

STEWART INFORMATION SERVICES CORP
Form 10-Q
November 08, 2018
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, 2018

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 every Interactive Data File required to be submitted 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 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

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 November 4, 2018, there were 23,740,794 outstanding shares of the issuer's Common Stock, \$1 par value per share.

FORM 10-Q QUARTERLY REPORT
QUARTER ENDED SEPTEMBER 30, 2018
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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
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|----------|------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| | (\$000 omitted, except per share) | | | |
| Revenues | | | | |
| Title revenues: | | | | |
| Direct operations | 213,134 | 216,830 | 622,886 | 635,921 |
| Agency operations | 272,875 | 268,545 | 756,986 | 736,301 |
| Ancillary services | 13,227 | 12,674 | 38,790 | 45,096 |
| Operating revenues | 499,236 | 498,049 | 1,418,662 | 1,417,318 |
| Investment income | 4,781 | 4,567 | 14,732 | 14,179 |
| Investment and other gains (losses) – net | 3,623 | (1,047) | 4,345 | (1,436) |
| | 507,640 | 501,569 | 1,437,739 | 1,430,061 |
| Expenses | | | | |
| Amounts retained by agencies | 224,966 | 221,460 | 623,967 | 605,192 |
| Employee costs | 138,288 | 140,054 | 423,389 | 419,184 |
| Other operating expenses | 90,810 | 88,489 | 257,029 | 255,593 |
| Title losses and related claims | 21,503 | 25,428 | 59,181 | 70,591 |
| Depreciation and amortization | 6,221 | 6,578 | 18,609 | 19,397 |
| Interest | 1,076 | 963 | 2,722 | 2,492 |
| | 482,864 | 482,972 | 1,384,897 | 1,372,449 |
| Income before taxes and noncontrolling interests | 24,776 | 18,597 | 52,842 | 57,612 |
| Income tax expense | 4,371 | 4,686 | 8,679 | 15,536 |
| Net income | 20,405 | 13,911 | 44,163 | 42,076 |
| Less net income attributable to noncontrolling interests | 2,851 | 2,967 | 8,012 | 8,475 |
| Net income attributable to Stewart | 17,554 | 10,944 | 36,151 | 33,601 |
| Net income | 20,405 | 13,911 | 44,163 | 42,076 |
| Other comprehensive (loss) income, net of taxes: | | | | |
| Foreign currency translation adjustments | 1,140 | 4,141 | (4,490) | 8,670 |
| Change in net unrealized gains and losses on investments | (1,910) | 63 | (12,344) | 2,885 |
| Reclassification adjustment for net gains included in net income | (137) | (331) | (617) | (792) |
| Other comprehensive (loss) income, net of taxes: | (907) | 3,873 | (17,451) | 10,763 |
| Comprehensive income | 19,498 | 17,784 | 26,712 | 52,839 |
| Less net income attributable to noncontrolling interests | 2,851 | 2,967 | 8,012 | 8,475 |
| Comprehensive income attributable to Stewart | 16,647 | 14,817 | 18,700 | 44,364 |
| Basic average shares outstanding (000) | 23,556 | 23,448 | 23,537 | 23,442 |
| Basic earnings per share attributable to Stewart | 0.75 | 0.47 | 1.54 | 1.43 |
| Diluted average shares outstanding (000) | 23,699 | 23,564 | 23,677 | 23,571 |
| Diluted earnings per share attributable to Stewart | 0.74 | 0.46 | 1.53 | 1.43 |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

| | As of September 30, 2018 (Unaudited) (\$000 omitted) | As of December 31, 2017 |
|--|--|-------------------------------|
| Assets | | |
| Cash and cash equivalents | 149,669 | 150,079 |
| Short-term investments | 23,954 | 24,463 |
| Investments in debt and equity securities, at fair value | 662,089 | 709,355 |
| Receivables: | | |
| Premiums from agencies | 31,656 | 27,903 |
| Trade and other | 44,470 | 51,299 |
| Income taxes | 559 | 1,267 |
| Notes | 3,594 | 3,203 |
| Allowance for uncollectible amounts | (4,925) | (5,156) |
| | 75,354 | 78,516 |
| Property and equipment, at cost: | | |
| Land | 3,991 | 3,991 |
| Buildings | 23,018 | 22,849 |
| Furniture and equipment | 234,405 | 226,461 |
| Accumulated depreciation | (196,943) | (186,279) |
| | 64,471 | 67,022 |
| Title plants, at cost | 74,737 | 74,237 |
| Investments on equity method basis | 8,360 | 9,202 |
| Goodwill | 247,190 | 231,428 |
| Intangible assets, net of amortization | 10,843 | 9,734 |
| Deferred tax assets | 4,186 | 4,186 |
| Other assets | 49,576 | 47,664 |
| | 1,370,429 | 1,405,886 |
| Liabilities | | |
| Notes payable | 106,440 | 109,312 |
| Accounts payable and accrued liabilities | 97,233 | 117,740 |
| Estimated title losses | 476,870 | 480,990 |
| Deferred tax liabilities | 13,152 | 19,034 |
| | 693,695 | 727,076 |
| Contingent liabilities and commitments | | |
| Stockholders' equity | | |
| Common Stock and additional paid-in capital | 185,432 | 184,026 |
| Retained earnings | 510,068 | 491,698 |
| Accumulated other comprehensive (loss) income: | | |
| Net unrealized investment (losses) gains on investments available-for-sale | (8,383) | 7,526 |
| Foreign currency translation adjustments | (13,507) | (8,373) |
| Treasury stock – 352,161 common shares, at cost | (2,666) | (2,666) |
| Stockholders' equity attributable to Stewart | 670,944 | 672,211 |
| Noncontrolling interests | 5,790 | 6,599 |
| Total stockholders' equity (23,740,900 and 23,719,522 shares outstanding) | 676,734 | 678,810 |
| | 1,370,429 | 1,405,886 |

See notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | Nine Months Ended September 30, 2018 2017 (\$000 omitted) | |
|--|--|------------|
| Reconciliation of net income to cash provided by operating activities: | | |
| Net income | 44,163 | 42,076 |
| Add (deduct): | | |
| Depreciation and amortization | 18,609 | 19,397 |
| Provision for bad debt | 510 | 697 |
| Investment and other (gains) losses – net | (4,345) | 1,436 |
| Amortization of net premium on investments available-for-sale | 4,617 | 5,114 |
| Payments for title losses (in excess of) lesser than provisions | (1,106) | 6,697 |
| Adjustment for insurance recoveries of title losses | 1,023 | 757 |
| Decrease (increase) in receivables – net | 2,020 | (13,032) |
| Increase in other assets – net | (406) | (5,633) |
| Decrease in payables and accrued liabilities – net | (23,480) | (20,482) |
| Change in net deferred income taxes | (1,693) | 8,749 |
| Net income from equity investees | (1,344) | (1,813) |
| Dividends received from equity investees | 2,187 | 2,053 |
| Stock-based compensation expense | 3,039 | 2,078 |
| Other – net | (61) | (46) |
| Cash provided by operating activities | 43,733 | 48,048 |
| Investing activities: | | |
| Proceeds from sales of investments in securities | 32,500 | 55,533 |
| Proceeds from matured investments in debt securities | 25,258 | 33,867 |
| Purchases of investments in securities | (35,683) | (125,415) |
| Net purchases of short-term investments | (366) | (327) |
| Purchases of property and equipment, and real estate – net | (8,478) | (12,411) |
| Cash paid for acquisition of businesses | (17,639) | (17,784) |
| Other – net | 327 | 960 |
| Cash used by investing activities | (4,081) | (65,577) |
| Financing activities: | | |
| Payments on notes payable | (16,767) | (18,848) |
| Proceeds from notes payable | 9,583 | 48,043 |
| Distributions to noncontrolling interests | (8,665) | (8,376) |
| Repurchases of common stock | (687) | — |
| Cash dividends paid | (21,195) | (21,100) |
| Payment of contingent consideration related to an acquisition | — | (1,298) |
| Purchase of remaining interest in consolidated subsidiary | (1,102) | (1,014) |
| Cash used by financing activities | (38,833) | (2,593) |
| Effects of changes in foreign currency exchange rates | (1,229) | 3,096 |
| Decrease in cash and cash equivalents | (410) | (17,026) |
| Cash and cash equivalents at beginning of period | 150,079 | 185,772 |
| Cash and cash equivalents at end of period | 149,669 | 168,746 |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF EQUITY (UNAUDITED)

| | Common Stock (\$1 par value) (\$000 omitted) | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Treasury stock | Noncontrolling interests | Total |
|--|--|----------------------------------|----------------------|---|-------------------|-----------------------------|-----------|
| Balances at December 31, 2017 | 24,072 | 159,954 | 491,698 | (847) | (2,666) | 6,599 | 678,810 |
| Cumulative effect adjustments on adoption of new accounting standards (Note 1-D) | — | — | 3,592 | (3,592) | — | — | — |
| Net income attributable to Stewart | — | — | 36,151 | — | — | — | 36,151 |
| Dividends on Common Stock (\$0.90 per share) | — | — | (21,373) | — | — | — | (21,373) |
| Stock-based compensation and other | 38 | 3,001 | — | — | — | — | 3,039 |
| Stock repurchases | (17) | (670) | — | — | — | — | (687) |
| Purchase of remaining interest in consolidated subsidiary | — | (946) | — | — | — | (156) | (1,102) |
| Net change in unrealized gains and losses on investments, net of taxes | — | — | — | (12,344) | — | — | (12,344) |
| Net realized gain reclassification, net of taxes | — | — | — | (617) | — | — | (617) |
| Foreign currency translation adjustments, net of taxes | — | — | — | (4,490) | — | — | (4,490) |
| Net income attributable to noncontrolling interests | — | — | — | — | — | 8,012 | 8,012 |
| Distributions to noncontrolling interests | — | — | — | — | — | (8,665) | (8,665) |
| Balances at September 30, 2018 | 24,093 | 161,339 | 510,068 | (21,890) | (2,666) | 5,790 | 676,734 |

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 nine months ended September 30, 2018 and 2017, and as of September 30, 2018, 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, 2017.

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 voting stock, are accounted for using the equity method.

C. 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 \$468.8 million and \$490.8 million at September 30, 2018 and December 31, 2017, 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 \$27.7 million and \$14.2 million at September 30, 2018 and December 31, 2017, 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.

D. Cumulative effect adjustments on adoption of new accounting standards. In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02, Income Statement - Reporting Comprehensive Income, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which amended its standard on comprehensive income to provide a one-time option for an entity to reclassify the stranded tax effects of the Tax Cuts and Jobs Act (the 2017 Act) that was passed in December 2017 from accumulated other comprehensive income/loss (AOCI) directly to retained earnings. The stranded tax effects result from the remeasurement of deferred tax assets and liabilities which were originally recorded in comprehensive income but whose remeasurement is reflected in the income statement. The Company adopted ASU 2018-02 effective on January 1, 2018 and reclassified \$1.0 million of net tax expense from AOCI to retained earnings in the consolidated statement of equity.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which, among others, (i) required equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplified the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminated the requirement for public business entities to disclose the methods and significant assumptions used to estimate the

fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and (iv) required separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. The Company adopted ASU 2016-01 effective on January 1, 2018, which resulted in a reclassification of the outstanding net unrealized investment gains, net of taxes, of \$4.6 million relating to investments in equity securities previously carried in AOCI to retained earnings in the consolidated statement of equity.

E. Recent significant accounting pronouncements. In February 2016, the FASB issued ASU 2016-02, Topic 842: Leases (Topic 842), which updates the current guidance related to leases. Topic 842 includes the requirement for the lessee to recognize in the balance sheet a liability equal to the present value of contractual lease payments with terms of more than twelve months and a right-of-use asset representing the right to use the underlying asset for the lease term. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Additional financial statement disclosures are required to meet the objective of enabling users to assess the amount, timing, and uncertainty of cash flows arising from leases. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842: Leases and ASU 2018-11, Leases (Topic 842) - Targeted Improvements. ASU 2018-10 clarifies certain aspects of the new lease standard which include amendments addressing, among others, the rate implicit in the lease, lessee reassessment of lease classification, variable payments that depend on an index or rate and certain transition adjustments. ASU 2018-11 provides an optional transition method which will allow the application of the recognition and measurement requirements of Topic 842 in the period of adoption. If elected, the comparative periods would continue to be reported under the legacy lease guidance in Topic 840, including the related disclosures, and a cumulative effect adjustment would be made to retained earnings as of the adoption date. These ASUs are effective for annual and interim periods beginning after December 15, 2018 and early adoption is permitted.

The Company expects to adopt Topic 842 on January 1, 2019 using the optional transition method of adoption. The adoption is expected to result in material increases in the assets and liabilities to be reported on its 2019 consolidated balance sheets based on the Company's estimate of undiscounted future minimum lease payments of approximately \$90 million to \$100 million as of December 31, 2018. However, the Company expects the new lease standard will likely have an insignificant impact on its consolidated statements of income and comprehensive income and cash flows. The Company is currently in the process of system implementation and data migration, and expects the transition to be completed during the fourth quarter 2018. The Company is planning to elect most of the practical expedients permitted by Topic 842 at adoption date.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement, which removes Topic 820 disclosure requirements relating to the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels; and the valuation processes for Level 3 fair value measurements. Also, ASU 2018-13 adds new requirements to disclose changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period, and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted. The Company expects this ASU will have minimal effect on its financial statements and related disclosures when it is adopted on January 1, 2020 considering the Company does not have any Level 3 fair value measurements.

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract. ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. ASU 2018-15 is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted. The Company is currently evaluating the effect that the new guidance will have on its consolidated financial statements and related disclosures.

F. Merger Agreement. On March 18, 2018, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Fidelity National Financial, Inc., a Delaware corporation (FNF), A Holdco Corp., a Delaware corporation and a wholly-owned direct subsidiary of FNF (Merger Sub I), and S Holdco LLC, a Delaware limited liability company and a wholly-owned direct subsidiary of FNF (Merger Sub II and, together with Merger Sub I, the

Merger Subs). Upon the terms and subject to the conditions set forth in the Merger Agreement, at the Effective Time (as defined below), Merger Sub I will merge with and into the Company (Merger I), with the Company surviving Merger I as a direct wholly-owned subsidiary of FNF, and at the Subsequent Effective Time (as defined in the Merger Agreement), the Company will merge with and into Merger Sub II (Merger II and, together with Merger I, the Mergers), with Merger Sub II surviving Merger II as a direct wholly-owned subsidiary of FNF.

Subject to the terms and conditions of the Merger Agreement, at the effective time of Merger I (the Effective Time, each share of the Company's Common Stock outstanding immediately prior to the Effective Time (other than (i) shares owned by the Company, its subsidiaries, FNF or the Merger Subs and (ii) shares in respect of which appraisal rights have been properly exercised and perfected under Delaware law) will be converted into the right to receive cash consideration of \$25.00 and 0.6425 shares of FNF common stock, par value \$0.0001 per share (FNF Common Stock), subject to potential adjustment as described below. Pursuant to the terms of the Merger Agreement, the Company's stockholders have the option to elect to receive the merger consideration in all cash (the Cash Election Consideration), all FNF Common Stock (the Stock Election Consideration) or a mix of 50% cash and 50% FNF Common Stock (the Mixed Election Consideration), subject to pro-rata reductions to the extent either the election for the Cash Election Consideration or the election for the Stock Election Consideration is oversubscribed. Stockholders that elect to receive the Cash Election Consideration will receive \$50.00 per share, subject to potential adjustment as described below and proration to the extent the cash option is oversubscribed. The Stock Election Consideration and the stock portion of the Mixed Election Consideration will be calculated using a fixed exchange ratio that is based on the average of the volume weighted average prices of FNF Common Stock for each of the twenty (20) trading days prior to the signing of the Merger Agreement, or \$38.91 (the Parent Share Price). The exchange ratio for the Stock Election Consideration will be equal to 1.2850 shares of FNF Common Stock per share of Common Stock (the Exchange Ratio), subject to potential adjustment described below and proration to the extent the stock option is oversubscribed.

Under the terms of the Merger Agreement, if the combined company is required to divest assets or businesses with 2017 annual revenues in excess of \$75 million in order to receive required regulatory approvals (up to a cap of \$225 million of 2017 annual revenues), the per share purchase price will be adjusted downwards on a sliding scale between such amounts of divestitures up to a maximum reduction of \$4.50 in value in the event that businesses or assets with 2017 annual revenues of \$225 million are divested, with such adjustment to consist of (i) in the case shares of Common Stock with respect to which Cash Election Consideration has been elected, a reduction of the amount of cash paid in respect of each share, (ii) in the case shares of Common Stock with respect to which Stock Election Consideration has been elected, a reduction in the Exchange Ratio based on the Parent Share Price, and (iii) in the case of shares of Common Stock with respect to which Mixed Election Consideration has been elected, a reduction in both the amount of cash and the Exchange Ratio to be paid to the holders of such shares, with 50% of the aggregate value of such reduction to consist of a reduction of the cash consideration and 50% of the aggregate value of such reduction to consist of a reduction in the Exchange Ratio based on the Parent Share Price.

The consummation of the Mergers, which is expected during the first or second quarter of 2019, is subject to the satisfaction or waiver of customary conditions, including, among other things, (i) the adoption of the Merger Agreement by the holders of a majority of the outstanding shares of Common Stock entitled to vote on the Mergers (the Company Stockholder Approval), (ii) the absence of any injunction or court or other governmental order (with respect to applicable antitrust or insurance laws, solely with respect to the Required Antitrust Regulatory Filings/Approvals and the Required Insurance Regulatory Filings/Approvals (each as defined in the Merger Agreement)) enjoining, prohibiting or rendering illegal the consummation of the Mergers, (iii) obtaining certain Required Antitrust Regulatory Filings/Approvals, (iv) obtaining certain Required Insurance Regulatory Filings/Approvals, (v) the Securities and Exchange Commission (SEC) declaring the Registration Statement (as defined in the Merger Agreement) on Form S-4 effective, (vi) the shares of FNF Common Stock to be issued in the Mergers having been approved for listing on the New York Stock Exchange, (vii) the representations and warranties made by each of the Company and FNF being true at and as of the Closing Date (as defined in the Merger Agreement), subject to the materiality standards contained in the Merger Agreement, (viii) the performance, in all material respects, by each of the Company, FNF and the Merger Subs of all of their respective obligations under the Merger Agreement and (ix) no Company Material Adverse Effect or Parent Material Adverse Effect (each as defined in the Merger Agreement) having occurred since the signing of the Merger Agreement. The Company Stockholder Approval was obtained during a special stockholders' meeting held on September 5, 2018.

The Merger Agreement contains certain customary representations, warranties and covenants made by the Company and FNF. The Merger Agreement also contains customary covenants for each of the parties, including the obligation for the parties to refrain from taking specified actions without the consent of the other party, and, in the case of the Company, conduct its business in the ordinary course and use commercially reasonable efforts to preserve intact its business organizations and relationships with third parties. Under the Merger Agreement, each of the Company and FNF has agreed to use its reasonable best efforts to take all actions and to do all things necessary or advisable under applicable law to consummate the Mergers, including preparing and filing as promptly as practicable with any governmental authority or other third party all documentation to effect all necessary filings, notices, petitions, statements, registrations, submissions of information, applications and other documents and obtaining and maintaining all approvals, consents, registrations, permits, authorizations and other confirmations required to be obtained from any governmental authority or other third party that are necessary, proper or advisable to consummate the transactions contemplated by this Agreement. Notwithstanding such obligation, in connection with obtaining any required regulatory approval, (a) FNF is not required to sell, divest, dispose of, license or hold separate (i) title plants and rights to title plants, businesses, product lines or assets to the extent that such title plants, rights to title plants, businesses, product lines or assets generated 2017 revenues in excess of \$225 million in the aggregate, or (ii) any of its own brands in full and (b) FNF and its affiliates are not required to litigate in order to avoid or have terminated any legal restraint that would prevent the Mergers from being consummated.

The Merger Agreement contains certain customary termination rights in favor of either the Company or FNF, which are exercisable (i) by mutual consent, (ii) upon the failure to complete the Mergers by March 18, 2019 (the End Date), subject to certain exceptions and subject to up to two (2) extensions of up to three (3) months each upon the election of either the Company or FNF if, as of such date, all closing conditions (other than the receipt of the Required Antitrust Regulatory Filings/Approvals, the receipt of the Required Insurance Regulatory Filings/Approvals and the absence of any law or court or other governmental order relating thereto) having been met or being capable of being satisfied as of such time, (iii) in the event of a final and non-appealable law or order that prohibits the consummation of the Mergers or (iv) if the Company's stockholders do not vote to approve the Mergers.

The Merger Agreement contains certain customary termination rights in favor of the Company, which are exercisable (i) for a breach of any representation, warranty, covenant or agreement made by FNF under the Merger Agreement that would result in failure to satisfy a closing condition (subject to certain cure periods) or (ii) if, prior to the Company Stockholder Approval being obtained, the Company's board of directors authorizes the Company to enter into, and the Company enters into, an alternative acquisition agreement in connection with a superior proposal. Under the Merger Agreement, the Company will be obligated to pay a termination fee of \$33 million to FNF if the Merger Agreement is terminated due to the Company's board of directors changing its recommendation or if the Company terminates the Merger Agreement to enter into an agreement for a superior proposal.

The Merger Agreement also contains certain customary termination rights in favor of FNF. If the Merger Agreement is terminated due to (i) the failure to complete the Mergers by the End Date because of a failure to obtain the Required Antitrust Regulatory Filings/Approvals or Required Insurance Regulatory Filings/Approvals, and all other closing conditions have been or are capable of being satisfied at the time of such termination, or (ii) an injunction or governmental or other court order enjoining, prohibiting or rendering illegal the consummation of the Mergers that is based on the failure to obtain the Required Antitrust Regulatory Filings/Approvals or Required Insurance Regulatory Filings/Approvals, then FNF will be obligated to pay a reverse termination fee of \$50 million to the Company.

The Merger Agreement was included as Exhibit 2.1 to the Form 8-K filed with the SEC on March 19, 2018.

NOTE 2

Revenues. The Company's operating revenues, summarized by type, are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|---------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| | (\$000 omitted) | | (\$000 omitted) | |
| Title insurance premiums: | | | | |
| Direct | 152,739 | 146,314 | 444,447 | 436,803 |
| Agency | 272,875 | 268,545 | 756,986 | 736,301 |
| Escrow fees | 32,649 | 37,478 | 95,984 | 109,688 |
| Search, abstract and valuation services | 24,105 | 24,201 | 71,006 | 80,401 |
| Other revenues | 16,868 | 21,511 | 50,239 | 54,125 |
| | 499,236 | 498,049 | 1,418,662 | 1,417,318 |

Direct premiums - Premiums from title insurance policies directly issued or issued by affiliate offices are recognized at the time of the closing of the related real estate transaction.

Agency premiums - Premiums from title insurance policies written by independent agencies (agencies) are recognized when the policies are reported to the Company. In addition, where reasonable estimates can be made, the Company accrues for policies issued but not reported until after period end. The Company believes that reasonable estimates can be made when recent and consistent policy issuance information is available. Estimates are based on historical reporting patterns and other information obtained about agencies, as well as current trends in direct operations and in the title industry. In this accrual, future transactions are not being estimated. The Company is estimating revenues on policies that have already been issued by agencies but not yet reported to or received by the Company. The Company has consistently followed the same basic method of estimating unreported policy revenues for more than 10 years.

Escrow fees - An escrow is a transaction pursuant to an agreement of a buyer, seller, borrower, or lender wherein an impartial third party, such as the Company, acts in a fiduciary capacity on behalf of the parties in accordance with the terms of such agreement in order to accomplish the directions stated therein. Services provided include, among others, acting as escrow or other fiduciary agent, obtaining releases, and conducting the actual closing or settlement. Escrow fees are recognized upon closing of the escrow, which is generally at the same time of the closing of the related real estate transaction.

Search, abstract and valuation services - These services are primarily related to establishing the ownership, legal status and valuation of the property in a real estate transaction. In these cases, the Company does not issue a title insurance policy or perform duties of an escrow agent. Revenues from these services are recognized upon delivery of the service to the customer.

Other revenues - Other revenues consist primarily of fees related to tax-deferred property exchange services, information technology products related to real property records and closing settlement services, income from equity investees, and other services performed to facilitate the closing of real estate transactions. For those products and services that are delivered at a point in time, the related revenue is recognized upon delivery based on the unit price of the product or service. For those products and services where delivery occurs over time, the related revenue is recognized ratably over the duration of the contract.

Debt securities as of September 30, 2018 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 | 48,839 | 48,844 |
| After one year through five years | 364,717 | 359,727 |
| After five years through ten years | 182,578 | 177,919 |
| After ten years | 38,899 | 37,932 |
| | 635,033 | 624,422 |

Gross unrealized losses on investments in debt securities 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 September 30, 2018, were:

| | Less than 12 months | | More than 12 months | | Total | |
|---------------------|---------------------|-------------|---------------------|-------------|--------|-------------|
| | Losses | Fair values | Losses | Fair values | Losses | Fair values |
| | (\$000 omitted) | | | | | |
| Municipal | 314 | 33,036 | 341 | 6,808 | 655 | 39,844 |
| Corporate | 6,862 | 266,231 | 693 | 15,359 | 7,555 | 281,590 |
| Foreign | 1,242 | 70,048 | 4,103 | 104,795 | 5,345 | 174,843 |
| U.S. Treasury Bonds | 150 | 4,277 | 327 | 8,088 | 477 | 12,365 |
| | 8,568 | 373,592 | 5,464 | 135,050 | 14,032 | 508,642 |

The number of specific debt investment holdings held in an unrealized loss position as of September 30, 2018 was 334. Of these securities, 83 securities were in unrealized loss positions for more than 12 months. The increased gross unrealized losses on corporate and foreign debt securities were primarily driven by increases in the overall rate environment, while the decline in value of the Canadian dollar against the U.S. dollar also contributed to higher gross unrealized losses on foreign debt securities. 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 as other-than-temporarily impaired. 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.

Gross unrealized losses on investments in debt securities 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, 2017, were:

| | Less than 12 months | | More than 12 months | | Total | |
|---------------------|---------------------|-------------|---------------------|-------------|--------|-------------|
| | Losses | Fair values | Losses | Fair values | Losses | Fair values |
| | (\$000 omitted) | | | | | |
| Municipal | 58 | 17,023 | 117 | 5,784 | 175 | 22,807 |
| Corporate | 386 | 81,632 | 111 | 4,926 | 497 | 86,558 |
| Foreign | 1,528 | 116,130 | 1,727 | 39,031 | 3,255 | 155,161 |
| U.S. Treasury Bonds | 53 | 5,830 | 183 | 6,772 | 236 | 12,602 |
| | 2,025 | 220,615 | 2,138 | 56,513 | 4,163 | 277,128 |

NOTE 4

Fair value measurements. The Fair Value Measurements and Disclosures Topic (Topic 820) of the 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 September 30, 2018, financial instruments measured at fair value on a recurring basis are summarized below:

| | Level 1 | Level 2 | Fair value measurements |
|----------------------------|-----------------|---------|----------------------------|
| | (\$000 omitted) | | |
| Investments in securities: | | | |
| Debt securities: | | | |
| Municipal | — | 61,703 | 61,703 |
| Corporate | — | 340,919 | 340,919 |
| Foreign | — | 209,329 | 209,329 |
| U.S. Treasury Bonds | — | 12,471 | 12,471 |
| Equity securities | 37,667 | — | 37,667 |
| | 37,667 | 624,422 | 662,089 |

As of December 31, 2017, financial instruments measured at fair value on a recurring basis are summarized below:

| | Level 1 | Level 2 | Fair value measurements |
|----------------------------|-----------------|---------|----------------------------|
| | (\$000 omitted) | | |
| Investments in securities: | | | |
| Debt securities: | | | |
| Municipal | — | 72,669 | 72,669 |
| Corporate | — | 357,933 | 357,933 |
| Foreign | — | 228,237 | 228,237 |
| U.S. Treasury Bonds | — | 12,602 | 12,602 |
| Equity securities | 37,914 | — | 37,914 |
| | 37,914 | 671,441 | 709,355 |

As of September 30, 2018, 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. The fair value of the Company's investments in available-for-sale securities are primarily determined using a third-party pricing service provider. The third-party pricing service provider calculates the fair values using both market approach and model valuation methods, as well as pricing information obtained from brokers, dealers and custodians. Management ensures the reasonableness of the third-party service valuations by comparing them with pricing information from the Company's investment manager.

There were no transfers of investments between levels during the nine months ended September 30, 2018 and 2017.

NOTE 5

Investment and other gains (losses) - net. Investments and other gains (losses) are detailed as follows:

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|---------------------------------------|---------|--------------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| | (\$000 omitted) | | | |
| Investment and other gains | 1,597 | 548 | 2,763 | 1,392 |
| Investment and other losses | (151) | (1,595) | (220) | (2,828) |
| Net unrealized investment gains (losses) recognized on equity securities held | 2,177 | — | 1,802 | — |
| | 3,623 | (1,047) | 4,345 | (1,436) |

Investment and other gains for the third quarter and first nine months of 2018 included a net unrealized gain of \$1.2 million that resulted from a fair value change of an equity investment with previously no readily determinable fair value.

Following the adoption of ASU 2016-01, as discussed in Notes 1 and 3, net investment gains recognized during the three and nine months ended September 30, 2018 related to investments in equity securities still held as of September 30, 2018 are calculated as follows (\$000 omitted):

| | September 30, 2018 | |
|--|--------------------|-------------------|
| | Three Months Ended | Nine Months Ended |
| | (\$000 omitted) | |
| Total net investment gains recognized on equity securities during the period | 2,775 | 2,161 |
| Less: Net realized gains on equity securities sold during the period | 598 | 359 |
| Net unrealized investment gains recognized on equity securities still held | 2,177 | 1,802 |

Proceeds from sales of investments in securities are as follows:

| Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---------------------------------------|------|--------------------------------------|------|
| 2018 | 2017 | 2018 | 2017 |
| | | | |

| | (\$000 omitted) | | | |
|---|-----------------|-------|--------|--------|
| Proceeds from sales of debt securities | 6,326 | 1,419 | 27,475 | 50,245 |
| Proceeds from sales of equity securities | 452 | 4,459 | 5,025 | 5,288 |
| Total proceeds from sales of investment in securities | 6,778 | 5,878 | 32,500 | 55,533 |

NOTE 6

Goodwill and other intangibles. The summary of changes in goodwill is as follows.

| | Title | Ancillary Services and Corporate (\$000 omitted) | Consolidated Total |
|--------------------------------|---------|---|-----------------------|
| Balances at December 31, 2017 | 225,699 | 5,729 | 231,428 |
| Acquisitions | 15,804 | — | 15,804 |
| Disposals | (42) | — | (42) |
| Balances at September 30, 2018 | 241,461 | 5,729 | 247,190 |

During 2018, the Company acquired several title businesses which increased goodwill related to the title segment by a total of \$15.8 million, which is substantially deductible for income tax purposes over a period of 15 years. Also, in connection with the acquisitions, the Company identified and recorded \$4.4 million of other intangibles, primarily related to employment and non-compete agreements, to be amortized between 1 year to 3 years from the dates of acquisition.

The Company evaluates goodwill for impairment annually based on information as of June 30 of the current year or more frequently if circumstances suggest that an impairment may exist. The Company performed its annual goodwill impairment analysis during the quarter ended September 30, 2018, utilizing the quantitative assessment method for its direct operations, agency operations, international operations and ancillary services reporting units. Based on the quantitative analysis performed, the Company concluded that the goodwill related to all reporting units was not impaired.

NOTE 7

Estimated title losses. A summary of estimated title losses for the nine months ended September 30 is as follows:

| | 2018 | 2017 |
|--|-----------------|-----------|
| | (\$000 omitted) | |
| Balances at January 1 | 480,990 | 462,572 |
| Provisions: | | |
| Current year | 62,592 | 69,067 |
| Previous policy years | (3,410) | 1,524 |
| Total provisions | 59,182 | 70,591 |
| Payments, net of recoveries: | | |
| Current year | (9,466) | (10,403) |
| Previous policy years | (50,822) | (53,491) |
| Total payments, net of recoveries | (60,288) | (63,894) |
| Effects of changes in foreign currency exchange rates | (3,014) | 6,576 |
| Balances at September 30 | 476,870 | 475,845 |
| Loss ratios as a percentage of title operating revenues: | | |
| Current year provisions | 4.5 | % 5.0 |
| Total provisions | 4.3 | % 5.1 |

During the nine months ended September 30, 2018, the Company decreased its loss provisioning rate due to lower loss experience and also reduced its prior policy year reserves as a result of its semi-annual actuarial reserve review. This primarily resulted in a \$3.4 million net favorable loss development for previous policy years and also decreased the total title loss provisions for the nine months ended September 30, 2018 compared to the same period in 2017.

NOTE 8

Share-based payments. Prior to 2018, the Company granted executives and senior management shares of restricted common stock, consisting of time-based shares, which vest on each of the first three anniversaries of the grant date, and performance-based shares, which vest upon achievement of certain financial objectives over the period of three years. Starting on January 1, 2018, the Company began granting time-based and performance-based restricted stock units, which have vesting conditions generally similar to those restricted common stock shares awarded previously. Each restricted stock unit represents a contractual right to receive a share of the Company's common stock.

The aggregate grant-date fair values of these awards during 2018 and 2017 were \$4.8 million (110,600 shares with an average grant price per share of \$43.39) and \$5.1 million (120,000 shares with an average grant price per share of \$42.55), respectively. Awards were made pursuant to the Company's employee incentive compensation plans and the compensation expense associated with restricted stock awards is recognized over the corresponding vesting period. Additionally, during the second quarters 2018 and 2017, the Company granted its board of directors, as a component of annual director retainer compensation, 14,300 and 13,000 shares, respectively, of common stock, which vested immediately. The aggregate fair values of these director awards at the grant dates in 2018 and 2017 were both \$0.6 million.

NOTE 9

Earnings per share. Basic earnings per share (EPS) attributable to Stewart is calculated by dividing net income attributable to Stewart by the weighted-average number of shares of Common Stock outstanding during the reporting periods. Outstanding shares of Common Stock granted to employees that are not yet vested (restricted shares) are excluded from the calculation of the weighted-average number of shares outstanding for calculating basic EPS. To calculate diluted EPS, the number of shares is adjusted to include the number of additional shares that would have been outstanding if the restricted shares and restricted units were vested. In periods of loss, dilutive shares are excluded from the calculation of the diluted EPS and diluted EPS is computed in the same manner as basic EPS.

The calculation of the basic and diluted EPS is as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------------------|--------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| | (\$000 omitted, except per share) | | | |
| Numerator: | | | | |
| Net income attributable to Stewart | 17,554 | 10,944 | 36,151 | 33,601 |
| Denominator (000): | | | | |
| Basic average shares outstanding | 23,556 | 23,448 | 23,537 | 23,442 |
| Average number of dilutive shares relating to grants of restricted shares and units | 143 | 116 | 140 | 129 |
| Diluted average shares outstanding | 23,699 | 23,564 | 23,677 | 23,571 |
| Basic earnings per share attributable to Stewart | 0.75 | 0.47 | 1.54 | 1.43 |
| Diluted earnings per share attributable to Stewart | 0.74 | 0.46 | 1.53 | 1.43 |

NOTE 10

Contingent liabilities and commitments. In the ordinary course of business, the Company guarantees the third-party indebtedness of certain of its consolidated subsidiaries. As of September 30, 2018, the maximum potential future payments on the guarantees are not more than the related notes payable recorded in the condensed consolidated balance sheets. The Company also guarantees the indebtedness related to lease obligations of certain of its consolidated subsidiaries. The maximum future obligations arising from these lease-related guarantees are not more than the Company's future minimum lease payments. As of September 30, 2018, the Company also had unused letters of credit aggregating \$5.7 million related to workers' compensation and other insurance. The Company does not expect to make any payments on these guarantees.

NOTE 11

Regulatory and legal developments. The Company is subject to claims and lawsuits arising in the ordinary course of its business, most of which involve disputed policy claims. In some of these lawsuits, the plaintiff seeks exemplary or treble damages in excess of policy limits. The Company does not expect that any of these ordinary course proceedings will have a material adverse effect on its consolidated financial condition or results of operations. In addition, along with the other major title insurance companies, the Company is party to class action lawsuits concerning the title insurance industry. The Company believes that it has adequate reserves for the various litigation matters and contingencies discussed in this paragraph and that the likely resolution of these matters will not materially affect its consolidated financial condition or results of operations.

Additionally, the Company receives from time to time various other inquiries from governmental regulators concerning practices in the insurance industry. Many of these practices do not concern title insurance. To the extent the Company is in receipt of such inquiries, it believes that it has adequately reserved for these matters and does not anticipate that the outcome of these inquiries will materially affect its consolidated financial condition or results of operations.

The Company is subject to various other administrative actions and inquiries into its business conduct in certain of the states in which it operates. While the Company cannot predict the outcome of the various regulatory and administrative matters, it believes that it has adequately reserved for these matters and does not anticipate that the outcome of any of these matters will materially affect its consolidated financial condition or results of operations.

NOTE 12

Segment information. The Company reports two operating segments: title and ancillary services and corporate. The title segment provides services needed to transfer title to property in a real estate transaction and includes services such as searching, examining, closing and insuring the condition of the title to the property. In addition, the title segment includes centralized title services, home and personal insurance services and Internal Revenue Code Section 1031 tax-deferred exchanges. The ancillary services and corporate segment includes search and valuation services, which are the principal offerings of ancillary services, and expenses of the parent holding company and certain other enterprise-wide overhead costs, net of centralized administrative services costs allocated to respective operating businesses.

Selected statement of income information related to these segments is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|----------|------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| | (\$000 omitted) | | | |
| Title segment: | | | | |
| Revenues | 493,186 | 488,612 | 1,397,722 | 1,384,857 |
| Depreciation and amortization | 5,362 | 5,534 | 15,929 | 16,081 |
| Income before taxes and noncontrolling interest | 35,999 | 24,610 | 78,860 | 76,354 |
| Ancillary services and corporate segment: | | | | |
| Revenues | 14,454 | 12,957 | 40,017 | 45,204 |
| Depreciation and amortization | 859 | 1,044 | 2,680 | 3,316 |
| Loss before taxes and noncontrolling interest | (11,223) | (6,013) | (26,018) | (18,742) |
| Consolidated Stewart: | | | | |
| Revenues | 507,640 | 501,569 | 1,437,739 | 1,430,061 |
| Depreciation and amortization | 6,221 | 6,578 | 18,609 | 19,397 |
| Income before taxes and noncontrolling interest | 24,776 | 18,597 | 52,842 | 57,612 |

The Company does not provide asset information by reportable operating segment as it does not routinely evaluate the asset position by segment.

Revenues generated in the United States and all international operations are as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------|--|---------|------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| | (\$000 omitted) | | | |
| United States | 473,477 | 464,111 | 1,347,310 | 1,335,129 |
| International | 34,163 | 37,458 | 90,429 | 94,932 |
| | 507,640 | 501,569 | 1,437,739 | 1,430,061 |

NOTE 13

Other comprehensive (loss) income. Changes in the balances of each component of other comprehensive (loss) income and the related tax effects are as follows:

| | Three Months Ended September 30, 2018 | | | Three Months Ended September 30, 2017 | | |
|--|--|-----------------------------|----------------------|--|-----------------------------|----------------------|
| | Before-Tax Amount | Tax Expense (Benefit) | Net-of-Tax Amount | Before-Tax Amount | Tax Expense (Benefit) | Net-of-Tax Amount |
| | (\$000 omitted) | | | | | |
| Net unrealized (losses) gains on investments: | | | | | | |
| Change in net unrealized gains and losses on investments | (2,417) | (507) | (1,910) | 95 | 32 | 63 |
| Less: reclassification adjustment for net gains included in net income | (174) | (37) | (137) | (508) | (177) | (331) |
| | (2,591) | (544) | (2,047) | (413) | (145) | (268) |
| Foreign currency translation adjustments | 1,620 | 480 | 1,140 | 5,817 | 1,676 | 4,141 |
| Other comprehensive (loss) income | (971) | (64) | (907) | 5,404 | 1,531 | 3,873 |
| | | | | | | |
| | Nine Months Ended September 30, 2018 | | | Nine Months Ended September 30, 2017 | | |
| | Before-Tax Amount | Tax Expense (Benefit) | Net-of-Tax Amount | Before-Tax Amount | Tax Expense (Benefit) | Net-of-Tax Amount |
| | (\$000 omitted) | | | | | |
| Net unrealized (losses) gains on investments: | | | | | | |
| Change in net unrealized gains and losses on investments | (15,625) | (3,281) | (12,344) | 4,438 | 1,553 | 2,885 |
| Less: reclassification adjustment for net gains included in net income | (781) | (164) | (617) | (1,218) | (426) | (792) |
| | (16,406) | (3,445) | (12,961) | 3,220 | 1,127 | 2,093 |
| Foreign currency translation adjustments | (5,234) | (744) | (4,490) | 11,831 | 3,161 | 8,670 |
| Other comprehensive (loss) income | (21,640) | (4,189) | (17,451) | 15,051 | 4,288 | 10,763 |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S OVERVIEW

We reported net income attributable to Stewart of \$17.6 million (\$0.74 per diluted share) for the third quarter 2018 compared to net income attributable to Stewart of \$10.9 million (\$0.46 per diluted share) for the third quarter 2017. Pretax income before noncontrolling interests for the third quarter 2018 was \$24.8 million compared to pretax income before noncontrolling interests of \$18.6 million for the third quarter 2017.

On March 18, 2018, Stewart entered into an agreement and plan of merger with Fidelity National Financial, Inc. (FNF), in which the outstanding shares of Stewart will be exchanged for a combination of cash and shares of FNF, and the Company will be merged into a subsidiary of FNF (the Mergers). Since the announcement, we initiated the regulatory approval process, which included the submission of our Hart-Scott-Rodino Act filings to the Federal Trade Commission (FTC) and the Form A filings to the states of Texas and New York, the domiciles of Stewart's two main underwriters. Furthermore, the merger was approved by a majority of our stockholders during a special meeting held on September 5, 2018. We continue to work cooperatively with FNF, the FTC and state regulators in the ongoing review process, responding to data and information requests as they arise. Of note, in August 2018, the Canadian Competition Bureau notified FNF that it had no opposition to the completion of the merger. We expect the Mergers to close by the first or second quarter 2019, subject to the remaining federal and state regulatory approvals and the satisfaction of other customary closing conditions.

Summary results of the title segment are as follows (\$ in millions, except pretax margin):

| | For the Three Months Ended September 30, | | | |
|---------------------------------------|---|-------|-------------|---|
| | 2018 | 2017 | % Change | |
| Total operating revenues | 486.0 | 485.4 | — | % |
| Investment income and other net gains | 7.2 | 3.2 | 122 | % |
| Pretax income | 36.0 | 24.6 | 46 | % |
| Pretax margin | 7.3 | % 5.0 | % | |

Title operating revenues in the third quarter 2018 were comparable to the prior year quarter, as a result of higher commercial and independent agency revenues, which were partially offset by lower non-commercial direct title revenues. Pretax income improved \$11.4 million in the third quarter 2018 compared to the third quarter 2017, primarily as a result of lower overall title operating expenses and higher investment income and other net gains. Included in the segment's results were \$2.2 million of net unrealized gains relating to fair value changes of equity securities investments, which were being recorded to other comprehensive income prior to the adoption of a new accounting standard in 2018.

Included in the non-commercial domestic revenues (as shown under the Results of Operations - Title revenues section) were revenues from purchase transactions, which were roughly flat year-over-year, and centralized title operations (processing primarily refinancing and default title orders), which were down \$5.7 million in the third quarter 2018 compared to the third quarter 2017. Total commercial revenues improved \$7.3 million, or 16%, from the prior year quarter due to our continued focus on delivering quality service and underwriting to our domestic and international commercial customers. Total international title revenues in the third quarter 2018 decreased \$4.2 million, or 12%, compared to the prior year quarter, primarily as a result of lower volumes from our Canada operations.

Both gross and net revenues from independent agency operations in the third quarter 2018 increased 2%, compared to the third quarter 2017, as we maintained our focus on enhancing customer service and technology connectivity. The

independent agency remittance rate in the third quarter 2018 remained comparable to the prior year quarter.

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Summary results of the ancillary services and corporate segment are as follows (\$ in millions):

For the Three Months
Ended September 30,
2018 2017 %
Change

| | | | | |
|----------------|--------|-------|------|---|
| Total revenues | 14.5 | 13.0 | 12 | % |
| Pretax loss | (11.2) | (6.0) | (87) | % |

Third quarter 2018 segment revenues increased \$1.5 million compared to the prior year quarter, primarily due to a \$1.2 million net unrealized gain resulting from a fair value change of an equity investment with previously no readily determinable fair value. The segment's third quarter 2018 pretax results declined compared to the prior year quarter, primarily due to the \$6.8 million of third-party advisory expenses incurred in the third quarter 2018 relating to the FNF merger transaction. Additionally, the segment's results for the third quarter 2018 and 2017 included approximately \$5.8 million and \$6.1 million, respectively, of net expenses attributable to parent company and corporate operations.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of certain assets, liabilities, revenues, expenses and related disclosures surrounding contingencies and commitments.

Actual results can differ from our accounting estimates. While we do not anticipate significant changes in our estimates, there is a risk that such changes could have a material impact on our consolidated financial condition or results of operations for future periods. During the nine months ended September 30, 2018, we made no material changes to our critical accounting estimates as previously disclosed in Management's Discussion and Analysis in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Operations. Our primary business is title insurance and settlement-related services. We close transactions and issue title policies on homes, commercial and other real properties located in all 50 states, the District of Columbia and international markets through policy-issuing offices, agencies and centralized title services centers. Our ancillary services and corporate segment includes our parent holding company expenses and certain enterprise-wide overhead costs, along with our remaining ancillary services operations, principally search and valuation services.

Factors affecting revenues. The principal factors that contribute to changes in operating revenues for our title and ancillary services and corporate segments include:

- mortgage interest rates;
- availability of mortgage loans;
- number and average value of mortgage loan originations;
- ability of potential purchasers to qualify for loans;
- inventory of existing homes available for sale;
- ratio of purchase transactions compared with refinance transactions;
- ratio of closed orders to open orders;
- home prices;
- consumer confidence, including employment trends;
- demand by buyers;
- number of households;
- premium rates;

foreign currency exchange rates;
market share;
ability to attract and retain highly productive sales associates;
independent agency remittance rates;
opening of new offices and acquisitions;
number and value of commercial transactions, which typically yield higher premiums;
government or regulatory initiatives, including tax incentives and the implementation of the new integrated disclosure requirements;

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- acquisitions or divestitures of businesses;
- volume of distressed property transactions; and
- seasonality and/or weather.

Premiums are determined in part by the values of the transactions we handle. To the extent inflation or market conditions cause increases in the prices of homes and other real estate, premium revenues are also increased. Conversely, falling home prices cause premium revenues to decline. As an overall guideline, a 5% change in median home prices results in an approximate 3.7% change in title premiums. Home price changes may override the seasonal nature of the title insurance business. Historically, our first quarter is the least active in terms of title insurance revenues as home buying is generally depressed during winter months. Our second and third quarters are the most active as the summer is the traditional home buying season, and while commercial transaction closings are skewed to the end of the year, individually large commercial transactions can occur any time of year.

RESULTS OF OPERATIONS

Comparisons of our results of operations for the three and nine months ended September 30, 2018 with the three and nine months ended September 30, 2017 are set forth below. Factors contributing to fluctuations in the results of operations are presented in the order of their monetary significance, and we have quantified, when necessary, significant changes. Segment results are included in the discussions and, when relevant, are discussed separately.

Our statements on home sales and loan activity are based on published industry data from sources including Fannie Mae, the National Association of Realtors® (NAR), the Mortgage Bankers Association (MBA) and Freddie Mac. We also use information from our direct operations.

Operating environment. Actual existing home sales in the third quarter 2018 declined approximately 2% from the third quarter 2017. September 2018 existing home sales totaled 420,000, which was down (seasonally-adjusted) 4% from a year ago and 3% from August 2018. According to NAR, the decline in existing home sales, which is the lowest since November 2015, was primarily the result of rising interest rates and lower affordable home listings in the market. September 2018 median and average home prices rose approximately 4% and 2%, respectively, compared to September 2017 prices. September 2018 housing starts declined 5% sequentially from August 2018, but improved 4% from a year ago. Newly issued building permits in September 2018 were down 1% both sequentially from August 2018 and from a year ago. According to Fannie Mae, one-to-four family residential lending declined 10% to \$428 billion in the third quarter 2018 from \$477 billion in the third quarter 2017, primarily driven by a 35%, or \$54 billion, reduction in refinance originations. Purchase lending slightly improved 2%, or \$5 billion, in the third quarter 2018 compared to the prior year quarter. Total lending is forecasted to decrease \$42 billion, or 10%, in the fourth quarter 2018 compared to the third quarter 2018, as purchase lending is expected to decline \$38 billion, or 12%, primarily due to seasonality and the rising interest rates.

Title revenues. Direct title revenue information is presented below:

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|----------------|-------------------------------------|-------|-------------|------------------------------------|-------|-------------|
| | 2018 | 2017 | % Change | 2018 | 2017 | % Change |
| | (\$ in millions) | | | (\$ in millions) | | |
| Non-commercial | | | | | | |
| Domestic | 136.2 | 141.7 | (4)% | 397.7 | 417.8 | (5)% |
| International | 24.9 | 30.4 | (18)% | 65.9 | 75.9 | (13)% |

| | | | | | | |
|-----------------------------|-------|-------|-------|-------|-------|-------|
| | 161.1 | 172.1 | (6)% | 463.6 | 493.7 | (6)% |
| Commercial: | | | | | | |
| Domestic | 45.2 | 39.2 | 15 % | 140.9 | 127.4 | 11 % |
| International | 6.8 | 5.5 | 24 % | 18.4 | 14.8 | 24 % |
| | 52.0 | 44.7 | 16 % | 159.3 | 142.2 | 12 % |
| Total direct title revenues | 213.1 | 216.8 | (2)% | 622.9 | 635.9 | (2)% |

Revenues from direct title operations, which include residential, commercial, international and centralized title services transactions, decreased \$3.7 million in the third quarter 2018 and \$13.0 million in the first nine months of 2018, compared to the same periods in 2017, due to lower closed orders (primarily on refinancing activities), partially offset by improved commercial title revenues. Residential revenues, which comprise approximately 60% of our total direct revenues, were flat in the third quarter 2018 compared to the third quarter 2017, and slightly declined 1% (\$3.5 million) in the first nine months of 2018, compared to the same period in 2017. Revenues from centralized title operations, which primarily process refinancing and default title orders, decreased \$5.7 million, or 54%, in the third quarter 2018 and \$16.6 million, or 46%, in the first nine months of 2018, compared to the respective periods in 2017, primarily due to decreased refinancing orders and lower demand for default services which are in line with industry trends.

Our direct operations include local offices and international operations, and we generate commercial revenues both domestically and internationally. U.S. commercial revenues increased \$7.3 million in the third quarter 2018 and \$17.1 million in the first nine months of 2018, compared to the respective periods in 2017, primarily due to our continued focus on delivering quality underwriting service and technological connectivity to our customers. Total international revenues declined \$4.2 million, or 12%, in the third quarter 2018 and \$6.4 million, or 7%, in the first nine months of 2018, compared to the same periods in 2017, primarily as a result of decreased transaction volume from our Canada operations, partially offset by increased commercial revenues. Direct revenues constituted 44% and 45% of our total title revenues in the third quarter and first nine months of 2018, respectively, compared to 45% and 46%, respectively, in the same periods in 2017.

Orders information for the three and nine months ended September 30 is as follows:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|-----------------------|----------------------------------|---------|----------|----------|---------------------------------|---------|----------|----------|
| | 2018 | 2017 | Change | % Change | 2018 | 2017 | Change | % Change |
| Opened Orders: | | | | | | | | |
| Commercial | 7,497 | 10,685 | (3,188) | (30)% | 24,824 | 32,923 | (8,099) | (25)% |
| Purchase | 58,928 | 59,679 | (751) | (1)% | 181,493 | 188,744 | (7,251) | (4)% |
| Refinance | 20,441 | 27,155 | (6,714) | (25)% | 65,188 | 74,794 | (9,606) | (13)% |
| Other | 1,825 | 4,565 | (2,740) | (60)% | 7,369 | 13,584 | (6,215) | (46)% |
| Total | 88,691 | 102,084 | (13,393) | (13)% | 278,874 | 310,045 | (31,171) | (10)% |
| Closed Orders: | | | | | | | | |
| Commercial | 6,209 | 7,643 | (1,434) | (19)% | 19,697 | 23,136 | (3,439) | (15)% |
| Purchase | 46,041 | 48,432 | (2,391) | (5)% | 131,791 | 140,996 | (9,205) | (7)% |
| Refinance | 13,146 | 17,965 | (4,819) | (27)% | 42,607 | 53,471 | (10,864) | (20)% |
| Other | 1,414 | 2,872 | (1,458) | (51)% | 7,065 | 10,205 | (3,140) | (31)% |
| Total | 66,810 | 76,912 | (10,102) | (13)% | 201,160 | 227,808 | (26,648) | (12)% |

Gross revenues from independent agency operations increased \$4.3 million, or 2%, in the third quarter 2018, compared to the third quarter 2017, primarily as a result of revenue increases in Texas, Florida and New Jersey, partially offset by declines in Washington and Vermont. Gross agency revenues also increased \$20.7 million, or 3%, in the first nine months of 2018, compared to the same period in 2017, primarily as a result of revenue increases in Texas, New York, Pennsylvania, Arizona and Wisconsin, partially offset by decreases in Massachusetts, Michigan, Colorado and Utah. Agency revenues, net of retention, improved 2% (\$0.8 million and \$1.9 million, respectively) in both the third quarter and first nine months of 2018, compared to the same periods in 2017, primarily driven by the higher gross agency revenues accompanied by comparable average agency remittance rates. Refer further to the "Retention by agencies" discussion under Expenses below.

Ancillary services revenues. Ancillary services operating revenues increased \$0.6 million, or 4%, in the third quarter 2018 compared to the prior year quarter as a result of increased revenues from the search services operations, partially offset by lower revenues from the valuation services operations. Revenues decreased \$6.3 million, or 14%, in the first nine months of 2018, compared to the same period in 2017, primarily due to lower orders in both the search and valuation services operations.

Investment income. Investment income during the third quarter and first nine months of 2018 was comparable to the same periods in 2017.

Investment and other gains (losses) - net. Investment and other gains - net for the third quarter and first nine months of 2018 included net unrealized gains of \$2.2 million and \$1.8 million, respectively, related to fair value changes of equity securities investments (refer to Note 5 to the condensed consolidated financial statements for details), and a net unrealized gain of \$1.2 million that resulted from a fair value change of an equity investment with previously no readily determinable fair value. Investments and other losses - net for the third quarter 2017 included net realized losses of \$0.6 million from the sale of investments available-for-sale, while investment and other losses - net for the first nine months of 2017 included a net realized loss of \$0.8 million that resulted from a change in the fair value of a contingent liability related to a prior acquisition.

Expenses. An analysis of expenses is shown below:

| | Three Months Ended | | | Nine Months Ended | | |
|---------------------------------|--------------------|--------|-------------|-------------------|--------|-------------|
| | September 30, | | % Change | September 30, | | % Change |
| | 2018 | 2017 | | 2018 | 2017 | |
| | (\$ in millions) | | | (\$ in millions) | | |
| Amounts retained by agencies | 225.0 | 221.5 | 2 % | 624.0 | 605.2 | 3 % |
| As a % of agency revenues | 82.4 % | 82.5 % | | 82.4 % | 82.2 % | |
| Employee costs | 138.3 | 140.1 | (1) % | 423.4 | 419.2 | 1 % |
| As a % of operating revenues | 27.7 % | 28.1 % | | 29.8 % | 29.6 % | |
| Other operating expenses | 90.8 | 88.5 | 3 % | 257.0 | 255.6 | 1 % |
| As a % of operating revenues | 18.2 % | 17.8 % | | 18.1 % | 18.0 % | |
| Title losses and related claims | 21.5 | 25.4 | (15) % | 59.2 | 70.6 | (16) % |
| As a % of title revenues | 4.4 % | 5.2 % | | 4.3 % | 5.1 % | |

Retention by agencies. Amounts retained by title agencies are based on agreements between agencies and our title underwriters. Amounts retained by independent agencies, as a percentage of revenues generated by them, averaged 82.4% and 82.5% in the third quarters 2018 and 2017, respectively, and 82.4% and 82.2% in the first nine months of 2018 and 2017, respectively. The average retention percentage may vary from period to period due to the geographical mix of agency operations, the volume of title revenues and, in some states, laws or regulations. Due to the variety of such laws or regulations, as well as competitive factors, the average retention rate can differ significantly from state to state. In addition, a high proportion of our independent agencies are in states with retention rates greater than 80%. We continue to focus on increasing profit margins in every state, increasing premium revenue in states where remittance rates are above 20%, and maintaining the quality of our agency network, which we believe to be the industry's best, in order to mitigate claims risk and drive consistent future performance. While market share is important in our agency operations channel, it is not as important as margins, risk mitigation and profitability.

Employee costs. Total employee costs decreased \$1.8 million, or 1%, in the third quarter 2018 compared to the third quarter 2017, primarily due to lower average employee counts, partially offset by higher commissions on increased commercial title revenues and higher incentive compensation. For the first nine months of 2018, employee costs increased \$4.2 million, or 1%, compared to the same period in 2017, primarily due to higher commissions on increased commercial title revenues and additional employee costs attributed to acquisitions in the title segment, which were partially offset by decreased salaries resulting from reduced employee counts. During the third quarter and first nine months of 2018, average employee counts have decreased approximately 8% and 6%, respectively, compared to the same periods in 2017, primarily resulting from continued volume declines in our title and ancillary services operations.

Title segment employee costs in the third quarter 2018 were comparable to the third quarter 2017, while employee costs for the first nine months of 2018 increased \$10.5 million, or 3%, compared to the first nine months of 2017, primarily due to increased commissions and additional costs from previous acquisitions. In the ancillary services and corporate segment, employee costs decreased \$0.9 million, or 12%, and \$6.3 million, or 22%, in the third quarter and first nine months of 2018, compared to the same periods in 2017, primarily as a result of the reductions in average employee count.

Other operating expenses. Other operating expenses include costs that are fixed in nature, costs that follow, to varying degrees, changes in transaction volumes and revenues and costs that fluctuate independently of revenues. Costs that are fixed in nature include attorney and professional fees, third-party outsourcing provider fees, equipment rental, insurance, rent and other occupancy expenses, repairs and maintenance, technology costs, telephone and title plant expenses. Costs that follow, to varying degrees, changes in transaction volumes and revenues include attorney fee splits, bad debt expenses, ancillary services cost of sales expenses, copy supplies, delivery fees, outside search fees, postage, premium taxes and title plant maintenance expenses. Costs that fluctuate independently of revenues include general supplies, litigation defense, business promotion and marketing and travel.

Consolidated other operating expenses increased \$2.3 million, or 3%, and \$1.4 million, or 1%, in the third quarter and first nine months of 2018 compared to the same periods in 2017; while as a percentage of total operating revenues, other operating expenses were 18.2% and 17.8% in the third quarters 2018 and 2017, respectively, and 18.1% and 18.0% in the first nine months of 2018 and 2017, respectively. During the third quarter and first nine months of 2018, we incurred \$6.8 million and \$9.7 million, respectively, of third-party advisory expenses recorded in the ancillary services and corporate segment related to the strategic alternatives review and FNF merger transaction. During the third quarter 2017, we also incurred \$1.4 million of acquisition integration costs in the title segment. Excluding these non-operating charges, other operating expenses as a percentage of operating revenues during the third quarter and first nine months of 2018 were 16.8% and 17.4%, respectively, compared to 17.5% and 17.9% for the third quarter and first nine months of 2017, respectively.

Costs that follow, to varying degrees, changes in transaction volumes and revenues decreased \$1.7 million, or 4%, and \$6.5 million, or 6%, in the third quarter and first nine months of 2018, compared to the same periods in 2017, primarily due to reduced outside title search fees, attorney fee splits and costs of services related to lower revenues from our centralized title, ancillary services and Canada title operations. Costs that fluctuate independently of revenues decreased \$0.6 million, or 5%, in the third quarter 2018 compared to the prior year quarter; while they increased \$1.7 million, or 6%, in the first nine months of 2018, compared to the same period in 2017, primarily due to increased travel and marketing expenses. Excluding the non-operating charges mentioned above, costs that are fixed in nature decreased \$1.1 million, or 3%, and \$1.9 million, or 2%, in the third quarter and first nine months of 2018, compared to the same periods in 2017, primarily due to reduced third-party outsourcing provider fees and professional fees.

Title losses. Provisions for title losses, as a percentage of title operating revenues, were 4.4% and 5.2% for the third quarters 2018 and 2017, respectively, and 4.3% and 5.1% for the first nine months of 2018 and 2017, respectively. Title losses decreased \$3.9 million, or 15%, and \$11.4 million, or 16%, in the third quarter and first nine months of 2018, respectively, compared to the similar periods in 2017, primarily because we reduced our loss provisioning rate in 2018 as a result of better claims experience. The title loss ratio in any given quarter can be significantly influenced by changes in new large claims incurred, escrow losses and adjustments to reserves for existing large claims. We expect our loss provisioning rate will range between 4.0% to 4.5% for the year 2018.

Cash claim payments increased \$3.2 million, or 17%, in the third quarter 2018 compared to the third quarter 2017, primarily due to higher payments on existing non-large claims; while payments decreased \$3.6 million, or 6%, in the first nine months of 2018 compared to the same period in 2017, primarily due to higher payments on large claims in 2017. We continue to manage and resolve large claims prudently and in keeping with our commitments to our

policyholders.

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The composition of title policy loss expense is as follows:

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---------------------------------------|--|--------|---|--------|
| | 2018 | 2017 | 2018 | 2017 |
| | (\$ in millions) | | (\$ in millions) | |
| Provisions – known claims: | | | | |
| Current year | 3.8 | 3.9 | 11.3 | 8.1 |
| Prior policy years | 15.1 | 13.6 | 45.3 | 48.3 |
| | 18.9 | 17.5 | 56.6 | 56.4 |
| Provisions – IBNR | | | | |
| Current year | 17.4 | 21.3 | 51.3 | 61.0 |
| Prior policy years | 0.3 | 0.2 | (3.4) | 1.5 |
| | 17.7 | 21.5 | 47.9 | 62.5 |
| Transferred from IBNR to known claims | (15.1) | (13.6) | (45.3) | (48.3) |
| Total provisions | 21.5 | 25.4 | 59.2 | 70.6 |

Provisions for known claims arise primarily from prior policy years as claims are not typically reported until several years after policies are issued. Provisions - Incurred But Not Reported (IBNR) are estimates of claims expected to be incurred over the next 20 years; therefore, it is not unusual or unexpected to experience changes to those estimated provisions in both current and prior policy years as additional loss experience on policy years is obtained. This loss experience may result in changes to our estimate of total ultimate losses expected (i.e., the IBNR policy loss reserve). Current year provisions - IBNR are recorded on policies issued in the current year as a percentage of premiums earned (provisioning rate). As claims become known, provisions are reclassified from IBNR to known claims. Adjustments relating to large losses (those individually in excess of \$1.0 million) may impact provisions either for known claims or for IBNR.

Known claims provisions increased \$1.4 million, or 8%, in the third quarter 2018 compared to the third quarter 2017, while known claims provisions were comparable in the first nine months of 2018 and 2017. Total provisions - IBNR decreased \$3.8 million, or 18%, and \$14.6 million, or 23%, in the third quarter and first nine months of 2018, compared to the same periods in 2017, primarily as a result of the \$4.0 million prior policy year reserve reduction recorded in the second quarter 2018, as well as a decrease in the provisioning rate related to the current year. As a percentage of title operating revenues, provisions - IBNR for the current policy year were 3.6% and 3.7% in the third quarter and first nine months of 2018 compared to 4.4% in both the third quarter and the first nine months of 2017.

In addition to title policy claims, we incur losses in our direct operations from escrow, closing and disbursement functions. These escrow losses typically relate to errors or other miscalculations of amounts to be paid at closing, including timing or amount of a mortgage payoff, payment of property or other taxes and payment of homeowners' association fees. Escrow losses also arise in cases of fraud, and in those cases, the title insurer incurs the loss under its obligation to ensure that an unencumbered title is conveyed. Escrow losses are recognized as expense when discovered or when contingencies associated with them (such as litigation) are resolved and are typically paid less than 12 months after the loss is recognized. During the third quarter and first nine months of 2018, we recorded approximately \$0.3 million and \$4.7 million, respectively, of policy loss reserves relating to escrow losses arising from fraud, as compared to \$1.5 million and \$3.6 million during the third quarter and first nine months of 2017, respectively.

Total title policy loss reserve balances are as follows:

December 31,

September 30,

2017

2018

(\$ in millions)

| | | |
|------------------------------|-------|-------|
| Known claims | 66.1 | 69.8 |
| IBNR | 410.8 | 411.2 |
| Total estimated title losses | 476.9 | 481.0 |

The amount of the reserve represents the aggregate, non-discounted future payments (net of recoveries) that we expect to incur on policy and escrow losses and in costs to settle claims. Title claims are generally incurred three to five years after policy issuance and the timing of payments on these claims can significantly impact the balance of known claims. In many cases, claims may be open for several years before the resolution and payment of the claims occur; as a result, the estimate of the ultimate amount to be paid may be modified over that time period. Due to the inherent uncertainty in predicting future title policy losses, significant judgment is required by both our management and our third party actuaries in estimating reserves. As a consequence, our ultimate liability may be materially greater or less than current reserves and/or our third party actuary's calculated estimates.

Depreciation and amortization. Depreciation and amortization expenses during the third quarter and first nine months of 2018 were comparable to the same periods in 2017.

Income taxes. Our effective tax rates, based on income before taxes and after deducting income attributable to noncontrolling interests, were 20% and 19% in the third quarter and first nine months of 2018, respectively. Our tax provision included effects of discrete income tax net benefits of approximately \$1.5 million and \$3.0 million in the third quarter and first nine months of 2018, respectively. The third quarter 2018 discrete income tax net benefits were primarily related to previously unrecognized research and development tax credits and other return-to-provision adjustments, including an adjustment to the one-time transition tax on deemed repatriated earnings of foreign subsidiaries, for the 2017 Federal consolidated tax return filed during the quarter. Additionally, discrete income tax benefits in the first nine months of 2018 included the tax effect of a cumulative foreign currency adjustment on deemed repatriation of branch foreign earnings. Excluding the discrete income tax effects, our effective tax rates were 27% and 26% in the third quarter and first nine months of 2018, respectively.

Our effective tax rates in the third quarter and first nine months of 2017 were 30% and 32%, respectively, which included discrete income tax net benefit effects of \$0.7 million and \$2.1 million, respectively, principally related to previously unrecognized research and development tax credits. Excluding the discrete income tax effects, our effective tax rates were 34% and 36% in the third quarter and first nine months of 2017, respectively. The lower effective tax rates in 2018, compared to 2017, were primarily the result of the reduced corporate tax rate of the Tax Cuts and Jobs Act enacted in December 2017.

LIQUIDITY AND CAPITAL RESOURCES

Our liquidity and capital resources reflect our ability to generate cash flow to meet our obligations to shareholders, customers (payments to satisfy claims on title policies), vendors, employees, lenders and others. As of September 30, 2018, our cash and investments, including amounts reserved pursuant to statutory requirements, aggregated \$835.7 million (\$339.2 million, net of statutory reserves on cash and investments). Of our total cash and investments at September 30, 2018, \$564.3 million (\$272.1 million, net of statutory reserves) was held in the United States (U.S.) and the rest internationally, principally in Canada.

Cash held at the parent company totaled \$0.4 million at September 30, 2018. As a holding company, the parent company is funded principally by cash from its subsidiaries in the form of dividends, operating and other administrative expense reimbursements and pursuant to intercompany tax sharing agreements. The expense reimbursements are paid in accordance with management agreements, approved by the Texas Department of Insurance (TDI), among us and our subsidiaries. In addition to funding operating expenses, cash held at the parent company is used for dividend payments to common stockholders and for stock repurchases, if any. To the extent such uses exceed cash available, the parent company is dependent on distributions from its regulated title insurance underwriter, Stewart Title Guaranty Company (Guaranty).

A substantial majority of our consolidated cash and investments as of September 30, 2018 was held by Guaranty and its subsidiaries. The use and investment of these funds, dividends to the parent company, and cash transfers between Guaranty and its subsidiaries and the parent company are subject to certain legal and regulatory restrictions. In general, Guaranty may use its cash and investments in excess of its legally-mandated statutory premium reserve (established in accordance with requirements under Texas law) to fund its insurance operations, including claims payments. Guaranty may also, subject to certain limitations, provide funds to its subsidiaries (whose operations consist principally of field title offices and ancillary services operations) for their operating and debt service needs.

We maintain investments in accordance with certain statutory requirements in the states of domicile of our underwriters for the funding of statutory premium reserves. Statutory premium reserves, which approximated \$468.8 million and \$490.8 million at September 30, 2018 and December 31, 2017, 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 \$27.7 million and \$14.2 million at September 30, 2018 and December 31, 2017, 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. As of September 30, 2018, our known claims reserve totaled \$66.1 million and our estimate of claims that may be reported in the future, under generally accepted accounting principles, totaled \$410.8 million. In addition to this, we had cash and investments (excluding equity method investments) of \$294.8 million which are available for underwriter operations, including claims payments.

The ability of Guaranty to pay dividends to its parent is governed by Texas insurance law. The TDI must be notified of any dividend declared, and any dividend in excess of the statutory maximum of 20% of surplus (approximately \$102.0 million as of December 31, 2017) would be, by regulation, considered extraordinary and subject to pre-approval by the TDI. Also, the Texas Insurance Commissioner may raise an objection to a planned distribution during the notification period. Guaranty's actual ability or intent to pay dividends to its parent may be constrained by business and regulatory considerations, such as the impact of dividends on surplus and the liquidity ratio, which could affect its ratings and competitive position, the amount of insurance it can write and its ability to pay future dividends. As of June 30, 2018, our liquidity ratio for our principal underwriter was 110% based on its statutory balance sheet. The liquidity ratio is calculated using Guaranty's total cash and investments divided over its total liabilities. Our internal objective is to maintain a ratio of at least 100%, as we believe that ratio is crucial to our competitiveness in the market and our insurer financial strength ratings. On an ongoing basis, this ratio will largely guide our decisions as to frequency and magnitude of dividends from Guaranty to the parent company. Further, depending on business and regulatory conditions, we may in the future need to retain cash in Guaranty or even raise cash in the capital markets to contribute to it in order to maintain its ratings or statutory capital position. Such a requirement could be the result of investment losses, reserve charges, adverse economic environment operating conditions or changes in interpretation of statutory accounting requirements by regulators. No dividend was paid by Guaranty to its parent during the first nine months of 2018 and 2017.

As the parent company conducts no operations apart from its wholly-owned subsidiaries, the discussion below focuses on consolidated cash flows.

| | For the Nine Months Ended September 30, 2018 2017 (\$ in millions) | |
|---|---|--------|
| Net cash provided by operating activities | 43.7 | 48.0 |
| Net cash used by investing activities | (4.1) | (65.6) |
| Net cash used by financing activities | (38.8) | (2.6) |

Operating activities. Our principal sources of cash from operations are premiums on title policies and revenue from title service-related transactions, ancillary services and other operations. Our independent agencies remit cash to us net of their contractual retention. Our principal cash expenditures for operations are employee costs, operating costs and

title claims payments.

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Cash provided by operations decreased \$4.3 million in the first nine months of 2018, compared to the same period in 2017, primarily due to lower net operating revenues (net of agency retention) and higher employee costs and other operating expenses. Although our business is labor intensive, we are focused on a cost-effective, scalable business model which includes utilization of technology, centralized back and middle office functions and business process outsourcing. Our approach allows us to adjust more easily to seasonal and cyclical fluctuations in transaction volumes. We are continuing our emphasis on cost management, specifically focusing on lowering unit costs of production, which will result in improved margins. Our plans to improve margins also include additional automation of manual processes, and further consolidation of our various systems and production operations. We are currently investing in the technology necessary to accomplish these goals.

Investing activities. Cash used by investing activities was primarily driven by purchases of investments, capital expenditures and acquisition of subsidiaries, offset by proceeds from matured and sold investments. For the first nine months of 2018 and 2017, total proceeds from securities investments sold and matured were \$57.8 million and \$89.4 million, respectively; while cash used for purchases of securities investments was \$35.7 million and \$125.4 million, respectively. The higher purchases and sale of investments in 2017, compared to 2018, was primarily due to a reallocation of cash to investments in the portfolio held by our Canadian operations, as well as overall portfolio repositioning in the first half of 2017 to prepare for a higher rate environment.

During the first nine months of 2018 and 2017, we used \$17.6 million and \$17.8 million, respectively, of cash for acquisitions of new subsidiaries; while cash used for purchases of property and equipment were \$8.5 million and \$12.4 million, respectively. We maintain investment in capital expenditures at a level that enables us to implement technologies for increasing our operational and back-office efficiencies and to pursue growth in key markets.

Financing activities and capital resources. Total debt and stockholders' equity were \$106.4 million and \$676.7 million, respectively, as of September 30, 2018. Notes payable payments during the first nine months of 2018 and 2017 of \$13.9 million and \$16.0 million, respectively, were related to short-term loan agreements in connection with our Section 1031 tax-deferred property exchange (Section 1031) business. During the first nine months of 2017, we borrowed \$16.0 million from our line of credit facility and added \$32.0 million of notes payable related to our Section 1031 business. At September 30, 2018, the outstanding balance of the line of credit facility was \$98.9 million, while the remaining balance of the line of credit available for use was \$23.6 million, net of an unused \$2.5 million letter of credit. At September 30, 2018, our debt-to-equity ratio, excluding our Section 1031 notes, was approximately 15.7%, below the 20% we have set as our unofficial internal limit on leverage.

During both the first nine months of 2018 and 2017, we paid total dividends of \$0.90 per common share, which aggregated to \$21.2 million and \$21.1 million, respectively. There were no stock repurchases during the first nine months of 2018 and 2017, except for repurchases during 2018 of approximately 16,900 shares (aggregate purchase price of approximately \$0.7 million) related to the statutory income tax withholding on the vesting of restricted share grants to executives and senior management.

Effect of changes in foreign currency exchange rates. The effect of changes in foreign currency exchange rates on our cash and cash equivalents on the consolidated statements of cash flows was a net decrease of \$1.2 million during the first nine months of 2018 and a net increase of \$3.1 million during the same period in 2017. Our principal foreign operating unit is in Canada, and, on average, the value of the Canadian dollar declined relative to the U.S. dollar during the first nine months of 2018, compared to its appreciation during the same period in 2017.

We believe we have sufficient liquidity and capital resources to meet the cash needs of our ongoing operations. However, we may determine that additional debt or equity funding is warranted to provide liquidity for achievement of strategic goals or acquisitions or for unforeseen circumstances. Other than scheduled maturities of debt, operating

lease payments and anticipated claims payments, we have no material contractual commitments. We expect that cash flows from operations and cash available from our underwriters, subject to regulatory restrictions, will be sufficient to fund our operations, including claims payments. However, to the extent that these funds are not sufficient, we may be required to borrow funds on terms less favorable than we currently have or seek funding from the equity market, which may not be successful or may be on terms that are dilutive to existing stockholders.

Contingent liabilities and commitments. See discussion of contingent liabilities and commitments in Note 10 to the condensed consolidated financial statements included in Item 1 of Part I of this Report.

Other comprehensive (loss) income. Unrealized gains and losses on available-for-sale securities investments and changes in foreign currency exchange rates are reported net of deferred taxes in accumulated other comprehensive (loss) income, a component of stockholders' equity, until realized. For the first nine months of 2018, net unrealized investment losses of \$13.0 million, net of taxes, which increased our other comprehensive loss, were primarily related to temporary decreases in the fair values over costs of our corporate bond securities available-for-sale investments, driven by increases in the overall rate environment. During the first nine months of 2018, the five-year U.S. treasury yield increased approximately 70 basis points and our net unrealized investment losses were consistent with this level of interest rate increase and our average bond investments duration of slightly more than 4 years. For the first nine months of 2017, net unrealized investment gains of \$2.1 million, net of taxes, which increased our other comprehensive income, were primarily related to temporary increases in the fair values over costs of our corporate and municipal bond securities available-for-sale investments as a result of the slight decline in interest rates during the first nine months of 2017.

Changes in foreign currency exchange rates, primarily related to our Canadian operations, increased our other comprehensive loss, net of taxes, by \$4.5 million for the first nine months of 2018; while they increased our other comprehensive income, net of taxes, by \$8.7 million for the same period in 2017.

Off-balance sheet arrangements. We do not have any material source of liquidity or financing that involves off-balance sheet arrangements, other than our contractual obligations under operating leases. We also routinely hold funds in segregated escrow accounts pending the closing of real estate transactions and have qualified intermediaries in tax-deferred property exchanges for customers pursuant to Section 1031 of the Internal Revenue Code. The Company holds the proceeds from these transactions until a qualifying exchange can occur. In accordance with industry practice, these segregated accounts are not included on the balance sheet. See Note 17 in our Annual Report on Form 10-K for the year ended December 31, 2017.

Forward-looking statements. Certain statements in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to future, not past, events and often address our expected future business and financial performance. These statements often contain words such as "expect," "anticipate," "intend," "plan," "believe," "seek," "will," "foresee" or other similar words. Forward-looking statements by their nature are subject to various risks and uncertainties that could cause our actual results to be materially different than those expressed in the forward-looking statements. These risks and uncertainties include, among other things, the challenging economic conditions; adverse changes in the level of real estate activity; changes in mortgage interest rates, existing and new home sales, and availability of mortgage financing; our ability to respond to and implement technology changes, including the completion of the implementation of our enterprise systems; the impact of unanticipated title losses or the need to strengthen our policy loss reserves; any effect of title losses on our cash flows and financial condition; the ability to attract and retain highly productive sales associates; the impact of vetting our agency operations for quality and profitability; independent agency remittance rates; changes to the participants in the secondary mortgage market and the rate of refinancing that affects the demand for title insurance products; regulatory non-compliance, fraud or defalcations by our title insurance agencies or employees; our ability to timely and cost-effectively respond to significant industry changes and introduce new products and services; the outcome of pending litigation; the impact of changes in governmental and insurance regulations, including any future reductions in the pricing of title insurance products and services; our dependence on our operating subsidiaries as a source of cash flow; the continued realization of expense savings from our cost management program; our ability to successfully integrate acquired businesses; our ability to access the equity and debt financing markets when and if needed; our ability to grow our international operations; seasonality and weather; and our ability to respond to the actions of our competitors. These risks and uncertainties, as well as others, are discussed in more detail in our documents filed with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2017, and if applicable, our Quarterly Reports on Form 10-Q, and our Current Reports on Form 8-K. All forward-looking statements included in this report are expressly qualified in their entirety by such cautionary statements. We expressly disclaim any obligation to update, amend or clarify any forward-looking

statements contained in this report to reflect events or circumstances that may arise after the date hereof, except as may be required by applicable law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes during the quarter ended September 30, 2018 in our investment strategies, types of financial instruments held or the risks associated with such instruments that would materially alter the market risk disclosures made in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. Our principal executive officer and principal financial officer are responsible for establishing and maintaining disclosure controls and procedures. They evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of September 30, 2018, and have concluded that, as of such date, our disclosure controls and procedures are adequate and effective to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting during the quarter ended September 30, 2018, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

See discussion of legal proceedings in Note 11 to the condensed consolidated financial statements included in Item 1 of Part I of this Report, which is incorporated by reference into this Part II, Item 1, as well as Item 3. Legal Proceedings, in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 1A. Risk Factors

There are no other changes during the nine months ended September 30, 2018 to our risk factors as listed in our Annual Report on Form 10-K for the year ended December 31, 2017, except for the risk factors described below relating to Stewart's merger with Fidelity National Financial (FNF) (the Mergers) as announced during the first quarter 2018.

The Mergers may present certain risks to Stewart's business and operations prior to the closing of the Mergers, including, among other things, risks that:

FNF's stock price may be negatively impacted by risks and conditions that apply to FNF, which are different from the risks and conditions applicable to Stewart.

Upon completion of the Mergers, our stockholders who elect to receive the Stock Election Consideration or Mixed Election Consideration will become holders of FNF Common Stock. The businesses and markets of FNF and the other companies it has acquired and may acquire in the future are different from those of Stewart. There is a risk that various factors, conditions and developments that would not affect the price of our Common Stock could negatively affect the price of FNF Common Stock.

The Mergers are subject to the receipt of consents and clearances from regulatory authorities that may impose conditions that could have an adverse effect on Stewart or that could delay or, if not obtained, could prevent completion of the Mergers.

The Mergers are subject to approvals or non-disapprovals from or notices to state insurance regulators, state financial institution regulators, state real estate regulators and various other federal and state regulatory authorities, as well as insurance authorities in Canada, Mexico and the United Kingdom. Additionally, the Mergers are subject to review by the FTC and the Antitrust Division of the DOJ under the HSR Act, and the Canada Competition Bureau under the Canadian Competition Act. Before the Mergers may be completed, applicable waiting periods must expire or terminate under antitrust laws and various approvals, consents or clearances may be required to be obtained from regulatory entities. In deciding whether to grant antitrust or other regulatory clearances, the relevant governmental entities will consider the effect of the Mergers on competition within their relevant jurisdictions. The terms and conditions of the approvals that are granted may impose requirements, limitations or costs or place restrictions on the conduct of FNF's business following the Mergers. There can be no assurance that regulators will not impose conditions, terms, obligations or restrictions and that such conditions, terms, obligations or restrictions will not have the effect of delaying completion of the Mergers or imposing additional material costs on or materially limiting the revenues of FNF following the Mergers. In addition, neither FNF nor Stewart can provide assurance that any such conditions, terms, obligations or restrictions will not result in the delay or abandonment of the Mergers.

Our stockholders may not receive all consideration in the form they elect, and the form of consideration that they receive may have a lower value or less favorable tax consequences than the form of consideration that they elect to receive.

Our stockholders that make an election for either the Cash Election Consideration or the Stock Election Consideration will be subject to proration if holders of our Common Stock, in the aggregate, elect to receive more or less than the aggregate amount of cash consideration to be paid in the Mergers. Accordingly, some of the consideration our stockholders receive in the Mergers may differ from the type of consideration they select and such difference may be significant. This may result in, among other things, tax consequences that differ from those that would have resulted if our stockholders had received solely the form of consideration that they elected. The relative proportion of stock and cash that one of our stockholders receives may also have a value that is higher or lower than the relative proportion of stock and cash that such stockholder elected to receive.

We may have difficulty attracting, motivating and retaining executives and other employees in light of the Mergers.

Uncertainty about the effect of the Mergers on our employees may have an adverse effect on us. This uncertainty may impair our ability to attract, retain and motivate personnel until the Mergers are completed. We are dependent on the experience and industry knowledge of our officers and other key employees to execute our business plans. The combined company's success after the Mergers will depend in part upon its ability to retain key management personnel and other key employees of FNF and Stewart. Employee retention may be particularly challenging during the pendency of the Mergers, as employees may feel uncertain about their future roles with the combined company. In addition, we may have to provide additional compensation in order to retain employees. If employees of FNF and Stewart depart because of issues relating to the uncertainty and difficulty of integration or a desire not to become employees of the combined company, the combined company's ability to realize the anticipated benefits of the Mergers could be reduced.

We will incur substantial transaction-related costs in connection with the Mergers.

We expect to incur a number of non-recurring transaction-related costs associated with completing the Mergers, combining the operations of the two companies and achieving desired synergies. These fees and costs will be substantial. Non-recurring transaction costs include, but are not limited to, fees paid to legal, financial and accounting advisors, filing fees and printing costs. Additional unanticipated costs may be incurred in the integration of the businesses of FNF and Stewart. There can be no assurance that the elimination of certain duplicative costs, as well as the realization of other efficiencies related to the integration of the two businesses, will offset the incremental transaction-related costs over time. Thus, any net benefit may not be achieved in the near term, the long term or at all.

The Mergers are subject to conditions, including certain conditions that may not be satisfied, and may not be completed on a timely basis, or at all. Failure to complete the Mergers could have material and adverse effects on us.

The completion of the Mergers is subject to a number of conditions which make the completion and timing of the completion of the Mergers uncertain. Also, either we or FNF may terminate the Merger Agreement if the Mergers have not been completed by March 18, 2019 (or the extended end date, if applicable), unless the failure of the Mergers to be completed by such date has resulted from the failure of the party seeking to terminate the Merger Agreement to perform its obligations.

If the Mergers are not completed on a timely basis, or at all, our ongoing businesses may be adversely affected and, without realizing any of the benefits of having completed the Mergers, we will be subject to a number of risks, including the following:

- we may be required, under certain circumstances, to pay FNF a termination fee of \$33 million if the Merger Agreement is terminated under qualifying circumstances, as described in the Merger Agreement;
- we will be required to pay certain costs relating to the Mergers, whether or not the Mergers are completed, such as legal, accounting, financial advisor and printing fees;
- under the Merger Agreement, we are subject to certain restrictions on the conduct of our business prior to completing the Mergers which may adversely affect our ability to execute certain of our business strategies;
- time and resources committed by our management to matters relating to the Mergers could otherwise have been devoted to pursuing other beneficial opportunities;
- the market price of our Common Stock could decline below current market prices to the extent that such current market prices reflect a market assumption that the Mergers will be completed; and
- if the Merger Agreement is terminated and our board seeks another business combination, our stockholders cannot be certain that we will be able to find a party willing to enter into a business combination or other strategic transaction on terms equivalent to or more attractive than the terms that FNF has agreed to in the Merger Agreement.

In addition, if the Mergers are not completed, we may experience negative reactions from the financial markets and from our customers and employees. We could also be subject to litigation related to any failure to complete the Mergers or to enforcement proceedings commenced against us to perform our obligations under the Merger Agreement. If the Mergers are not completed, we cannot assure our stockholders that the risks described above will not materialize and will not adversely affect the business, financial results and stock prices of Stewart.

The Merger Agreement contains provisions that limit our ability to pursue alternatives to the Mergers, could discourage a potential competing acquirer from making a favorable alternative transaction proposal and, in specified circumstances, could require us to pay a termination fee of \$33 million to FNF.

Under the Merger Agreement, we are restricted from entering into an alternative transaction. Unless and until the Merger Agreement is terminated, subject to specified exceptions, we are restricted from soliciting, initiating, knowingly facilitating, knowingly encouraging or knowingly inducing or negotiating, any inquiry, proposal or offer for a competing acquisition proposal with any person. Additionally, under the Merger Agreement, in the event of a potential change by our board of its recommendation with respect to the Mergers in light of a superior proposal, we must provide FNF with four business days' notice to allow FNF to propose an adjustment to the terms and conditions of the Merger Agreement. We may terminate the Merger Agreement and enter into an agreement with respect to a superior proposal only if specified conditions have been satisfied, including compliance with the no solicitation and termination provisions of the Merger Agreement. These provisions could discourage a third party that may have an interest in acquiring all or a significant part of Stewart from considering or proposing that acquisition, even if such third party were prepared to pay consideration with a higher per share cash or market value than the market value proposed to be received or realized in the Mergers, or might result in a potential competing acquirer proposing to pay a lower price than it would otherwise have proposed to pay because of the added expense of the termination fee that may become payable in specified circumstances.

Under the Merger Agreement, we may be required to pay to FNF a termination fee of \$33 million if the Merger Agreement is terminated under specified circumstances. If such a termination fee is payable, the payment of this fee could have material and adverse consequences to our financial condition and operations.

We are subject to business uncertainties and contractual restrictions while the Mergers are pending, which could adversely affect our business and operations.

Under the terms of the Merger Agreement, we are subject to certain restrictions on the conduct of our business prior to completing the Mergers, which may adversely affect our ability to execute certain of our business strategies, including the ability in certain cases to enter into contracts or incur capital expenditures to grow our business. Such limitations could negatively affect our businesses and operations prior to the completion of the Mergers. Furthermore, the process of planning to integrate two businesses and organizations for the post-merger period can divert management attention and company resources and could ultimately have an adverse effect on us.

In connection with the pending Mergers, it is possible that some customers, suppliers and other persons with whom we have a business relationship may delay or defer certain business decisions or might decide to seek to terminate, change or renegotiate their relationships with us as a result of the proposed Mergers, which could negatively affect our revenues, earnings and cash flows, as well as the market price of shares of our Common Stock, regardless of whether the Mergers are completed.

Because the exchange ratio is fixed and because the market price of FNF Common Stock and our Common Stock will fluctuate, our stockholders receiving FNF Common Stock as part of the merger consideration cannot be sure of the market value of such merger consideration relative to the value of their shares of our Common Stock that they are exchanging.

If the Mergers are completed, each share of our Common Stock will be converted into the right to receive either \$50.00 in cash, 1.2850 shares of FNF Common Stock or \$25.00 in cash and 0.6425 shares of FNF Common Stock (subject to the adjustment and proration procedures set forth in the Merger Agreement). During the pendency of the Mergers, the market value of FNF Common Stock will fluctuate, and decreases in the market value of FNF Common Stock will negatively affect the value of the merger consideration that our stockholders receive. The market value of our Common Stock will also fluctuate during the pendency of the Mergers, and increases in the market value of our Common Stock may mean that the merger consideration issued to our stockholders will be worth less than the market value of the shares of our Common Stock such stockholders are exchanging. The exchange ratio was fixed at the time the Merger Agreement was executed, and the value of FNF and Stewart stock may vary significantly from their values on the date of the Merger Agreement, the date of this report, the date on which our stockholders make their election and the date on which our stockholders receive the merger consideration. Neither Stewart nor FNF is permitted to terminate the Merger Agreement solely due to changes in the market price of either party's common stock.

There will be a time lapse between the date on which our stockholders make an election with respect to the form of merger consideration to be received by them in exchange for their Common Stock and the date on which our stockholders actually receive FNF Common Stock, depending on their election and subject to proration. Fluctuations in the market value of FNF stock during this time period will also affect the value of the merger consideration, once it is actually received.

If any of our stockholders makes a stock election or mixed election and the market value of FNF Common Stock falls between the time of the election and the time the merger consideration is actually received, the value of the merger consideration received may be less than the value of the merger consideration such stockholder would have received under a cash election. Conversely, if any of our stockholders makes a cash election and the market value of FNF Common Stock rises between the time of the election and the time the merger consideration is actually received, the value of the merger consideration received may be less than the value of the merger consideration such stockholder would have received under a stock or mixed election. Our stockholders are urged to obtain current market quotations for FNF Common Stock when they make their elections.

If the Mergers are approved, the date that our stockholders will receive the merger consideration is uncertain and, due to potential divestitures required by regulatory authorities, the per share purchase price may be adjusted downwards.

If the proposed Mergers are approved, the date that our stockholders will receive the merger consideration depends on the completion date of the Mergers, which is uncertain. Additionally, under the terms of the Merger Agreement, if the combined company is required to divest assets or businesses with 2017 annual revenues in excess of \$75 million in order to receive required regulatory approvals (up to a cap of \$225 million of 2017 annual revenues), the per share purchase price will be adjusted downwards on a sliding scale between such amounts of divestitures up to a maximum reduction of \$4.50 in value in the event that businesses or assets with 2017 annual revenues of \$225 million are divested.

There can be no assurance that a divestiture or divestitures of businesses and assets in excess of \$75 million in 2017 annual revenues will not occur, and accordingly there can be no assurance that holders of our Common Stock will receive (i) for those who make an election for the Cash Election Consideration, \$50.00 per share in cash instead of an amount less than \$50.00 per share in cash (but in any case, no less than \$45.50 per share in cash), (ii) for those who make an election for the Stock Election Consideration, an amount of FNF Common Stock equal to 1.2850 shares of FNF Common Stock per share of our Common Stock instead of an amount of FNF Common Stock less than 1.2850 shares of FNF common stock per share of our common stock calculated based on a reduced exchange ratio for the number of shares of FNF Common Stock per share of our Common Stock or (iii) for those who make an election for the Mixed Election Consideration, \$25.00 per share in cash and an amount of FNF Common Stock equal to 0.6425 shares of FNF Common Stock per share of our Common Stock instead of an amount less than \$25.00 per share in cash and an amount of FNF Common Stock less than 0.6425 shares of FNF Common Stock per share of our Common Stock calculated based on a reduced exchange ratio for the number of shares of FNF Common Stock per share of our Common Stock, as applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no repurchases of our Common Stock during the quarter ended September 30, 2018, except for repurchases related to the statutory income tax withholding on the vesting of restricted share grants to executives and senior management.

Item 5. Other Information

Book value per share. Our book value per share was \$28.50 and \$28.62 as of September 30, 2018 and December 31, 2017, respectively. As of September 30, 2018, our book value per share was based on approximately \$676.7 million in stockholders' equity and 23,740,900 shares of Common Stock outstanding. As of December 31, 2017, our book value per share was based on approximately \$678.8 million in stockholders' equity and 23,719,522 shares of Common Stock outstanding.

Item 6. Exhibits

Exhibit

- 2.1 - Agreement and Plan of Merger, dated as of March 18, 2018, among the Registrant, Fidelity National Financial, Inc., A Holdco Corp. and S Holdco LLC. (incorporated by reference in this report from Exhibit 2.1 of the Current Report on Form 8-K filed on March 19, 2018)
- 3.1 - Restated Certificate of Incorporation of the Registrant, dated April 28, 2016 (incorporated by reference in this report from Exhibit 3.1 of the Current Report on Form 8-K filed April 29, 2016)
- 3.2 - Third Amended and Restated By-Laws of the Registrant, as of April 27, 2016 (incorporated by reference in this report from Exhibit 3.2 of the Current Report on Form 8-K filed April 28, 2016)
- 31.1* - Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2* - Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1* - Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2* - Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS* - XBRL Instance Document
- 101.SCH* - XBRL Taxonomy Extension Schema Document
- 101.CAL* - XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF* - XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB* - XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE* - XBRL Taxonomy Extension Presentation Linkbase Document
- * Filed herewith
- † Management contract or compensatory plan

SIGNATURE

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 8, 2018

Date

Stewart Information Services Corporation
Registrant

By: /s/ David C. Hisey

David C. Hisey, Chief Financial Officer, Secretary and Treasurer