

LANDAMERICA FINANCIAL GROUP INC

Form 10-Q

August 03, 2005

[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2005

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 No.: 1-13990

LANDAMERICA FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

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Virginia
(State or other jurisdiction of
incorporation or organization)

54-1589611
(I.R.S. Employer
Identification No.)

101 Gateway Centre Parkway

Richmond, Virginia
(Address of principal executive offices)

23235-5153
(Zip Code)

(804) 267-8000

(Registrant's telephone number, including area code)

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). **Yes** ☒ **No** ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, No Par Value

18,063,244

July 29, 2005

Table of Contents

LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES

INDEX

	<u>Page No.</u>
<u>PART I. FINANCIAL INFORMATION</u>	
ITEM 1. <u>CONSOLIDATED FINANCIAL STATEMENTS:</u>	
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Operations</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	7
<u>Notes to Consolidated Financial Statements</u>	8
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	18
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	32
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	32
<u>PART II. OTHER INFORMATION</u>	
ITEM 1. <u>LEGAL PROCEEDINGS</u>	33
ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	33
ITEM 4. <u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	33
ITEM 6. <u>EXHIBITS</u>	35
<u>SIGNATURE</u>	36

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In millions)

(Unaudited)

	June 30, 2005	December 31, 2004
<u>ASSETS</u>		
INVESTMENTS:		
Fixed maturities available-for-sale - at fair value (amortized cost: 2005 \$1,126.8; 2004 \$1,075.8)	\$ 1,158.2	\$ 1,113.3
Equity securities - at fair value (cost: 2005 \$33.7; 2004 \$31.4)	44.6	42.1
Federal funds sold	0.3	4.5
Short term investments	286.6	276.4
	<u>1,489.7</u>	<u>1,436.3</u>
Total Investments	1,489.7	1,436.3
CASH	78.0	73.0
LOANS RECEIVABLE	386.6	344.6
ACCRUED INTEREST RECEIVABLE	19.0	16.4
NOTES AND ACCOUNTS RECEIVABLE		
Notes (less allowance for doubtful accounts: 2005 \$4.2; 2004 \$4.1)	14.5	16.5
Trade accounts receivable (less allowance for doubtful accounts: 2005 \$8.7; 2004 \$8.2)	121.3	111.3
	<u>135.8</u>	<u>127.8</u>
Total Notes and Accounts Receivable	135.8	127.8
TAXES RECEIVABLE	4.3	12.2
PROPERTY AND EQUIPMENT - at cost (less accumulated depreciation and amortization: 2005 \$197.5; 2004 \$202.7)	108.8	106.1
TITLE PLANTS	94.4	93.9
GOODWILL	581.5	568.5
INTANGIBLE ASSETS (less accumulated amortization 2005 - \$47.1; 2004 \$32.5)	209.9	213.0
DEFERRED INCOME TAXES	146.3	149.5
OTHER ASSETS	167.7	148.7
	<u>3,422.0</u>	<u>3,290.0</u>
Total Assets	\$ 3,422.0	\$ 3,290.0

See Notes to Consolidated Financial Statements.

Table of Contents**LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In millions, except share amounts)

(Unaudited)

	June 30, 2005	December 31, 2004
	<u>2005</u>	<u>2004</u>
<u>LIABILITIES</u>		
POLICY AND CONTRACT CLAIMS	\$ 746.4	\$ 715.5
DEPOSITS	414.0	373.1
ACCOUNTS PAYABLE AND ACCRUED LIABILITIES	338.3	329.1
NOTES PAYABLE	472.9	465.4
DEFERRED SERVICE ARRANGEMENTS	192.9	202.4
OTHER	60.0	53.4
	<u>2,224.5</u>	<u>2,138.9</u>
Total Liabilities	<u>2,224.5</u>	<u>2,138.9</u>
<u>COMMITMENTS AND CONTINGENCIES</u>		
<u>SHAREHOLDERS' EQUITY</u>		
Common stock, no par value, 45,000,000 shares authorized, shares issued and outstanding: 2005 18,060,771; 2004 17,962,527	489.2	491.5
Accumulated other comprehensive loss	(21.5)	(17.6)
Retained earnings	729.8	677.2
	<u>1,197.5</u>	<u>1,151.1</u>
Total Shareholders' Equity	<u>1,197.5</u>	<u>1,151.1</u>
Total Liabilities and Shareholders' Equity	<u>\$ 3,422.0</u>	<u>\$ 3,290.0</u>

See Notes to Consolidated Financial Statements.

Table of Contents**LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2005 AND 2004**

(In millions, except per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
REVENUE				
Operating revenue	\$ 956.3	\$ 903.8	\$ 1,771.0	\$ 1,663.7
Investment and other income	20.5	17.1	40.6	33.6
Net realized investment gains	0.3	1.1	1.1	4.2
	<u>977.1</u>	<u>922.0</u>	<u>1,812.7</u>	<u>1,701.5</u>
EXPENSES				
Agents commissions	371.6	356.2	696.2	699.1
Salaries and employee benefits	282.9	256.4	530.2	470.2
General, administrative and other	197.8	141.0	338.4	270.4
Provision for policy and contract claims	50.9	46.7	100.1	85.7
Premium taxes	10.6	10.9	20.3	20.5
Interest expense	8.1	7.0	16.0	12.8
Amortization of intangibles	7.7	5.6	14.7	10.3
Exit and termination costs		3.5		5.4
	<u>929.6</u>	<u>827.3</u>	<u>1,715.9</u>	<u>1,574.4</u>
INCOME BEFORE INCOME TAXES	<u>47.5</u>	<u>94.7</u>	<u>96.8</u>	<u>127.1</u>
INCOME TAX EXPENSE	<u>19.9</u>	<u>33.2</u>	<u>38.9</u>	<u>44.7</u>
NET INCOME	<u>27.6</u>	<u>\$ 61.5</u>	<u>57.9</u>	<u>\$ 82.4</u>
NET INCOME PER COMMON SHARE	<u>\$ 1.57</u>	<u>\$ 3.35</u>	<u>\$ 3.28</u>	<u>\$ 4.45</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	<u>17.6</u>	<u>18.4</u>	<u>17.6</u>	<u>18.5</u>
NET INCOME PER COMMON SHARE ASSUMING DILUTION	<u>\$ 1.56</u>	<u>\$ 3.32</u>	<u>\$ 3.25</u>	<u>\$ 4.41</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING ASSUMING DILUTION	<u>17.8</u>	<u>18.5</u>	<u>17.8</u>	<u>18.7</u>
CASH DIVIDENDS DECLARED PER COMMON SHARE	<u>\$ 0.15</u>	<u>\$ 0.10</u>	<u>\$ 0.30</u>	<u>\$ 0.20</u>

See Notes to Consolidated Financial Statements.

Table of Contents**LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****SIX MONTHS ENDED JUNE 30, 2005 AND 2004**

(In millions)

(Unaudited)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Net income	\$ 57.9	\$ 82.4
Depreciation and amortization	29.2	23.0
Amortization of bond premium	3.2	3.7
Net realized investment gains	(1.1)	(4.2)
Deferred income tax expense (benefit)	4.4	(10.4)
Change in assets and liabilities, net of businesses acquired:		
Accounts and notes receivable	(8.4)	(15.5)
Income taxes receivable/payable	7.8	42.1
Accounts payable and accrued expenses	8.9	(19.5)
Policy and contract claims	30.9	27.7
Deferred service arrangements	(9.5)	11.2
Other	(1.8)	(5.7)
Net cash provided by operating activities	<u>121.5</u>	<u>134.8</u>
Cash flows from investing activities:		
Purchase of property and equipment, net	(15.9)	(14.5)
Purchase of business, net of cash acquired	(25.7)	(105.7)
Investments in unconsolidated subsidiaries	(11.2)	(8.2)
Change in cash surrender value of life insurance	(1.6)	(1.1)
Change in short-term investments	(10.2)	(29.4)
Cost of investments acquired:		
Fixed maturities	(209.1)	(298.6)
Equity securities	(7.0)	(11.1)
Proceeds from investment sales or maturities:		
Fixed maturities	157.3	241.9
Equity securities	6.2	10.4
Net change in federal funds sold	4.2	(0.1)
Change in loans receivable	(42.7)	(60.6)
Net cash used in investing activities	<u>(155.7)</u>	<u>(277.0)</u>
Cash flows from financing activities:		
Net change in deposits	40.9	69.9
Proceeds from the exercise of options and incentive plans	5.5	7.1
Sale of stock warrants		22.5
Purchase of bond hedge call options		(32.0)
Cost of common shares repurchased	(9.1)	(34.0)
Dividends paid	(5.3)	(3.8)
Proceeds from issuance of notes payable	12.4	145.7

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Payments on notes payable	(5.2)	(10.6)
Net cash provided by financing activities	39.2	164.8
Net increase in cash	5.0	22.6
Cash at beginning of period	73.0	52.9
Cash at end of period	\$ 78.0	\$ 75.5

See Notes to Consolidated Financial Statements.

Table of Contents

LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(In millions, except per share amounts)

(Unaudited)

		Common Stock		Accumulated Other Comprehensive	Retained	Total
		Shares	Amounts	Income (Loss)	Earnings	Shareholders Equity
BALANCE	December 31, 2003	18.8	\$ 520.9	\$ (16.5)	\$ 540.1	\$ 1,044.5
Comprehensive income:						
Net income					82.4	82.4
Other comprehensive income:						
Net unrealized losses on securities, net of tax benefit of \$9.8				(18.3)		(18.3)
						64.1
Purchase of call options, net of tax benefit of \$11.2						
			(20.8)			(20.8)
Sale of common stock warrants			22.5			22.5
Common stock retired		(0.9)	(34.0)			(34.0)
Stock option and incentive plans		0.2	8.5			8.5
Common dividends (\$0.20/share)					(3.8)	(3.8)
BALANCE	June 30, 2004	18.1	\$ 497.1	\$ (34.8)	\$ 618.7	\$ 1,081.0
BALANCE	December 31, 2004	18.0	\$ 491.5	\$ (17.6)	\$ 677.2	\$ 1,151.1
Comprehensive income:						
Net income					57.9	57.9
Other comprehensive income:						
Net unrealized losses on securities, net of tax benefit of \$1.9				(3.9)		(3.9)
						54.0
Purchase of call options, net of tax						
			(0.7)			(0.7)
Common stock retired		(0.2)	(9.1)			(9.1)
Stock option and incentive plans		0.3	7.5			7.5
Common dividends (\$0.30 share)					(5.3)	(5.3)
BALANCE	June 30, 2005	18.1	\$ 489.2	\$ (21.5)	\$ 729.8	\$ 1,197.5

See Notes to Consolidated Financial Statements.

Table of Contents**LANDAMERICA FINANCIAL GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. INTERIM FINANCIAL INFORMATION**

The unaudited consolidated financial information included in this report has been prepared in conformity with the accounting principles and practices reflected in the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004 as filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934. This report should be read in conjunction with the aforementioned Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of this information have been made. The results of operations for the interim periods are not necessarily indicative of results for a full year.

Certain 2004 amounts have been reclassified to conform to the 2005 presentation.

2. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
	(In millions, except per share amounts)			
Numerator:				
Net income numerator for earnings per share	\$ 27.6	\$ 61.5	\$ 57.9	\$ 82.4
Denominator:				
Weighted average shares denominator for basic earnings per share	17.6	18.4	17.6	18.5
Effect of dilutive securities:				
Employee stock options	0.2	0.1	0.2	0.2
Denominator for diluted earnings per share	17.8	18.5	17.8	18.7
Basic earnings per common share	\$ 1.57	\$ 3.35	\$ 3.28	\$ 4.45
Diluted earnings per common share	\$ 1.56	\$ 3.32	\$ 3.25	\$ 4.41

Table of Contents**3. INVESTMENTS**

The Company had a total of 298 securities which had unrealized losses at June 30, 2005 due primarily to an increase in interest rates. The duration of these securities range from one year to thirty years. There were 73 securities that the Company owned that have been in a loss position for more than twelve months, all of which are investment grade long-term bonds and notes which management has the intent and ability to hold to maturity. These securities had an aggregate unrealized loss of \$1.1 million at June 30, 2005.

Management has concluded that none of the available-for-sale securities with unrealized losses at June 30, 2005 has experienced an other-than temporary impairment. This conclusion was based on a number of factors including: (1) there were no securities with fair values less than 80% of amortized cost at June 30, 2005, (2) there were no securities rated below investment grade, and (3) there were no securities for which fair value had been significantly below amortized cost for a period of six months or longer.

Investments totaling \$27.3 million are held on deposit with various state regulatory entities and are not available for use in operations.

4. PENSIONS AND OTHER POST-RETIREMENT BENEFITS

The following presents the estimated net pension expense recorded in the financial statements for each of the three and six-month periods ended June 30, 2005, and 2004. The 2005 information is based on preliminary data provided by the Company's independent actuaries. The amounts are as follows:

	Three Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
	(In millions)			
Components of net pension expense:				
Service cost	\$	\$ 3.1	\$ 0.2	\$ 0.2
Interest cost	3.5	3.8	0.8	0.8
Expected return on plan assets	(3.9)	(4.3)		
Amortization of unrecognized transition obligation			0.3	0.3
Prior service cost recognized		(0.4)	0.1	0.1
Recognized loss	1.0	1.3		0.1
Loss recognized due to settlements	2.2			
Net pension expense	\$ 2.8	\$ 3.5	\$ 1.4	\$ 1.5

Table of Contents

	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
	(In millions)			
Components of net pension expense:				
Service cost	\$	\$ 6.3	\$ 0.4	\$ 0.4
Interest cost	7.0	7.5	1.6	1.7
Expected return on plan assets	(7.8)	(8.7)		
Amortization of unrecognized transition obligation			0.6	0.6
Prior service cost recognized		(0.8)	0.2	0.2
Recognized loss	2.0	2.6		0.2
Loss recognized due to settlements	2.2			
Net pension expense	\$ 3.4	\$ 6.9	\$ 2.8	\$ 3.1

On December 31, 2004, the Company froze the accumulation of benefits available under its principal deferred pension plan.

Weighted-average assumptions used to determine net cost for each of the three and six-month periods ended June 30, 2005, and 2004 are as follows:

	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Discount rate	6.00%	6.00%	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%	N/A	N/A
Rate of compensation increase	4.63%	4.63%	4.63%	4.63%

5. COMMITMENTS AND CONTINGENCIES**Legal Proceedings**

The Company and its subsidiaries are involved in certain litigation arising in the ordinary course of their businesses. Although the ultimate outcome of these matters cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, the Company believes, based on current knowledge, that the resolution of these matters will not have a material adverse effect on the Company's financial position or results of operations.

Litigation Not in the Ordinary Course of Business

On September 5, 2002, Thomas Branick and Ardra Campbell filed a representative suit on behalf of the general public against Southland Title Corporation (Southland), a subsidiary of the Company, in the Los Angeles Superior Court (Case No. BC 280961). The Complaint, as amended, pleads causes of action for unfair competition (California Business and Professions Code §§ 17200, et. seq.) and unfair business practices (California Business and Professions Code §§ 17500, et. seq.) and generally alleges that Southland improperly charged its customers for recording documents incident to real estate transactions and overcharged its customers for administrative fees. Plaintiffs seek injunctive relief and restitution. On September 3, 2004, the trial court granted Southland s

Table of Contents

Motion for Judgment on the Pleadings and on September 16, 2004 entered a final judgment dismissing this case. On November 15, 2004, Plaintiffs filed a Notice of Appeal of the judgment. The parties executed a settlement agreement that provides for injunctive relief and a cash payment of \$75,000 for attorneys' fees and costs. The appeal was dismissed by the Second District of the California Court of Appeals on June 13, 2005. On June 24, 2005, Plaintiffs filed a dismissal with prejudice with the Los Angeles Superior Court. The attorneys' fees and costs have been paid.

On May 9, 2000, Romeo Jergess filed a putative class action suit (the "Jergess Suit") in the United States District Court for the Eastern District of Michigan, Southern Division (Case No. 00-72124) against Transnation Title Insurance Company ("Transnation"), a subsidiary of the Company. The suit alleges that Transnation's rate for an owner's title insurance policy, charged in accordance with rates for new construction filed with the Insurance Bureau of the State of Michigan, are less than the rate paid by the lender for a simultaneously issued lender's title insurance policy, and that the lower rate paid by the builder/developer for the owner's policy involves an illegal kickback for a referral and an illegal splitting of fees in violation of the Real Estate Settlement Procedures Act ("RESPA"). On April 27, 2001, a similar suit was filed by Elaine Miller (the "Miller Suit") in the same court (Case No. 01-71647) against Lawyers Title Insurance Corporation ("Lawyers Title"), a subsidiary of the Company. The plaintiffs in both suits seek an unspecified amount of damages equal to three times the amount of the charge for each simultaneously issued lender's title insurance policy in connection with a new home purchase commencing with the period one year before the filing of each complaint, plus costs, interest and attorneys' fees. Transnation and Lawyers Title have engaged a forensic accountant to review plaintiffs' estimate that the charges collected for such policies by Transnation and Lawyers Title from the class as originally defined is approximately \$15 million. The Jergess Suit and the Miller Suit were consolidated on July 18, 2002 with cases pending against First American Title Insurance Company and Chicago Title Insurance Company. On December 5, 2002, the court certified a class defined as all individuals who, during the period commencing prior to one year of the filing of the applicable suit and ending on October 30, 2002, purchased a newly constructed one to four family dwelling or condominium and were charged for a lender's title insurance policy allegedly in violation of RESPA. On February 12, 2003, the United States Court of Appeals for the Sixth Circuit denied Transnation's and Lawyers Title's petitions for an interlocutory appeal of the class certification order. On October 30, 2003, the judge ordered that individuals otherwise meeting the class definition, but who closed transactions involving relevant policies between October 31, 2002 through October 30, 2003, would not be subject to a statute of limitations defense raised by Transnation Title or Lawyers Title between October 30, 2003 and October 31, 2004. On October 28, 2004, Transnation and Lawyers Title stipulated to an order that individuals otherwise meeting the class definition, but who closed transactions involving relevant policies between October 31, 2002 through October 30, 2004, would not be subject to a statute of limitations defense raised by Transnation or Lawyers Title between October 30, 2004 and October 31, 2005. The court reserved decision on a Motion to proceed to trial with the certified class as originally defined. On January 13, 2005, the court denied Transnation's and Lawyers Title's motion to dismiss the case for lack of standing. On February 7, 2005,

Table of Contents

the court dismissed without prejudice Transnation's and Lawyers Title's Motion for Partial Summary Judgment with respect to those members of the class covered by the affiliated business exception under RESPA with the court indicating that the parties could resubmit the motion with additional information. The court has not yet ruled on the parties' cross Motions for Summary Judgment on Count II of plaintiffs' complaint alleging an illegal splitting of fees under RESPA. On April 21, 2005, Transnation and Lawyers Title filed various Motions for Summary Judgment and Limine with respect to multiple issues. The parties participated in nonbinding mediation beginning May 3, 2005. On May 19, 2005, Transnation and Lawyers Title entered into a binding term sheet to settle the consolidated suits. The terms of the settlement are subject to court approval. If approved, Transnation and Lawyers Title will be obligated to make a single aggregate payment of \$10,325,000 into a settlement fund to be established for the benefit of eligible class members. Transnation and Lawyers Title, who did not admit any liability in the settlement, would be required to deposit the settlement funds into escrow within seven days following the issuance of a final order by the court approving the settlement. The parties intend to enter into a final Settlement Agreement that will incorporate the provisions of the Term Sheet. Pursuant to the Term Sheet, the Settlement Agreement will provide for the dismissal with prejudice of all claims by plaintiffs against Transnation and Lawyers Title and a release of all claims by plaintiffs except claims under their title policies.

On June 22, 2004, Gateway Title Company, Inc., Commonwealth Land Title Company, Inc. and LandAmerica Financial Group, Inc. (Plaintiffs) filed a Complaint, subsequently amended by a First Amended Complaint filed June 25, 2004, in the Superior Court of California, County of Los Angeles, Central District, against the Mercury Company and its affiliates Financial Title, Alliance Title, Investors Title and various individuals including Joseph DiChiacchio, a former manager of LandAmerica (Case No. BC 317441) (collectively, the Defendants). The lawsuit claims substantial monetary and punitive damages for unfair competitive business practices in conjunction with Plaintiffs' loss of over 300 employees in California, most of which occurred within an approximately twenty-four month period. On August 12, 2004, the Court granted a Temporary Restraining Order, followed by a request for a Preliminary Injunction, which was granted September 27, 2004 against the Defendants based upon a showing of significant likelihood of Plaintiffs prevailing on the merits combined with irreparable harm to Plaintiffs if injunctive relief did not issue. The injunctive relief generally prohibited the solicitation of Plaintiffs' employees. The preliminary injunctive relief has now expired and discovery and the calculation of damages are underway. On December 13, 2004, Alliance Title Company, Inc., Financial Title Company, Inc., Roberto Olivera and Ray Arias filed a Cross-Complaint for unfair competitive business practices. On December 13, 2004, Mr. DiChiacchio also filed a Cross-Complaint alleging similar claims, including back wages and additional bonus payments. Plaintiffs are disputing and intend to vigorously defend the Cross-Complaints. A mandatory settlement conference was held on August 1, 2005. A trial date has been set for October 3, 2005. Management believes that damages caused to Plaintiffs by Defendants far exceed any claim of offset raised in the Cross-Complaints.

Table of Contents

Regulatory Investigations and Inquiries

The Company has received certain information requests and subpoenas from various state regulatory authorities relating to investigations of the business practices of the Company and the title insurance industry.

In 2004, the Office of the Attorney General of the State of New York (NYAG) initiated an investigation into the business practices of companies engaged in the title insurance business. The Company has received subpoenas and supplemental requests from the NYAG seeking information and documents related to its investigation of certain industry business practices, including, among other things, competitive market practices, the compensation of title insurance agents and producers by underwriters and captive reinsurance arrangements. The insurance department of the State of New York is also examining the Company's reinsurance arrangements.

In addition, the insurance departments of various states have been making inquiries into the title industry's business practices. The Company has received letters of inquiry from the insurance departments of the states of North Carolina and Pennsylvania as part of their review of competitive market practices and agent compensation in the title insurance industry. The Company has received letters of inquiry from the Connecticut department of insurance seeking information on the Company's agent and producer commission practices and captive reinsurance arrangements. The Hawaii insurance division has issued letters of inquiry to the Company to review the relationship between the Company, its producers and other participants in the real estate industry. The California department of insurance is conducting examinations of the Company's adherence to filed premium rates and claims handling practices, is reviewing the Company's captive reinsurance arrangements and has requested information on community development and investment and the Company's California title plants. The Company reached an agreement with the California department of insurance to settle the captive reinsurance and other regulatory matters. The Tennessee department of insurance has issued a requirement for the submission of an attestation regarding any finite reinsurance arrangements of the Company in that state. In connection with its bi-annual rate hearing, the Company has received subpoenas from the Texas department of insurance seeking information regarding business practices that may have the effect of raising prices to Texas consumers.

Additional states are specifically investigating captive reinsurance arrangements in the title insurance industry and the Company has received inquiries regarding those arrangements, in addition to those described above, from the Colorado state attorney general and ten state departments of insurance. During the period from the Company's inception of its captive reinsurance programs in 1997 through 2004, reinsurance premiums paid by the Company to the reinsurers have totaled approximately \$12 million. In February 2005, the Company announced that it intended to terminate its captive reinsurance arrangements despite its belief that it had operated the programs in accordance with applicable law. The revenues from these programs were not material to the Company's results of operations.

In June 2005, the Company established reserves of \$19.0 million to cover anticipated exposure to regulatory matters nationwide, an amount which includes the settlement with the California department of insurance.

Table of Contents

The Company may receive additional subpoenas and/or requests for information in the future from attorneys general and/or insurance departments of other states. The Company will evaluate, and intends to cooperate in connection with, all such subpoenas and requests.

Based on the information known to management at this time, it is not possible to predict the outcome of the governmental inquiries and investigations into the title insurance industry's business practices or the market's response thereto. However, any material change in the Company's business practices may have an adverse effect on its results of operations.

6. SHAREHOLDERS' EQUITY

In February 2004, the Board of Directors approved a one-year authorization program allocating \$50.0 million to repurchase up to 1.25 million shares or 7% of the Company's existing common stock over the following twelve months. During the first three quarters of 2004, the Company repurchased the entire 1.25 million authorized shares of the Company's common stock at an average price of \$39.44 per share. In December 2004, the Board of Directors approved a program expiring February 2006 which authorized the Company to repurchase up to 1.0 million additional shares at a cost not to exceed \$60.0 million. During the first two quarters of 2005, the Company repurchased approximately 170,400 shares for \$9.1 million at an average price of \$53.23 per share.

The Company's stock-based compensation plans include stock options and equity-based compensation and are valued using the intrinsic value method of accounting for stock option plans in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, no compensation expense has been recognized for the Company's stock options since all options granted had an exercise price equal to the market value of the underlying stock on the date of grant. The following table represents the compensation expense, and related effect on earnings, for the Company's stock option plans if the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, had been applied, r