

Mercury General Corporation NYSE:MCY

FQ2 2015 Earnings Call Transcripts

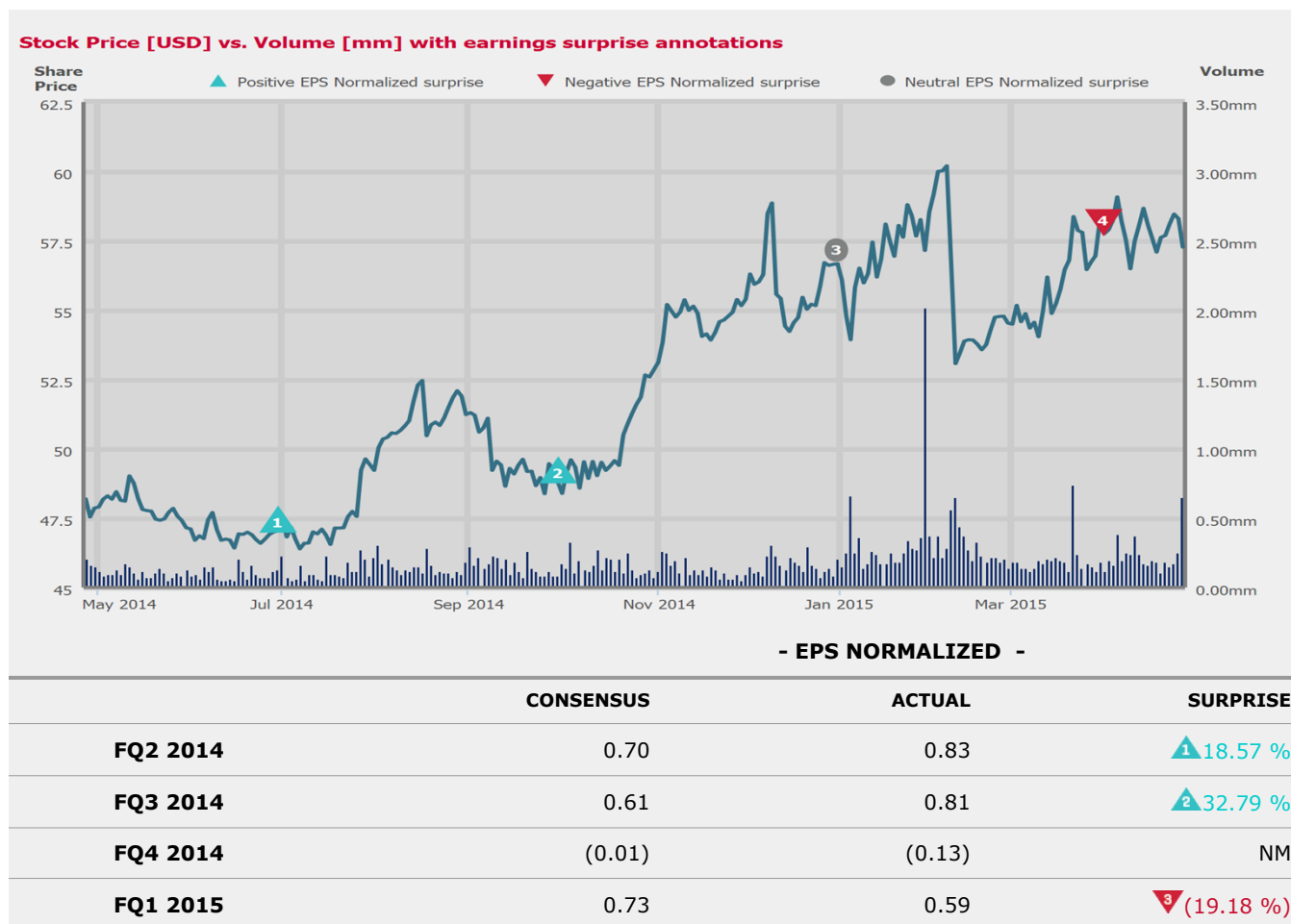
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S&P Capital IQ Estimates

	-FQ2 2015-			-FQ3 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.67	0.64	▼ (4.48 %)	0.68	2.35	2.68
Revenue (mm)	726.71	733.55	▲ 0.94	750.78	2946.64	3072.00

Currency: USD

Consensus as of Jul-09-2015 11:04 AM GMT



Call Participants

EXECUTIVES

Gabriel Tirador

*Chief Executive Officer, President
and Director*

Theodore R. Stalick

*Chief Financial Officer and Senior
Vice President*

ANALYSTS

Kenneth G. Billingsley

*Compass Point Research &
Trading, LLC, Research Division*

Presentation

Operator

Good morning. My name is Karen, 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 second 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; Robert Houlihan, 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 second quarter operating earnings were \$0.64 per share compared to \$0.83 per share in the second quarter of 2014. The deterioration in operating earnings was primarily due to higher catastrophe losses, increased advertising expenses, the results of the recently acquired Workmen's Auto and less favorable reserve development as compared to prior year.

Excluding the impact of catastrophes and favorable reserve development, the combined ratio was 97.9% in the second quarter compared to 96.3% in the second quarter of 2014.

Workmen's Auto added 0.2 points for the second quarter combined ratio.

Premiums written grew 5% in the quarter primarily due to higher-average premiums with policy, the acquisition of Workmen's Auto and an increase in new business policy sales. Workmen's Auto premiums written of \$5.3 million added 0.8 points to the quarter's premium growth.

In the second quarter of 2015, California private passenger auto frequency and severity increased in the low single-digits.

On a sequential basis, frequency and severity was relatively flat from the first quarter.

Higher-average premiums from rate increases taken in 2014 partially offset the year-over-year increase in the frequency and severity in the quarter.

To further address the increase in loss cost, a 6.4% rate increase was implemented in late May from Mercury Insurance Company representing about half of our company-wide premiums written.

In addition, a 6.9% rate increase for California Automobile Insurance Company, representing about 15% of our company-wide premiums, was implemented on August 2.

Results outside of California were negatively impacted by \$7 million of catastrophe losses, primarily in Texas and Oklahoma and our private passenger auto business in New York. Excluding catastrophe losses, the combined ratio was about 100% outside of California.

In New York, we continue to evaluate reserves as the impact of changes in claims procedures, which include the speeding up of claims settlement in case reserving, have added an element of uncertainty to the estimates.

In New York, we implemented a 3% rate increase in January of 2015 and a 9% rate increase in July of 2015.

Our expense ratio in the quarter increased to 27.3% from 26.8% in the second quarter of 2014. The increase in expense ratio was primarily due to higher advertising expenses, partially offset by lower average commissions.

Net advertising expense in the quarter was \$12.1 million compared to \$5.5 million in the second quarter of 2014.

Our 2015 advertising budget is heavily weighted toward the first half spend. The advertising spend will be lower for the remaining 2 quarters of 2015.

Company-wide, private passenger auto new business applications submitted to the company increased 11% in the second quarter of 2015 and homeowners new business submissions were up 32%.

In California, we posted premiums written growth of 5.6%. Outside of California and excluding our mechanical breakdown products, premiums written increased 5.5% in the quarter. This compares to negative growth of 3.9% and 7.6% for the years 2014 and 2013, respectively.

With that brief background, we will now take questions.
Hello? Are there any questions?

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Ken Billingsley from Compass Point.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

Just a few questions. One on tax expense. Was the operating tax expense, was there a benefit during the quarter? Or is it just naturally lower in general? Was there anything unique in the quarter?

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

No, there's nothing unique. We get a tax benefit on our realized losses on our investment portfolio, which is primarily due to mark-to-market adjustments as we flow all our investments changes through the P&L. And as you can know from the P&L, we had an investment loss for the quarter, so that would have positively impacted the income tax accruals.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

But after adjusting for -- backing up to realize loss portion, there was no other movement?

Theodore R. Stalick

Chief Financial Officer and Senior Vice President

No, no.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

Okay.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

On the underwriting leverage side, it looks like it's moving up slightly and I think I've asked this question before but just to clarify. Given your movement in mix of business, where do you feel comfortable taking underwriting leverage to?

Gabriel Tirador

Chief Executive Officer, President and Director

I would say about 2.5x.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

And that's with the addition of commercial business and the Workmen's group as well?

Gabriel Tirador

Chief Executive Officer, President and Director

Yes.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

Okay. And essentially, if you close in on that level depending on profitability, at what point on the dividend payout ratio do you guys have to maybe slow down on the dividend?

Gabriel Tirador*Chief Executive Officer, President and Director*

Well, the dividend payout ratio probably this quarter was what, close for about 100% or a little just under -- just a little bit under 100%. There's a lot of factors that go in to the dividend payout ratio. We take a look at our earnings, our prospects. It's something that the board decides every quarter. We feel that today, we have a pretty good capital position where in years that we haven't really earned the dividend, we've been able to pay out a dividend. So it's something for the board to evaluate every quarter, but at this point, with the amount of the capital position that we have, we feel pretty comfortable where we're at. Now to your question, if we get up to 2.5x leverage, and we're using more of our capital to buy more business, I think your question is, what happens to the dividend at that point. We, obviously, don't expect though to have earnings at this level for long periods of time. Our combined ratio was 98.5% in this quarter. We don't expect that 98.5% to continue for a long period of time. So we do anticipate that our margins are going to improve.

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

Okay. And on the realized loss side, I know you talk about the payout ratio on the operating side. In the first half of 2014, the first -- you had more realized gains than the last 4 quarter losses, but you have had 4 quarters of realized losses. Can -- is there something that you've invested in? Or is there some change that you're making that there's been this linked losses on the unrealized investment portfolio?

Theodore R. Stalick*Chief Financial Officer and Senior Vice President*

We -- I'll let Chris talk, but as we mark our securities to market, they're sensitive to changes in market interest rate. Because as you know, most of our portfolio is primarily fixed income. And we flow those changes through the P&L, so we get the negatives when interest rates go up, but the positive when interest rates go back down as far as our P&L adjustment.

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

And I apologize, I sort of -- most of the bulk of your portfolio held for trading?

Theodore R. Stalick*Chief Financial Officer and Senior Vice President*

The entire portfolio is trading.

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

And strategically, I'm assuming, obviously, you've put some thought into that, what is the reason for doing that versus available sale?

Theodore R. Stalick*Chief Financial Officer and Senior Vice President*

When the new pronouncement came out, I think it was 1 59 a few years ago. We evaluated the accounting, and we felt that the true measure of earnings is really our core operating earnings. But we had found that when you are having to write down securities due to temporary market gyrations, you weren't able to get the benefit of when the market bounced back. So we just felt like it was better for the company to flow all the changes through the P&L and mark everything to market as a trading portfolio.

Gabriel Tirador*Chief Executive Officer, President and Director*

And there was all these discussion with the auditors every quarter with respect to what was permanently impaired, what was other than temporary. And the fact of the matter is, whether you run it through your

balance sheet or your income statement, the numbers are there. So to us, it's simpler and if you back out the realized gains or losses, you get to your operating earnings.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

And the last question I was just on Policies-in-Force connected to the advertising. It looks like you did have another uptick in personal auto Policies-in-Force, but flat year-over-year. So I would imagine that maybe year-over-year comparison probably isn't most reflective given the fact that you've implemented a bunch of rate increases. So how are you viewing that flat year-over-year, but up on the sequential quarter?

Gabriel Tirador

Chief Executive Officer, President and Director

Well, in California, we have a very large book. So the new business probably represents about 10% of our premiums written, and you have 90% coming in from renewals. So new business, although it has an impact, it's obviously not as big as an impact as renewal business. And our California flight passenger auto new business sales were up something like 9% and they're up 11% company-wide. So we are seeing some nice new business sales growth, which should help our renewals in future years. Now in '14, my recollection is that in '14, our new business sales were down quite a bit over '13, which had an impact this year on renewals. So we feel relatively comfortable in our Mercury Insurance Company where we just implemented the 6.4% rate increase, our retention did go down slightly, but actually, went down less than we anticipated. So that was good news so far. It's only been one month into that rate increase, but we were anticipating a larger reduction and retention than we have seen so far.

Kenneth G. Billingsley

Compass Point Research & Trading, LLC, Research Division

Okay. And then on the advertising side, I believe most of your advertising was done more on a national plan as opposed to focus. How has that turnaround -- turned out in states outside of California?

Gabriel Tirador

Chief Executive Officer, President and Director

Most of the advertising, honestly, is coming in, in California. Now the TV advertising is a national cable ad and it's national. In addition to that, we get these from lead aggregators, we buy these, we do online advertising as well. So it encompasses a lot of -- a whole lot of avenues for us to try to get new business. And outside of California, I think our PPA count new business was up something like 15%, so it's having a positive impact. And when we take a look at how effective our advertising is overall, we take a look at the lifetime value of the premium that we expect from all these new business sales from the advertising, and we deduct the cost of the advertising, obviously, we deduct the cost of the commissions, which are lower -- much lower than our stated commissions because we pay much less commission on this type of business that we get to our advertising, we deduct lead fees that we get from our agents. So we take a look at the lifetime value of that premium, deducting all the expenses, including the advertising, and right now, we're not recovering quite all the dollars, we're recovering pretty much most of the dollars. But I will say when you add back the anticipated underwriting income from the sales generator of the premium sales, we're definitely in the black. So overall, where we need to improve but overall, I would say it's been a decent investment in the advertising.

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 this quarter, and we'll talk, again, next quarter.

Operator

This concludes today's conference call. All participants may now disconnect.

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