAL INFORMATION	
1. <u>Financial Statements</u>	<u>3</u>
2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>17</u>
3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>29</u>
4. <u>Controls and Procedures</u>	<u>29</u>
PART II – OTHER INFORMATION	
1. <u>Legal Proceedings</u>	<u>30</u>
1A. <u>Risk Factors</u>	<u>30</u>
2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>30</u>
5. <u>Other Information</u>	<u>30</u>
6. <u>Exhibits</u>	<u>30</u>
<u>Signature</u>	<u>30</u>

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
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(\$000 omitted, except per share)			
Revenues				
Title revenues:				
Direct operations	231,662	237,017	419,091	423,018
Agency operations	234,407	225,416	467,756	450,051
Ancillary services	15,118	21,182	32,422	43,217
Operating revenues	481,187	483,615	919,269	916,286
Investment income	4,941	4,856	9,613	9,926
Investment and other (losses) gains – net	(676)	966	(389)	1,454
	485,452	489,437	928,493	927,666
Expenses				
Amounts retained by agencies	192,558	183,485	383,733	367,329
Employee costs	139,346	152,427	279,131	302,636
Other operating expenses	88,786	86,458	167,103	174,168
Title losses and related claims	24,462	17,153	45,163	40,247
Depreciation and amortization	6,441	7,340	12,819	15,646
Interest	712	661	1,529	1,440
	452,305	447,524	889,478	901,466
Income before taxes and noncontrolling interests	33,147	41,913	39,015	26,200
Income tax expense	10,993	14,386	10,850	7,738
Net income	22,154	27,527	28,165	18,462
Less net income attributable to noncontrolling interests	3,586	3,928	5,508	6,058
Net income attributable to Stewart	18,568	23,599	22,657	12,404
Net income	22,154	27,527	28,165	18,462
Other comprehensive income, net of taxes:				
Foreign currency translation adjustments	3,204	(1,703)	4,529	1,592
Change in net unrealized gains on investments	355	6,182	2,822	11,971
Reclassification of adjustment for gains included in net income	(94)	(115)	(461)	(179)
Other comprehensive income, net of taxes:	3,465	4,364	6,890	13,384
Comprehensive income	25,619	31,891	35,055	31,846
Less net income attributable to noncontrolling interests	3,586	3,928	5,508	6,058
Comprehensive income attributable to Stewart	22,033	27,963	29,547	25,788
Basic average shares outstanding (000)	23,444	23,365	23,438	23,357
Basic earnings per share attributable to Stewart	0.79	0.50	0.97	0.02
Diluted average shares outstanding (000)	23,620	23,559	23,613	23,542
Diluted earnings per share attributable to Stewart	0.79	0.49	0.96	0.02

See notes to condensed consolidated financial statements.

3

CONDENSED CONSOLIDATED BALANCE SHEETS

	As of June 30, 2017 (Unaudited) (\$000 omitted)	As of December 31, 2016
Assets		
Cash and cash equivalents	147,205	185,772
Short-term investments	23,092	22,239
Investments in debt and equity securities available-for-sale, at fair value:		
Statutory reserve funds	479,155	485,409
Other	175,607	146,094
	654,762	631,503
Receivables:		
Premiums from agencies	34,603	31,246
Trade and other	50,023	41,897
Income taxes	1,223	4,878
Notes	3,702	3,402
Allowance for uncollectible amounts	(9,108)	(9,647)
	80,443	71,776
Property and equipment, at cost:		
Land	3,991	3,991
Buildings	22,771	22,529
Furniture and equipment	226,536	217,105
Accumulated depreciation	(183,179)	(173,119)
	70,119	70,506
Title plants, at cost	75,313	75,313
Investments in investees, on an equity method basis	9,536	9,796
Goodwill	234,667	217,094
Intangible assets, net of amortization	9,317	10,890
Deferred tax assets	3,865	3,860
Other assets	49,725	42,975
	1,358,044	1,341,724
Liabilities		
Notes payable	116,331	106,808
Accounts payable and accrued liabilities	97,095	115,640
Estimated title losses	465,294	462,572
Deferred tax liabilities	12,947	7,856
	691,667	692,876
Contingent liabilities and commitments		
Stockholders' equity		
Common Stock and additional paid-in capital	183,350	180,959
Retained earnings	479,860	471,788
Accumulated other comprehensive income (loss):		
Unrealized investment gains on investments - net	10,207	7,846
Foreign currency translation adjustments	(12,198)	(16,727)
Treasury stock – 352,161 common shares, at cost	(2,666)	(2,666)
Stockholders' equity attributable to Stewart	658,553	641,200
Noncontrolling interests	7,824	7,648
Total stockholders' equity (23,737,447 and 23,431,279 shares outstanding)	666,377	648,848

1,358,044 1,341,724

See notes to condensed consolidated financial statements.

4

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	June 30,	
	2017	2016
	(\$000 omitted)	
Reconciliation of net income to cash provided by operating activities:		
Net income	28,165	18,462
Add (deduct):		
Depreciation and amortization	12,819	15,646
Provision for bad debt	634	1,098
Investment and other loss (gains) – net	389	(1,454)
Amortization of net premium on investments available-for-sale	3,421	3,559
Payments for title losses in excess of provisions	(1,260)	(3,690)
Adjustment for insurance recoveries of title losses	793	538
(Increase) decrease in receivables – net	(8,999)	2,151
Increase in other assets – net	(6,526)	(2,936)
Decrease in payables and accrued liabilities – net	(18,868)	(20,768)
Change in net deferred income taxes	2,329	2,017
Net income from equity investees	(977)	(1,069)
Dividends received from equity investees	1,237	1,172
Stock-based compensation expense	3,372	3,723
Other – net	2	10
Cash provided by operating activities	16,531	18,459
Investing activities:		
Proceeds from investments available-for-sale sold	49,655	32,827
Proceeds from investments available-for-sale matured	22,834	7,782
Purchases of investments available-for-sale	(88,381)	(75,771)
Net purchases of short-term investments	(853)	(2,325)
Purchases of property and equipment, title plants and real estate – net	(9,328)	(11,494)
Cash paid for acquisition of businesses	(18,080)	—
Other – net	410	592
Cash used by investing activities	(43,743)	(48,389)
Financing activities:		
Payments on notes payable	(8,042)	(15,101)
Proceeds from notes payable	16,022	34,578
Distributions to noncontrolling interests	(5,300)	(5,660)
Cash dividends paid	(14,065)	(13,760)
Cash paid on Class B Common Shares conversion	—	(12,000)
Payment of contingent consideration related to an acquisition	(1,298)	(2,002)
Purchase of remaining interest in consolidated subsidiary	(1,013)	(301)
Cash used by financing activities	(13,696)	(14,246)
Effects of changes in foreign currency exchange rates	2,341	2,375
Decrease in cash and cash equivalents	(38,567)	(41,801)
Cash and cash equivalents at beginning of period	185,772	179,067
Cash and cash equivalents at end of period	147,205	137,266

See notes to condensed consolidated financial statements.

5

CONDENSED CONSOLIDATED STATEMENT OF EQUITY (UNAUDITED)

	Common Stock (\$1 par value)	Additional paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock	Noncontrolling interests	Total
	(\$000 omitted)						
Balances at December 31, 2016	23,783	157,176	471,788	(8,881)	(2,666)	7,648	648,848
Net income attributable to Stewart	—	—	22,657	—	—	—	22,657
Cash dividends on Common Stock (\$0.60 per share)	—	—	(14,585)	—	—	—	(14,585)
Stock-based compensation and other	307	3,065	—	—	—	—	3,372
Purchase of remaining interest in consolidated subsidiary	—	(981)	—	—	—	(32)	(1,013)
Net change in unrealized gains and losses on investments	—	—	—	2,822	—	—	2,822
Net realized gain reclassification	—	—	—	(461)	—	—	(461)
Foreign currency translation adjustments	—	—	—	4,529	—	—	4,529
Net income attributable to noncontrolling interests	—	—	—	—	—	5,508	5,508
Subsidiary dividends paid to noncontrolling interests	—	—	—	—	—	(5,300)	(5,300)
Balances at June 30, 2017	24,090	159,260	479,860	(1,991)	(2,666)	7,824	666,377

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, 2017 and 2016, and as of June 30, 2017, 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, 2016.

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 2016 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 \$479.2 million and \$485.4 million at June 30, 2017 and December 31, 2016, respectively, are required to be fully funded and invested in high-quality securities and short-term investments. Statutory reserve funds are not available for current claim payments, which must be funded from current operating cash flow. In addition, included within cash and cash equivalents are statutory reserve funds of approximately \$23.3 million and \$13.9 million at June 30, 2017 and December 31, 2016, 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 sufficient 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.

E. Recently adopted accounting pronouncements. In May 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-09, Compensation - Stock Compensation: Scope of Modification Accounting, to clarify when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new standard, modification is required only if the fair value, the vesting conditions, or the classification of an award as equity or liability changes as a result of the change in terms or conditions. This ASU is effective for annual and interim periods beginning after December 15, 2017, with prospective application, and early adoption is allowed. The Company early adopted ASU 2017-09 effective June 1, 2017.

NOTE 2

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

	June 30, 2017		December 31, 2016	
	Amortized costs	Fair values	Amortized costs	Fair values
	(\$000 omitted)			
Debt securities:				
Municipal	72,214	73,601	72,284	72,432
Corporate	324,116	332,226	338,365	343,047
Foreign	199,369	200,669	165,735	167,027
U.S. Treasury Bonds	13,016	12,894	12,795	12,613
Equity securities	30,345	35,372	30,255	36,384
	639,060	654,762	619,434	631,503

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

Gross unrealized gains and losses were:

	June 30, 2017		December 31, 2016	
	Gains	Losses	Gains	Losses
	(\$000 omitted)			
Debt securities:				
Municipal	1,635	248	723	575
Corporate	8,524	414	6,871	2,189
Foreign	2,972	1,672	2,912	1,620
U.S. Treasury Bonds	7	129	4	186
Equity securities	6,079	1,052	6,800	671
	19,217	3,515	17,310	5,241

Debt securities as of June 30, 2017 mature, according to their contractual terms, as follows (actual maturities may differ due to call or prepayment rights):

Amortized costs Fair