S&P Capital IQ

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Mercury General Corporation NYSE:MCY

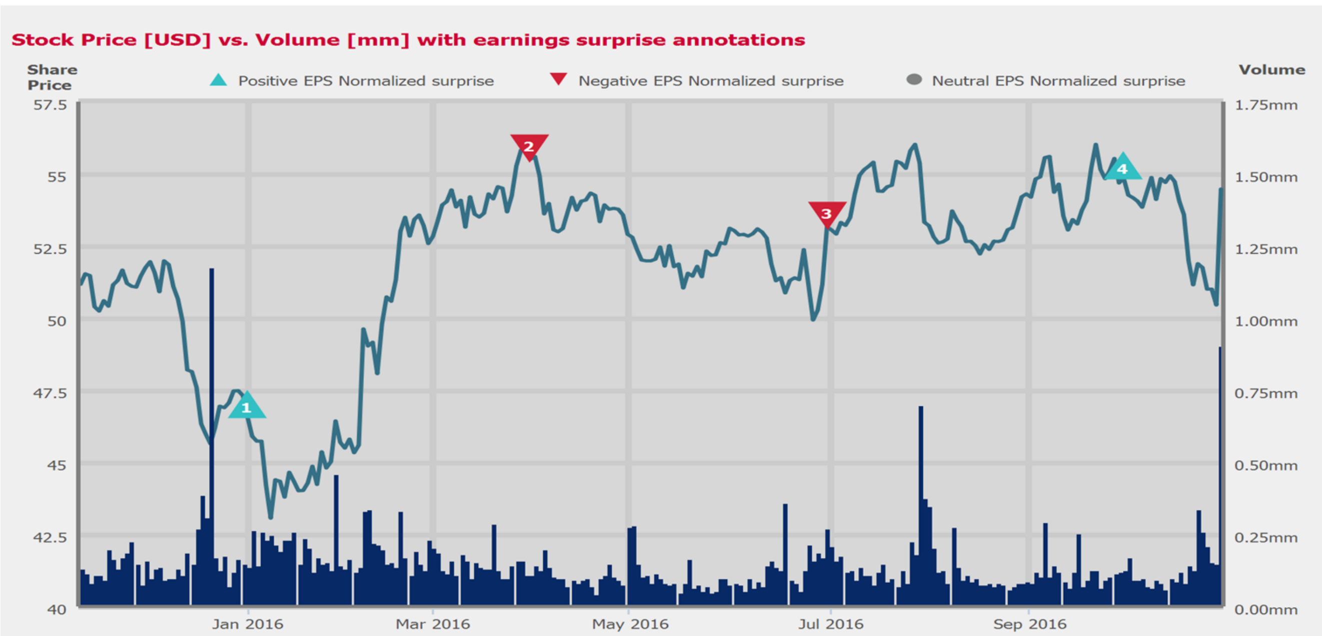
FQ4 2016 Earnings Call Transcripts

Monday, February 06, 2017 6:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.51	0.58	▲13.73	0.65	1.66	1.72
Revenue (mm)	776.40	768.08	▼(1.07 %)	817.41	3164.25	3155.79

Currency: USD
Consensus as of Jan-20-2017 2:06 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	0.45	0.52	▲1 15.56 %
FQ1 2016	0.68	0.13	▼2 (80.88 %)
FQ2 2016	0.59	0.35	▼3 (40.68 %)
FQ3 2016	0.54	0.67	▲4 24.07 %

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

Gabriel Tirador
Chief Executive Officer, President and Director

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Unknown Executive

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Presentation

Operator

Good afternoon. My name is Jessie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Quarterly 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.

I would now like to turn the call over to Mr. Gabriel Tirador. Sir, please go ahead.

Gabriel Tirador
Chief Executive Officer, President and Director

Thank you very much. I would like to welcome everyone to Mercury's fourth quarter conference call. I'm Gabe Tirador, President and CEO. In the room with me is Ted Stalick, Senior Vice President and CFO; Chris Graves, Vice President and Chief Investment Officer; and Robert Houlihan, Vice President and Chief Product Officer. Before we take questions, we will make a few comments regarding the quarter.

Our fourth quarter operating earnings were $0.58 per share compared to $0.52 per share in the fourth quarter of 2015. The improvement in operating earnings was primarily due to an improvement in the combined ratio from 100.2% in the fourth quarter of 2015 to 99.2% in the fourth quarter of 2016.

In California, we recorded an increase in personal auto severity in the mid-single-digit range for the 2016 accident year and an increase in frequency in the low single digits. To help offset the increase in loss trends, we have been increasing rates in California. Last year, in our personal auto business in California, we implemented a 5% rate increase in late March 2016 for Mercury Insurance Company and a 6.9% rate increase in June 2016 for California Automobile Insurance Company. In addition, a 6.9% rate increase is pending approval with the Department of Insurance for California Automobile Insurance Company.

Personal auto premiums in Mercury Insurance Company represents about half of our company-wide premiums earned, and California Automobile Insurance Company represents about 15% of our company-wide premiums earned. We have observed a significant number of our competitors also file for rate increases in California.

Outside of California, increasing loss cost trends have negatively impacted our results. To address profitability outside of California, we have been increasing rates and tightening our underwriting.

The expense ratio in the quarter declined to 24.9% from 25.9% in the fourth quarter of 2015. The decrease in expense ratio was primarily due to lower profitability-related accruals. Net advertising expense in the quarter was $5.5 million compared to $5 million in the fourth quarter of 2015.

Premiums written grew 2.9% in the quarter primarily due to higher average premiums per policy. Company-wide private passenger auto new business applications submitted to the company decreased approximately 8% in the fourth quarter of 2016 as we focused on improving profitability in our private passenger auto line.

Company-wide homeowners applications increased about 7% in the fourth quarter of 2016.

In California, we posted premiums written growth of 5.4%. Outside of California, premiums written decreased by 8.1% in the quarter.
With that brief background, we'll now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I wanted to just ask a couple questions around some previous comments you made. I think you said in the last quarter that you plan to file a class plan in Mercury Insurance. And at that time, it was 90 days. Where are you with that? And do you anticipate that you'll be looking for some additional rate at Mercury Insurance?

Gabriel Tirador
Chief Executive Officer, President and Director

I think that we're getting close to filing that. I would say within the next probably 30 to 60 days, we plan on making that filing, and I anticipate that the class plan filing will come with about low-single-digit rate increase, anywhere from -- up to 5%, let's say, is what we're expecting right now.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Perfect. And then in Cal Auto, I know you said you're waiting for approval on another 6.9%. And I think in the past, you've provided us some color that you think that's more of your standard-to-nonstandard book of business versus Mercury Insurance is just more of your preferred book. Can you give us what your perspective is in the nonstandard market? We're hearing a lot of challenged results from your peers, and I'm just curious where you think we might be in that pricing cycle. And is it reasonable to expect that profitability should improve in that component over the next year or 2?

Gabriel Tirador
Chief Executive Officer, President and Director

I think that's going to vary by company depending on how early they are in the cycle with respect to getting their rate approvals. We started increasing rates both inside and outside of California quite some time ago, so we feel that from a rate perspective, 2017 is going to be a much better year for us depending on what the loss trends continue to do. So I think it's going to vary by company. There are some companies that maybe were behind a little bit and it may take a little longer for the rate to catch up to the loss cost trends. So I do think it's going to be company specific depending on where they're at in the cycle. But there's no question that there's pressure, that severity trends are definitely up really in bodily injury severity, material damage severity is up as well. So there's no question that there's increased loss cost pressure. If that stabilizes, though, I think that the rate action that we've taken is really going to help profitability in '17.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

And how did the severity trend and frequency trend in the fourth quarter? I know you provided some color around that in the second and third quarters last year. Where were we in the fourth quarter?

Gabriel Tirador
Chief Executive Officer, President and Director

Ted, do you want...

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

It's pretty comparable mid- to high-mid-single digits on severity and low single-digits on frequency. We just saw the latest Fast Track in California, pure premiums running close to 10%, pure -- frequency about 5%, severity about 5%. So I think we're a little under Fast Track industry, but it's still mid-upper single digits for us.

Gabriel Tirador
Chief Executive Officer, President and Director

And that's for the 12-month period, I think, in the quarter.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, yes annualized, yes.

Gabriel Tirador
Chief Executive Officer, President and Director

Ending in September because there's -- they're a quarter behind.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. I'll just close out with one other question. I know there's sometimes other analysts that are on the call. I noticed that you took a realized loss in the quarter, and I thought maybe, Chris, if you could tell us what's going on there.

Christopher Graves
Chief Investment Officer and Vice President

Yes. We mark-to-market the entire portfolio. So we did -- so what you're -- most of that is just mark-to-market changes in the quarter, particularly with fixed income having sold off. But there is a small -- of that, we took about $12 million in losses that we realized against capital gains from prior periods. So there's that in there as well.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, that was part of tax planning utilizing expiring capital gains.

Gabriel Tirador
Chief Executive Officer, President and Director

Our portfolio is classified as trading. So everything flows through the income statement as a realized gain or loss, changes in market value as well.

Christopher Graves
Chief Investment Officer and Vice President

Yes. Dating back to 2008.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes.

Operator

[Operator Instructions] The next question comes from Ken Billingsley with Compass Point.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Question is on -- I've just been a -- and I apologize if you mentioned this. I got on just a little bit late. For the 2.7 points on the reserves increase, can you talk about where those -- where that's coming from specifically. Maybe the fourth quarter number, I estimate that's around $14 million, $15 million of unfavorable development. What years is that coming from?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

It's generally -- for the year, it's generally California and Florida personal auto and commercial auto. And about half of it is from the '15 accident year and the rest is kind of spread across the preceding couple 2, 3 years.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And did you -- and just looking at -- the question I have then -- and I hope I'm not looking at this wrong -- so I look at the accident year loss pick for 2015, and that's excluding cat. And my calculation is about 71.5%. And I'm showing that you're pretty much in the same position for '16. So if you're taking reserves up for, like you said, half of it’s from '15, does that mean that maybe your accident -- your loss picks even need to be a little higher for '16? Or is the rate flow that you -- the rate approvals that you've already received going to offset most of that uptick?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, go ahead.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, so we've taken substantial rate beginning in '15 and into '16. So our belief is that the rates that we're earning in, in '16 have outpaced or at least equaled the loss trend.

Gabriel Tirador
Chief Executive Officer, President and Director

And I will say the accident year combined ratio is at a 98%, and we are -- for '16, it varies by state. But overall, we are anticipating and have recorded higher severity in '16 on an accident year basis versus '15, there's no question about that.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

And were there any current year adjustments made true-ups at the end of the year? So current year adjustments for 2016?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We really evaluate it on a year-to-date basis. So we prefer to comment on the year-to-date numbers more than the intra-quarter numbers as far as development goes.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Okay. So maybe year-to-date, were -- I mean, on a cumulative basis, was there?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Correct. No, no, there was not.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Okay. All right. And the last question and I'll turn it back into the queue is just looking from a statutory surplus underwriting leverage, saw the statutory surpluses remain relatively flat year-over-year from a premium standpoint. How much can you take the leverage up given that your top line still is growing, but the surplus is remaining flat? Where is the comfort level on that underwriting leverage?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We think that the premiums to surplus in '17 will be relatively flat to what it was depending on what happens with our dividends and...

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we expect our operating earnings in '17 will be quite a bit better than '16. And we don't really anticipate '17 will have a lot of top line growth. So if those 2 things are achieved, I don't think you're going to see much movement in the premiums-to-surplus ratio in '17.

Kenneth G. Billingsley
Compass Point Research & Trading, LLC, Research Division

Okay. And then the expectation, obviously, that the payout ratio would be under 100%, so you wouldn't have a decline in surplus?

Gabriel Tirador
Chief Executive Officer, President and Director

That is certainly the objective, yes.

Operator

Your next question comes from Alison Jacobowitz with Bank of America Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I'm just wondering if you could talk a little bit maybe about the weather in California. The rain levels in the first quarter if you can and if there was anything seasonally in the fourth quarter that was of note from a weather standpoint.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think El Niño has come a year late, in my opinion. The forecasters have said that El Niño was coming last year. In my opinion, they got it a year late because we've had a significant amount of rain. It took me 2.5 hours to get into the office this morning because of the rain. And so there's definitely a lot of rain, and it's going to impact our homeowners results in the first quarter as an example. We've received a lot of rain-related claims in the first quarter. As far as the fourth quarter goes, Ted, do you have any comments on that?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

It was a typical fourth quarter, a little bit elevated frequency, but pretty typical.

Operator

Your next question comes from Greg Peters with Raymond James.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

I just wanted to follow up with just a couple other questions. First of all, Gabe, I think your objective from a combined ratio perspective, I think you've previously said you want to get the combined ratio down to around 96% or better. One, can you confirm that that's your target? And then two, what's the time horizon where you think you might be able to get to that objective, if there is that objective?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, one, yes, it is. And I think '17, I don't think that we're going to get there probably all the way down there in '17. But I certainly would expect our objective to be there in '18.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. And can you just -- it's a couple housekeeping items. I know your bonus accruals were down in '16. And is there an expectation that you're going to be paying out these bonus accruals in '17? And then also, have you set your objective for your advertising budget for '17? And how does that compare with '16?

Gabriel Tirador
Chief Executive Officer, President and Director

As far as the bonus accrual for '17, we expect to pay a bonus. What that level will be is hard to say at this point, but it was 0 -- bonus accrual was 0 for '16. In '17, the anticipation is that there will be some bonus accrual in '17. What was the second part of the question?

Unknown Executive

Advertising.

Gabriel Tirador
Chief Executive Officer, President and Director

Oh, advertising is going to be similar, about $40 million or so. '16 and '17, we anticipate the advertising spend to be similar.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. And then the final question I have for you, you talked about the rain affecting your drive and weather-related losses. Could you -- one of the most difficult things I've had in following your company is trying to understand exactly how your catastrophe exposures lay out. Could you provide us some color around where your book of business, where the exposures are and where the catastrophe risk is when we think about quarter-to-quarter volatility?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think it varies, obviously, by state. In California, we have rain-related events. And we follow ISO when they name a cat. We kind of -- we follow that, definition of a cat. And historically, we've averaged about, I think, over the last 5 years something in the neighborhood of about $24 million, $23 million, something in that neighborhood in cat losses. This last year, in '17 (sic) ['16] was a little higher. I think it was $27 million in '16. So we obviously price in for that amount of cat when we make our estimates. But in California, you're looking at primarily rain-related events. Outside of California, you have wind events in homeowners that are probably your biggest exposure in Texas. And in the Northeast states, you have hurricane exposure. We have fire following earthquake as an exposure here in California. Yes, wildfires as an exposure here in California. So it does vary a little bit by state. I don't know, does that answer your question?

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

That was very helpful.

Operator

There are no more questions at this time. I'll turn the call back to the presenters.

Gabriel Tirador
Chief Executive Officer, President and Director

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

Operator
This concludes today's conference call. You may now disconnect.