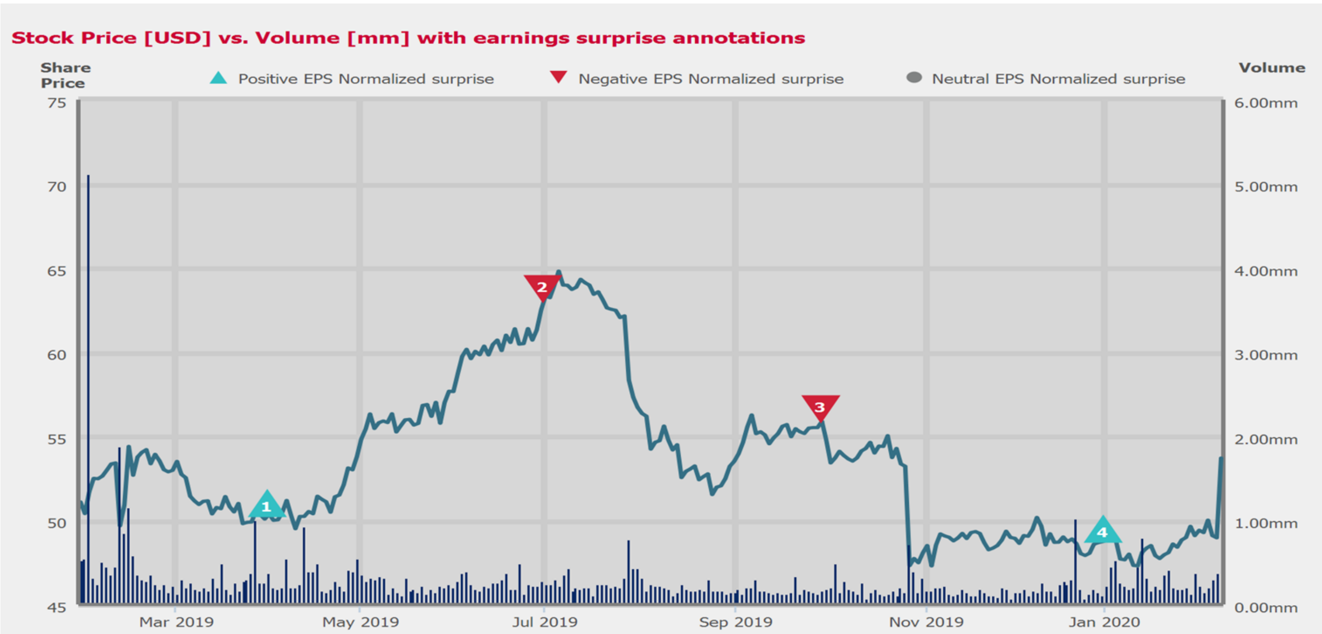
Mercury General Corporation NYSE:MCY
FQ4 2019 Earnings Call Transcripts
Monday, February 10, 2020 6:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ4 2019-			-FQ1 2020-	-FY 2019-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.18	0.21	▲16.67	0.87	2.56	2.60
Revenue (mm)	884.63	896.14	▲1.30	953.11	3720.00	3731.72

Currency: USD
Consensus as of Feb-02-2020 11:42 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2019	0.77	0.87	▲1 12.99 %
FQ2 2019	1.03	0.74	▼2 (28.16 %)
FQ3 2019	1.08	0.78	▼3 (27.78 %)
FQ4 2019	0.18	0.21	▲4 16.67 %

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Call Participants

EXECUTIVES

Gabriel Tirador
President, CEO & Director

Theodore Robert Stalick
Senior VP & CFO

ANALYSTS

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

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 Third Quarter 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
President, CEO & 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 Mr. George Joseph, Chairman; Ted Stalick, Senior Vice President and CFO; Jeff Schroeder, Vice President and Chief Product Officer; and Chris Graves, Vice President and Chief Investment Officer.

Before we take questions, we will make a few comments regarding the quarter. Our fourth quarter operating earnings were $0.21 per share compared to an operating loss of $0.26 per share in the fourth quarter of 2018. The improvement in operating earnings was primarily due to an increase in previously unrecognized income tax benefits, a reduction in the combined ratio and an increase in after-tax investment income.

Included in the fourth quarter of 2019 results was a $0.10 per share tax benefit related to the recognition of previously unrecognized federal tax benefits and a reduction in state tax accruals related to a California franchise tax audit. Included in the fourth quarter of 2018 results was a $0.07 per share tax benefit from the reversal of an IRS rule related to sequestration adjustments from the 2017 Tax Act.

The combined ratio was 103.2% in the fourth quarter of 2019 compared to 106.7% in the fourth quarter of 2018. The improvement in the combined ratio was primarily due to $1 million of positive reserve development in the quarter compared to $23 million of adverse reserve development in the fourth quarter of 2018. In addition, catastrophe losses of $36 million in the quarter were lower than the $43 million of catastrophe losses in the fourth quarter of 2018.

Excluding the impact of catastrophe losses, prior accident year reserve development and ceded reinstatement premiums earned, the combined ratio was 99.3% in the quarter and 97.3% for the 12-month period ended December 31, 2019, compared to 98.6% and 95.6% for the quarter and 12-month period ended December 31, 2018.

Our California private passenger auto combined ratio was approximately 97.9% in the fourth quarter of 2019 compared to 103.2% in the fourth quarter of 2018. The improvement in the California private passenger auto combined ratio was primarily due to rate increases taken during 2019 and to $10 million of favorable prior accident year reserve redundancies in the quarter compared to $14 million of adverse prior accident year reserve development in the fourth quarter of 2018. Partially offsetting the improvement in the combined ratio from reserve development and rate increases was an increase in the frequency and severity.

California private passenger auto frequency increased by about 2% in the quarter as compared to the fourth quarter of 2018, primarily from the bodily injury coverage and severity increase by 5% in the quarter as compared to the fourth quarter of 2018. A 5% personal auto rate increase for California automobile insurance company's pending approval with the California Department of Insurance and a

4% personal auto rate increase was recently filed for Mercury Insurance Company. Collectively, these represent 2/3 of company-wide direct premiums earned.

Our California homeowners combined ratio was 123% in the fourth quarter of 2019 compared to 125% in the fourth quarter of 2018. Catastrophe losses in our homeowners line, primarily from California wildfires, were $34 million in the quarter compared to $38 million in the fourth quarter of 2018. A 6.99% rate increase in our California homeowners line was approved by the California Department of Insurance and was implemented in August 2019. In addition, a 6.99% rate increase in our California homeowners line is pending approval with the California Department of Insurance. California homeowners premiums represent about 13% of direct company-wide premiums earned.

For states outside of California, we posted a personal lines, homeowner and auto combined ratio of approximately 110% in the fourth quarter of 2019 compared to 101% in the fourth quarter of 2018. Those results include approximately $2 million of unfavorable prior year reserve development on $103 million of earned premium compared to no development on the $104 million of earned premium in the fourth quarter of 2018.

Our year-to-date accident year personal lines combined ratio for states outside of California was 103% in 2019 compared to 97% in 2018. Increases in severity in several states in private passenger auto were the primary reason for the increase in the combined ratio in 2019.

We have been increasing our private passenger auto rates in many states outside of California to improve results. We have also introduced improved segmentation with an updated product we have named [Mercury Advantage]. [Mercury Advantage] has increased protection in the states where it has been deployed, and to date, the loss experience has been favorable. [Mercury Advantage] is scheduled to be released to all but one of our states outside of California by the end of 2020.

Our homeowners results outside of California saw double-digit premium growth in 2019 with favorable underwriting results in total and on an underlying basis. The expense ratio was 23.5% in the fourth quarter compared to 23.3% in the fourth quarter of 2018. The slightly higher expense ratio was primarily due to an increase in profitability-related accruals, partially offset by lower acquisition costs.

Premiums written, excluding reinsurance reinstatement premiums written, grew 3% in the quarter, primarily due to higher average premiums per policy and an increase in homeowners policies written. With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] The first question will come from the line of Greg Peters with Raymond James.

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

A couple of questions for you on your results. First of all, I was listening with interest about your commentary about the results outside of California. And with a combined ratio that apparent -- it seems to be deteriorating on a year-over-year basis for auto and home, do you have an objective or do you have a timeframe in mind of when you might be able to get that auto, home combined ratio outside of California down to below $100 million?

Gabriel Tirador
President, CEO & Director

Well Greg, it's a good question. As I mentioned earlier, our 2018 accident year results for personal auto, as an example, were in the 97.8%, I think, is what we posted in outside of California. And our homeowners was 93.2% in '19 and 94.6% in '18. So '18 actually was a decent year for our results outside of California. What we saw in '19 was just increases in severity that really offset any kind of rate increases that were built in into our rates. So severity increased much higher than we expected, driven by Florida, as an example, had some issues with PIP in Florida. And our other large state, Texas, also saw some increases in severity. So we were pretty much there in '18. We had some unexpected, I think, developments with respect to severity in 2019 that we didn't anticipate. But we are taking actions. As I mentioned in our prepared remarks, we have taken rate. In addition to that, we've introduced what we believe is a much better segmented product in most of the states, which is going to be rolling out for the rest of 2020.

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

And so both Florida and Texas are more of a file-and-use state of regulatory framework, correct, as it relates to rate? Or I guess, Florida, is it homeowners that you're getting -- you need prior approval on?

Gabriel Tirador
President, CEO & Director

Well, we don't write homeowners in Florida. So in Florida, you can file and use.

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

And same with Texas, correct?

Gabriel Tirador
President, CEO & Director

Yes.

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

So theoretically, this should be a pretty -- the fix shouldn't take very long because you're able to go after the rate you need to restore profitability. Is that a fair assumption?

Gabriel Tirador
President, CEO & Director

Well, I mean, it takes a little while, because if you have 6-month policies, it takes a little bit to earn in. So there's some rate earning in. But generally speaking, I would agree with that statement. If we file for enough rate to offset the increases in severity that we should see improved results. And we did that back in 2018, as I mentioned earlier.

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

Right. Right. One of the surprises last year -- well, I guess, it wasn't a surprise, but was a change was how your reinsurance changed and your retention per event, especially as it relates to like property losses, fires, catastrophes, was higher. And given the experience you had in 2019, can you give us a preview on how you think your reinsurance structure might change in 2020 and how we should think about your catastrophe exposure by a per event basis?

Gabriel Tirador
President, CEO & Director

Sure. I'll have Ted answer that.

Theodore Robert Stalick
Senior VP & CFO

Yes. So on the current treaty, which goes from July 1 to June 30, so we're behind the worst of the fire season. There were no reinsured losses that hit that treaty. So we're expecting the pricing come this next July to be pretty rational when we go up for renewal. As far as changing limits or retention at the renewal, a lot of that will depend on our risk tolerances and the pricing available in the market, also the capacity in the market. But as of now, we expect the renewal limits and retention to look similar to what we currently have. And again, we'll probably know a lot more in the spring once we finish our PML analysis and get those updated and then go start marketing the reinsurance.

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

But you said that there were no reinsured losses related to fire, so far. Obviously, the fire season is largely over with. But so far, on the last -- on this current reinsurance treaty year, correct?

Theodore Robert Stalick
Senior VP & CFO

That's correct. Our retention was $40 million, and none of the fires were large enough to get into that.

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

Okay. Great. And then, I guess, the final question would be just on the California business. It feels like your -- it feels like you should be getting rate that exceeds your loss cost trend. But I guess, we're just not seeing the improvement show up in your bottom line results. What -- do you have a view right now of how your rate compares to loss trend? Do you think -- when you talk about these 5% rate increases, filed 6.9%, et cetera, how do you feel about where you are sort of in that rate cycle relative to the results?

Gabriel Tirador
President, CEO & Director

Well, I think I mentioned in the prior call, last quarter, we do indications every quarter. And right now, with these latest 2 rate increases that we have applied for and that are pending, we feel pretty good about where we would be, both in MIC and Cal Auto. When you take a look at our California private passenger auto results, we booked about a 97% combined ratio for the entire year, and there was a lot of rate that was not earned in that 97%. So on an earned level basis, it's better than the 97%. So in addition, with these rate filings that hopefully will get approved in 2020, we actually feel pretty good where we're at right now.

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

What do you -- and when you look at the 2019 results, what do you think the combined ratio will look like for the homeowners-only portion of your business in California?

Gabriel Tirador
President, CEO & Director

How much was it in '19 or how much -- what do we expect?

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

What -- it's a historical numbers. Just what was -- just homeowners California...

Gabriel Tirador
President, CEO & Director

It was 106% combined.

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

And how did that compare with 2018?

Gabriel Tirador
President, CEO & Director

2018, the accident year for 2018 was 103% and the calendar year was like 102%.

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

And the 106% that you gave is the calendar year, correct?

Gabriel Tirador
President, CEO & Director

Yes, yes.

Operator

[Operator Instructions] We show no further audio questions at this time.

Gabriel Tirador
President, CEO & Director

Okay. We have a short call this quarter. I'd like to thank everyone for joining us, and we'll talk to you again next quarter. Thank you very much.

Operator
This does conclude today's conference call. We thank you for your participation and ask that you please disconnect your line.