S&P Capital IQ

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Mercury General Corporation NYSE:MCY

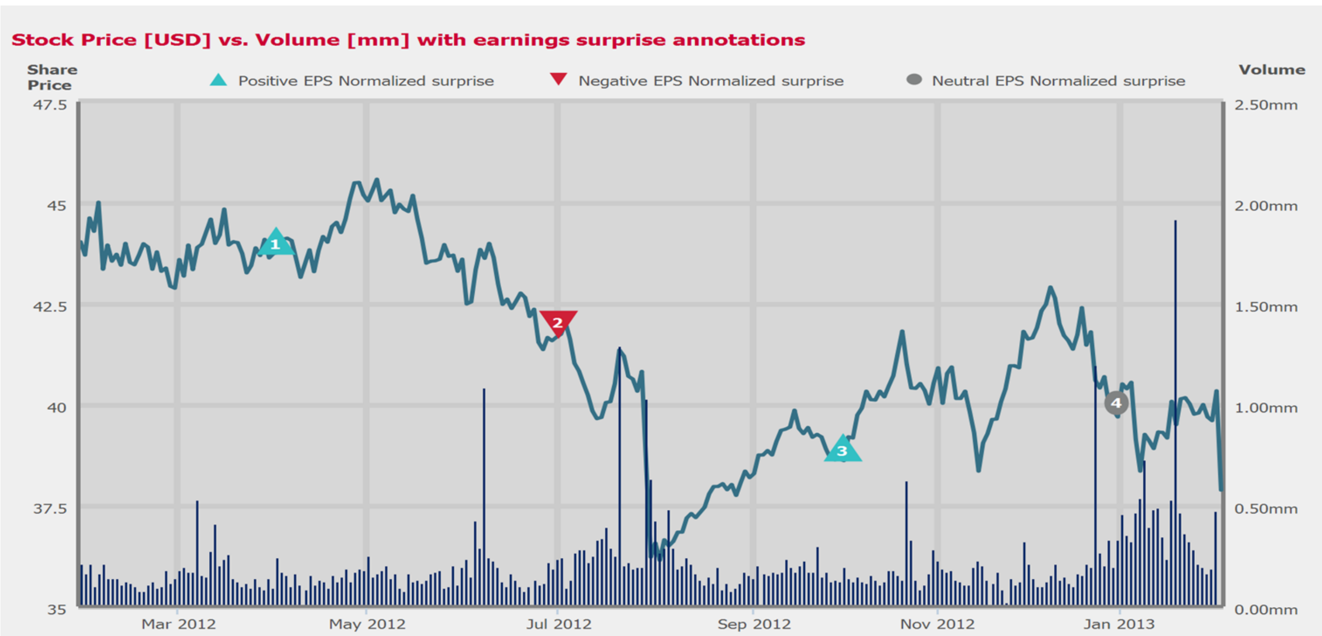
FQ1 2013 Earnings Call Transcripts

Monday, April 29, 2013 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2013-			-FQ2 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.47	0.69	▲46.81	0.59	2.23	2.57
Revenue (mm)	693.83	690.50	▼(0.48 %)	691.87	2799.94	2909.88

Currency: USD
Consensus as of Apr-29-2013 4:08 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2012	0.69	0.71	▲2.90 %
FQ2 2012	0.67	0.19	▼(71.64 %)
FQ3 2012	0.56	0.62	▲10.71 %
FQ4 2012	0.23	(0.17)	NM

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

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

Raymond Iardella
Macquarie Research

Thomas Moritz
Crowell, Weedon & Co., Research Division

Unknown Analyst

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good afternoon. My name is Tracy, and I will be your conference operator today. At this time, I would like to welcome everyone to 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.

Thank you. And I will now introduce and turn the call over to Mr. Gabriel Tirador, President and CEO. You may begin your conference, sir.

Gabriel Tirador
Chief Executive Officer, President and Director

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

Before we take questions, we will make a few comments regarding the quarter. I am pleased to report we started 2013 much better than we ended 2012. Our first quarter 2013 combined ratio was 97.9%, compared to 97.6% in the first quarter of 2012. Our first quarter results were negatively impacted by $10 million of pretax charges related to our previously announced consolidation of our operations outside of California and $1 million in catastrophe losses related to weather-related events in Georgia. This was partially offset by $3 million of favorable reserve development coming primarily from operations outside of California. Our California auto loss frequency trend is essentially flat compared to the first quarter of 2012. In addition, our results in the quarter were helped by the continued improvement of our financial results outside of California.

Last quarter, we reported on our decision to increase our estimates for California bodily injury severity as the more recent accident years are developing at a higher rate than historical averages. Our first quarter 2013 losses were consistent with the recent development trends we have observed. We believe the increase in severity we are seeing is in part due to more severe accidents and increases in medical procedures.

In California, we increased our private passenger auto rates approximately 4% effective October 26, 2012. Although the 4% rate increase will aid our result in 2013, we don't believe it is sufficient for us to reach our profitability target. Accordingly, we filed for a 6.9% rate increase in our non-standard California company and 6% in our preferred auto California company. The fundings are currently being reviewed by the California Department of Insurance.

In our California homeowners line, the insurance commissioner accepted a decision from the administrative law judge to reduce our homeowners' rates by approximately 5.5%. We strongly disagree with the administrative law judge's proposed decision. In fact, our actual results clearly demonstrate that the judge's forecasted trend collections were significantly too low for our largest homeowners forum. Accordingly, we are contesting a proposed rate reduction in Superior Court. We expect the superior court to render a decision in late summer.

In addition to the Superior Court proceeding, we filed for a 6.9% rate increase that reflects our more recent results. The insurance commissioner had issued a notice of this time, and the hearing is expected to commence in early September. We will continue to pursue rates that allow a fair rate of return in our homeowners line.

Offsetting some of the regulatory challenges we are experiencing in California are our results outside of California. Excluding the impact of our $10 million consolidation charge, our operations outside of California posted a combined ratio well under 100%. Over the past 2 years, we have taken significant rate of action in most states outside of California, and the impact of those reactions is having a positive impact on our results. Lastly, premiums written continue to grow due to the combination of rate increases and increase in Policies-in-Force. Premiums written grew by 4.9% in the quarter. However, as expected, new business private passenger sales and retention levels outside of California have declined due to rate increases. In addition, the California market remains very competitive.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Vincent DeAugustino with KBW.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

In the press release you've mentioned, Florida, New Jersey reserves developing favorably. And you just touched on it a couple of minutes ago. And I was just curious how did California do in the quarter, and would it basically be flat on reserve and just based on your comments about trends being consistent lately?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

That's correct. California was pretty much flat.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Perfect. And just -- I know this is kind of hard to do, but as far as the rate filings that you have for non-standard auto and the preferred, do you have any sense of how that's going through with the department? Or is last time just with I think it was about a year maybe that it took to get approval. Should we expect something like that this time around or do things seem to be expedited a little bit faster this time?

Robert Houlihan
Chief Product Officer and Vice President

This is Robert Houlihan. We've had some preliminary discussions with our Cal Auto filings for personal auto, and we have, as you know -- as you may know, there's an intervener on that filing and we're having a 3-way discussion between the department, the intervenor and ourselves in about 2 weeks. I would think at that point in time we would know a lot better the timing of resolution on that. So we're making progress but we really -- because we don't control all aspects of this, we really can't predict an exact date, but we have made some significant progress on the first rate trial.

Gabriel Tirador
Chief Executive Officer, President and Director

And the Cal Auto is the nonstandard company.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Perfect. And then if you can track it at all, just because we're hearing in the industry there's been a lot of benefit from unusually favorable non-cat weather if such a thing exists. Is there anything that you could quantify as far as just a benefit from unusually favorable weather either inside of California or maybe to the point about the lines outside of California doing pretty well this quarter, if there was any sort of one-off benefits there?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, a year ago, I think we didn't have any cash that at least, last year. In this quarter, we disclosed about $1 million in Georgia so it was a very light cat quarter. In California, yes, I think the weather was probably comparable to a year ago. I mean, we did have in rain in California in the first quarter. So our biggest market here in California... I don't think that we benefited.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Our frequency was essentially flat in California compared to a year ago.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

And I guess, in general, the weather was tended to be fairly favorable this quarter.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And I guess, just to be clear, I was looking at more of the non-catastrophe whether. So I know, in Georgia, there was obviously some cat activity but broadly speaking, so far if I'm looking at NOAA storm counts or just other comments, it seems to be more of the benefits coming from the non-catastrophe losses? And so just to be clear with...

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think in California, as we mentioned, we think that the frequency was relatively the same as a year ago and the weather, I would say, was comparable so I would say no to that. Outside of California, there was probably some benefit with respect to lighter weather but we don't have any -- we haven't quantified that.

Operator

[Operator Instructions] Your next question comes from the line of Alison Jacobowitz with Bank of America Merrill Lynch.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I was wondering if you could talk about investment income a little bit. I know we always have these quarters where it goes up a little bit, or down a little bit, but it does seem that the first quarter versus the fourth quarter, there's a notable drop off, also the tax rate, if I'm doing this right, went down a bit. So I was just wondering if you could talk about that and how it may trend going forward?

Christopher Graves
Chief Investment Officer and Vice President

Well as far as trends going forward, that's hard to make a call on because a lot of it is dependent upon interest rate, since we're so fixed income sensitive, but we do continue to see redemptions on our callable municipal bonds and then reinvesting those at market rates which are below where they were held. It does continue to put forward pressure on the investment income. We have -- we did have a lot of cash last year, and we've been soaking that up with other investments such as taxable corporate which is, weather is interesting, the tax rate creep. And we've also pushed a lot more into equities over the past 12 months. But as far as forward-looking trends, I can tell you we're just trying to maximize what is available to us.

Gabriel Tirador
Chief Executive Officer, President and Director

And I think in the fourth quarter we may have had some special dividends.

Christopher Graves
Chief Investment Officer and Vice President

We did pick up special dividends in the...

Gabriel Tirador
Chief Executive Officer, President and Director

We picked up some special dividends. So if you're looking on a sequential basis, maybe that's why, Allison.

Operator

Your next question comes from the line of Tom Moritz with Crowell.

Thomas Moritz
Crowell, Weedon & Co., Research Division

Alison got to most of it, but I guess maybe, Chris, could you give us an update where you are? Equities versus bonds and maybe where that target might go?

Christopher Graves
Chief Investment Officer and Vice President

The equity that I just stated, we have increased that investment over the past 12 months. Currently, it's -- basically it's maxed out. It's as far as I'm going to take it. We are now making more or less trades within that portfolio to further increase the investment income that it's providing, but the growth of that -- of the the equity assets will now basically be determined by the growth of the portfolio in general. Does that get to what you're looking for, Tom?

Operator

[Operator Instructions] Your next question comes from the line of Ray Iardella from Macquarie.

Raymond Iardella
Macquarie Research

I just had a couple questions. I guess, first, Gabe, in your prepared remarks you mentioned non-California combined ratio below 100 even assuming the $10 million charge. Just curious, can you give us, I guess, the sort of year-over-year improvement in the combined ratio for California and then x California?

Gabriel Tirador
Chief Executive Officer, President and Director

Well we don't disclose that. We don't separate that between California and non-California in our disclosures, but I can say that there was markedly improvement outside of California and it was pretty significant.

Raymond Iardella
Macquarie Research

Okay. And then in terms of California, was that roughly flat? Or was it -- did it move adversely? Or did that improve as well?

Gabriel Tirador
Chief Executive Officer, President and Director

Relatively flat.

Raymond Iardella
Macquarie Research

Okay. And then maybe can you talk a little bit about the homeowners business, obviously you've been adding that's been adding to the top line? I mean is there a sort of a different way you think about the combined ratio that you want to get the adequate return on that business, relative to the Auto business? Or maybe can you talk about that a little bit more broadly?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. In our homeowners line, we certainly -- it's subject to catastrophes, so there's a big, usually in states where there's a lot of catastrophes, there's a large catastrophe charge. So in quarters and years where there are no catastrophes, you should be running at a combined ratio, a very healthy combined ratio in those quarters. So, yes, our expectation for the homeowners line is to, non-cat/ or non-heavy cat quarters or years, is to run combined ratios well below our auto combined ratio.

Raymond Iardella
Macquarie Research

Okay. So that's -- so adding the homeowners business will help you get to that 95% target that you guys have talked about in the past?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Absent any catastrophes.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, yes.

Raymond Iardella
Macquarie Research

Okay, just want to try to figure out how you guys are going to get to the 95 just with all the moving pieces.

Gabriel Tirador
Chief Executive Officer, President and Director

So we need to get to the 95. We rate relief in California.

Operator

Your next question comes from the line of Norman Tamber [ph] with Morgan Stanley.

Unknown Analyst

To what extent, if any, does the activities of Harvey Rosenfield and like-minded parties poison the regulatory environment for you?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, in California, there's an intervenor process and, one of the largest intervenors is Consumer Watchdog, probably the only intervenor, and I would say it certainly adds significant delay to the process. That's what we're seeing today, is that it certainly adds quite a bit of delay to the process Norm.

Operator

There are no further questions in queue at this time. I turn the call back over to the presenters.

Gabriel Tirador
Chief Executive Officer, President and Director

We'll, thank you, everyone, for joining us this quarter, and we hope to bring good results next quarter as well. Thank you very much.

Operator

Ladies and gentlemen, thank you for joining. This concludes today's conference call. You may now disconnect.