S&P Capital IQ

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Mercury General Corporation NYSE:MCY

FQ1 2011 Earnings Call Transcripts

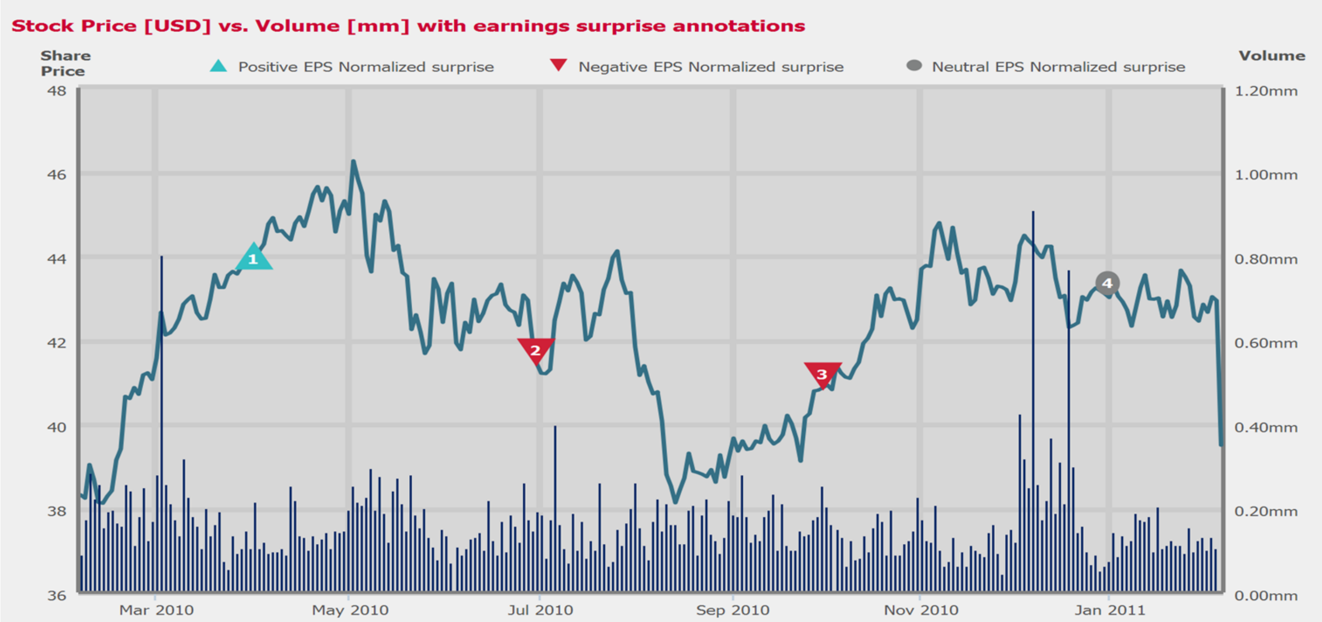
Monday, May 02, 2011 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2011-			-FQ2 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.53	0.72	35.85	0.61	2.49	2.53
Revenue (mm)	670.42	658.22	(1.82 %)	673.80	2616.25	2595.45

Currency: USD

Consensus as of May-02-2011 2:54 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2010	0.68	0.85	25.00 %
FQ2 2010	0.71	0.65	(8.45 %)
FQ3 2010	0.76	0.74	(2.63 %)
FQ4 2010	0.70	(0.15)	NM

Call Participants

EXECUTIVES

Gabriel Tirador
Chief Executive Officer, President and Director

Robert Houlihan
Chief Product Officer and Vice President

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Corey Wrenn

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Ron Bobman
Capital Returns

Presentation

Operator

Good afternoon. My name is Nicole, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General First Quarter 2011 Conference Call. [Operator Instructions]

This conference call may contain comments and forward-looking statements based on current plans, expectations, events and financial and industry trends which may affect Mercury General's future operating results and financial position. Such statements involve risks and uncertainties which cannot be predicted or quantified and which may cause future activities and results of operations to differ materially from those discussed here today.

Thank you. I would now like to turn the conference over to Mr. Gabe Tirador, President and CEO. Sir, you may begin your conference.

Gabriel Tirador
Chief Executive Officer, President and Director

Thank you, Nicole. I would like to welcome everyone to Mercury's first quarter conference call. In the room with me is Mr. George Joseph, Chairman; Ted Stalick, Vice President and CFO; Chris Graves, Vice President and Chief Investment Officer; John Sutton, Senior Vice President, Customer Service; and Robert Houlihan, Vice President and Chief Product Officer.

Before we take questions, we will make a few comments regarding the quarter. I am pleased to report that our first quarter results improved on many fronts. Although premiums written increased by a modest 0.9% in the quarter, it marked the first quarter of positive premium growth since the first quarter of 2007.

Our operating results also improved on a sequential and accident-year basis. Although the combined ratio of 98.2% in the current quarter was worse than the 96.3% combined ratio in the first quarter of 2010, it was significantly better than the 109.9% combined ratio posted in the fourth quarter of 2010.

In the first quarter of 2011, we recorded $1 million of unfavorable reserve development compared to $20 million of favorable development in the first quarter of 2010. Excluding the impact of the reserve development in both years, the combined ratio was 98% in the first quarter of 2011 compared to 99.4% in the first quarter of 2010. The combined ratio was aided during the quarter by our continued focus in reducing expenses. Consequently, our expense ratio declined to 28.3% from 29.1% in the first quarter of 2010.

Our loss adjustment expenses included approximately $4 million of severance-related costs from a reduction in force taken during the quarter. We estimate that the reduction will lower expenses by approximately $11 million on an annual go-forward basis.

We recently filed a class plan filing in our largest California company to improve our segmentation. We plan on making a similar filing for our 2 other California companies this week. Based on our analysis, we believe there are significant opportunities to improve our segmentation. In other words, our current rating plan is overpricing and underpricing many risks. Since these class plans are revenue neutral, we expect the approval process to be relatively smooth with an implementation date probably sometime in the fall.

In states outside of California, we continued to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. During the quarter, we implemented 10 rating changes in our auto line and 4 in our homeowner's line. For our private passenger auto business outside of California, 6 out of the 12 states had combined ratios under 100%. Although we are now where we want to be, we continue to improve our results outside of California, and my expectation is that most of our states outside of California will have a combined ratio below 100% by year end.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Gabe, could you comment on whether you're expecting a combined ratio below 100% in California auto for this year?

Gabriel Tirador
Chief Executive Officer, President and Director

What was the question? Expecting 100% where?

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

In California itself.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, we are expecting below 100% in California.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And secondly, I guess where I found a bit most outperformance relative to my expectations was in the policy acquisition expense. Can you talk about a little bit -- is that where the employees are where you had the restructuring? Or is there another initiative going on?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

No, Meyer. This is Ted. The restructuring was primarily in the claims operations. I think when you look at the policy acquisition cost ratio, you kind of need to look at it in the context of the entire expense ratio. The policy acquisition cost ratio is 19.1 this quarter, 20.1 in Q1 '10, but 19.5 sequentially in the fourth quarter of '10. There are some adjustments this quarter between policy acquisition expenses and general operating expenses as well as some reductions in contingent commission accruals. But these affected both the policy acquisition and general operating expenses during the quarter. But overall, the expense ratio was down compared to prior periods, which was generally helped by budgeted cost reduction efforts for 2011, primarily in the IT area. And for the rest of this year, we do expect the expense ratio to be lower than it was last year.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Expecting any seasonality in the expense ratio?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Seasonality? No.

Operator

Your next question comes from the line of Dean Evans with KBW.

Dean Evans

Keefe, Bruyette, & Woods, Inc., Research Division

I was, first, wondering if you could talk a bit about Florida. Did you have any -- was there any sinkhole losses in the quarter? And also, how is the planned withdrawal from Florida homeowners going?

Gabriel Tirador
Chief Executive Officer, President and Director

On the sinkhole losses, yes, we had some sinkhole losses in the quarter, although that has improved from previous quarters, although we are running -- on an accident-year basis, our Florida homeowners line is running well above 100%, but it's much improved as compared to previous quarters. And the withdrawal from our Florida homeowners line is proceeding as planned. We started manning out the nonrenewal notices in, I believe, early March. And we expect to be out of that line 18 months from March, so sometime in the fall of next year.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And do you know offhand what the dollar value of the sinkhole losses was in the quarter?

Gabriel Tirador
Chief Executive Officer, President and Director

Ted, do you know on an accident-year basis?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

I don't have that handy. I can tell you that the volume of sinkhole claims is running maybe less than half of what it was for the entire year last year. So the amount of claims reported has slowed down quite a bit.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. I guess thinking about so far what we've seen in the second quarter, how do you see your exposure to some of the events we've had, the tornadoes, et cetera? Do you have any sort of commentary?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, I mean it's preliminary right now. We weren't affected that we don't write business in Alabama, but we certainly write business in Georgia and some other states that were affected. Right now, and again it's very early, I would anticipate a reasonable range being somewhere in the $2 million, $3 million range, $1 million to $3 million, let's say. So not real significant, but again. it's very early on. We're still getting some claims in, but I think that range is reasonable from the information that we know today.

Operator

Your next question comes from the line of Corey Wrenn with Pecaut & Company.

Corey Wrenn

I had a question in regard to growth. I'm looking at the written premium line, and we're writing about the same level of premiums that we wrote back in 2004 on an annual basis. And I've noticed over the past few years, we've seen a huge ramp up in advertising spending by the direct writers in the Auto Line business. Where do you see growth going forward in the next 4 to 5 years without spending the kind of money that we're seeing that these larger companies are spending right now?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, as you mentioned, this is the first time in I think it was 16 quarters that we've had any kind of positive premium growth, and we were glad to see that positive premium growth for the first time in 16 quarters. But as you mentioned, it does continue to be a very competitive environment. The increased advertising spend in the insurance space today as compared to maybe 5 to 10 years ago is dramatic, but our goal is to increase the number of quotes being presented to potential customers. We believe we have competitive rates, but need more lucks [ph]. We also believe that our closing ratio can be improved upon with better segmentation. So we have plans to do both. So we're looking at various means to increase both the number of quotes, and as I mentioned before, just improving our segmentation which should improve our closing ratio. We also plan on adding to our distribution. We have some work that's being done that we refer to internally as the "buy button," where we're experimenting with selling online in conjunction with the agent. And that's going to roll out sometime probably in the next month or 2 in Georgia. So we'll see how that goes and see if we're going to expand that to other states. So we're going to get more lucks [ph], and we're trying to improve our closing ratio both at the same time.

Corey Wrenn

So that would be -- online, would that be through an agent still? Or would that be...

Gabriel Tirador
Chief Executive Officer, President and Director

No, we would actually close the business online and then have arrangements with the agent on the back end for servicing.

Corey Wrenn

Okay. I mean have you looked at trying to implement a direct line, direct business and with the agency business also? Are you still committed 100% to the agency?

Gabriel Tirador
Chief Executive Officer, President and Director

We're still committed. I mean, the way the buy button is currently modeled that we're going to test is, again, that we're going to be able to sell online but we're going to partner with the agent.

Operator

Your next question comes from the line of Alison Jacobowitz with BoA Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

So I think I'm sort of following up on the previous 2 questions, but maybe asking it in a slightly different way. When I look at the expense ratio, if I take out $4 million for the severance, I get about 27.6% for the quarter, so -- which is notably lower than the run rate in the past several quarters. Is that the kind of base expense ratio we should be looking at for the remainder of the year? And also, have you -- is ad spending a function to that? Have you slowed your ad expending? What other -- what are the cost saves that go into that, if you could elaborate?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Alison, first of all, the $4 million was primarily in claims, so that would be through the LAE and loss.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Oh, all right.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That probably is worth noting. Ad spend, I think, is comparable maybe to slightly lower than last year, but it's fairly comparable.

Gabriel Tirador
Chief Executive Officer, President and Director

It's down.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes. And as I mentioned before, we are expecting this year's expense ratio to be lower than it was in 2010.

Operator

Your next question comes from the line of Ron Bobman with Capital Returns.

Ron Bobman
Capital Returns

I had a question about Florida and the legislative session that I think is winding down. I'm not sure if it's a week left or 2 weeks left but measured in weeks and -- at most. Is there much hope of a PIP reform in any meaningful degree this session? Are you optimistic? I appreciate your thoughts. Presumably, you follow it quite closely.

Gabriel Tirador
Chief Executive Officer, President and Director

Based on the most recent information that I've received, I don't think that we're going to probably see PIP reform this year. That's again based on the most recent information that I have. We may see some legislation on the sinkhole issues. But as far as the PIP legislation that had been out there, it's my understanding that, that is probably not going to move forward.

Operator

[Operator Instructions] You do have a follow-up question from the line of Meyer Shields with Stifel, Nicolaus.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

I just wanted to dig into the class plan issues, because Gabe had talked about increasing sophistication there. Is this another step forward from the December 15 filing or the filing that was expected December 15 last year? Or were there some, I guess, miscalculations on that one that you want to undo?

Gabriel Tirador
Chief Executive Officer, President and Director

I'll have Robert Houlihan, our Vice President and Chief Product Officer, answer that.

Robert Houlihan
Chief Product Officer and Vice President

No, we just made some minor changes last year. So these aren't intended as corrections to the changes we made last year. For example, we updated our symbol relativities last year, which we believe are appropriate, and the new filing, we're going out with a whole new proprietary symbol set. So it's that sort of order of magnitude of difference. This is a full GLM, full symbol set filing. So it's an entirely new class plan. I would characterize last year's changes as just minor modifications to improve the existing class plan.

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. Is there a risk of the department deciding that you need another rate decrease even if that's not part of the original filing?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, not now with this filing. They're separate filings. In California, there are 2 separate filings. There are class plan filings and there's rate filings, and this is a class plan filing. And so when we make a rate filing, that's when the rates get discussed.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay, but you're not concerned about that at all this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Not with the filing that we just mentioned as far as the class plan. No.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And if I can shift gears a little bit. At you at the point now where you can start looking at additional phase for growth?

Gabriel Tirador
Chief Executive Officer, President and Director

I don't think we're ready for that right now. There are no plans right now. 2012 is about 6 months out, but currently, no plans for geographic expansion in 2012. But that may change as the year goes on. We're trying to get all of our class plans, all of our segmentation in order, our technology. So we're working on the existing states that we have. We have added products to existing states we're in. We've added homeowner products in various states. But at this point in time, there are no plans for geographic expansion right now.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

And Ted, is there any way I could get a ballpark estimate of the contingent commission adjustments?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

I think it's about $2 million, $2.5 million, something like that.

Operator

There are no further questions at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Okay. Well, I'd like to thank everyone for joining us today, and we look forward to talking to you next quarter. Thank you very much.

Operator
Thank you for participating in today's conference call. You may now disconnect.