S&P Global
Market Intelligence

Mercury General Corporation NYSE:MCY

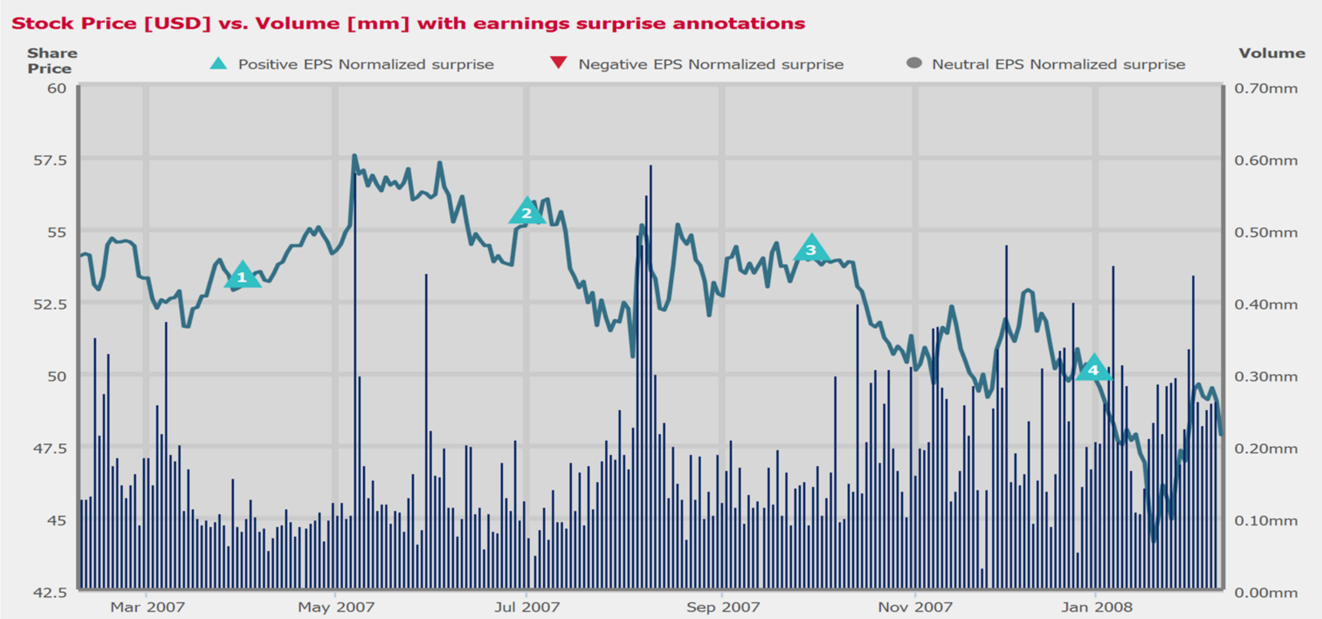
FQ1 2008 Earnings Call Transcripts

Monday, May 05, 2008 5:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2008-			-FQ2 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.00	1.02	0.99	1.03	4.02	3.96
Revenue	-	-	(4.40 %)	-	-	-
Revenue (mm)	762.87	729.27	-	710.82	2898.40	2912.38

Currency: USD
Consensus as of May-05-2008 4:21 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ1 2007	1.05	1.11	5.71 %
FQ2 2007	1.09	1.15	5.50 %
FQ3 2007	1.12	1.13	0.89 %
FQ4 2007	0.82	0.96	17.07 %

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Call Participants

EXECUTIVES

Gabriel Tirador

Robert Houlihan

Ronald Deep

ANALYSTS

Joshua Shanker
Citigroup

Meyer Shields
Stifel Nicolaus & Company, Inc.

Unidentified Analyst

Unidentified Company Representative

Presentation

Operator

Good afternoon. My name is Celeste, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General First Quarter Results 2008 Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions].

This conference 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'd now like to turn today's call to Mr. Gabriel Tirador. Sir, please go ahead.

Gabriel Tirador

Thank you very much. I would like to welcome everyone to Mercury's first quarter conference call. I am Gabe Tirador, President and CEO. In the room with me is Mr. George Joseph, Chairman; Ted Stalick, Vice President and CFO; Chris Graves, Chief Investment Officer; John Sutton, Senior Vice President, Customer Service; and Robert Houlihan, Vice President and Chief Product Officer. On the phone, we have Ron Deep, Vice President of the South East Region and Bruce Norman, Senior Vice President of Marketing.

Before we open it up for questions, I would like to make a few comments regarding the quarter. In our California operations, our combined ratio increased from 91.2% in the first quarter of 2007 to 94.1% in the first quarter of 2008. The primary reasons for the increase was an increase in auto frequency in the low-single digits, and increase in auto severity in the mid-single digits, adverse development of approximately $5 million, and an increase in our expense ratio.

Our California frequency was impacted in the quarter, especially in January and February from significantly higher rainfall amounts as compared to the prior year. The increase in the frequency was seen primarily in our collision coverage. The increase in severity was due to a higher bodily injury and physical damage costs related to higher medical, labor and parts [ph] cost.

Our homeowners' results were also negatively impacted by the weather during the quarter, as frequency increased significantly as compared to prior year. In California, we recently implemented new automobile rates. The overall rate impact of this new rate level is an approximately 2.4% rate reduction. In addition, this new rate level gets us very close to full compliance with the new territorial rate regulations. As required by the regulations, we plan on making new filing by July of 2008 to make us fully compliant.

Based on our review of other carriers' filings, there are some major competitors that do not appear to be close to full compliance. We believe there will be some dislocation in the market as competitors file and implement their new rate to comply with the new territorial regulations. We will continue to monitor our results closely and make any necessary future rate filings we feel necessary.

In addition, we have recently filed for an approximately 10% rate reduction in our California homeowners line. Subject to regulatory approval, our plan is to have the new rates be effective on September 1st. We believe our new homeowners rates will make us much more competitive on package policies.

Our combined ratio of a 100.2% in our non-California operations improved as compared to the 104.9% combined ratio in the first quarter of 2007. The improvement in the combined ratio is largely due to positive development of approximately $10 million recorded on prior accident years, primarily from our Florida and New Jersey operations.

In our Florida operations we continue to see improvement as a result of our continued focus on operational improvements. Consequently, we reduced our prior year ultimates for bodily injury during the quarter.

New Jersey continues to be the most difficult state to estimate our ultimate liabilities for the bodily injury and PIP coverages, due to both the lack of historical data and the long-term nature of these coverages. In the first quarter of 2008, we reduced our prior year estimates for bodily injury and increased our estimates for PIP and loss adjustment expenses for New Jersey.

Our expense ratio in our non-California operations increased from 30.4% in the first quarter of 2007 to 34.3% in the first quarter of 2008. The increase in the expenses ratio was due to various accrual adjustments, including adjustments related to improve profitability outside of California.

In addition, fixed costs have not declined in proportion to the declines and premiums, thereby, negatively impacting the expense ratio. To address the increase in the expense ratio, we had a reduction in force in of our states outside of California. In addition, we are freezing any new hiring except for certain positions.

Our new product management function headed by a new Vice President and Chief Product Officer, Robert Houlihan continues to make progress in improving our segmentation and overall pricing adequacy. During the quarter, we filed for rate changes in two of our states. The rate changes include an overall increase in rates as well as changes to improve our segmentation. The effective dates of these changes are expected to be in the summer. Our current plan is to make similar filings in an additional six states during the second quarter with proposed effective dates in the summer and in early fall.

The competitive environment remains intense. We believe our growth rate over next several quarters will be negative in the mid to high-single digit. Although we believe the market is beginning to change, it is difficult to accurately predict when the market will begin to harden.

However, we know that the margins of many of our competitors for the personal auto line are deteriorating. In addition, we continue to observe more filings for rate increases than rate reductions. Consequently, we believe we will continue to see an increased level or rate action taken by some of our competitors.

We continue to focus on various strategic initiatives that will allow us to take full advantage when the market begins to harden. The various strategic initiatives will include continuing to standardize our claims and underwriting processes, improving our pricing to improve segmentation, improving our technology and enhancing our customer service levels.

The development of our Mercury First front-end sales system originally scheduled to be rolled out in the first date in the first quarter of 2008 has been delayed a few months. Our revised deployment date to our first date is in June.

As we reported in our press release, our adoption of SFAS No. 159 resulted in $60.6 million after tax of changes in fair value that were recognized as realized losses instead of as changes to accumulated other comprehensive income in shareholders' equity. A significant portion of this loss was a result of liquidity problems in the overall municipal bound markets and credit downgrades for several municipal bound insurers. Our response to this crisis has been to take advantage of this current environment and locking attractive yields when possible.

Now with that brief background, I will now open it up for questions.
Question And Answer

Question and Answer

Operator

[Operator Instructions]. Your first question comes from the line of Josh Shanker with Citi.

Joshua Shanker
Citigroup

Good morning to you.

Gabriel Tirador

Good morning Josh.

Joshua Shanker
Citigroup

I was wondering if you could talk a little about your perceptions of excess capital. And I know that there is not much you can say, but I'm still interested in thoughts about perhaps a share repurchase or even a large share repurchase, if you could get perhaps Gloria to sell shares or what your thoughts are there?

Gabriel Tirador

Well, our capital management, as you know Josh, historically has been for us to distribute our capital back to our shareholders through dividends and increasing dividends pretty much every year. That really has not changed, and really don't foresee that to change.

Joshua Shanker
Citigroup

In terms of... can you talk about what you think your excess capital position might be, or even how much more capital you have compared to what you think you need to be operating your business at the current levels?

Gabriel Tirador

Well, we have said historically Josh that we would be comfortable writing at a higher premium to surplus ratios. I believe we are in the neighborhood of 1.4

Unidentified Company Representative

1.6.

Gabriel Tirador

1.6 to 1. And we've said in the past that... and we have done this in the past where we burn up to 3 to 1 if not in excess of that. So, our plan, as I said, is to continue to distribute our capital back to shareholders through increased dividends, and use that capital as the market begins to harden. And hopefully here we'll see some top-line growth when that occurs.

Joshua Shanker
Citigroup

Okay. And in terms of overall compensation with the agencies, are you finding that there is much change in terms of commission rates at this point right now? Or do you see that intensifying in terms of some companies paying more?

Gabriel Tirador

We have seen... in this market we have seen some companies pay more. We've seen companies with contests increasing commission levels. We've seen some of that. Although, I believe that that will start to diminish as you probably have noticed Josh, the results of some of the major competitors have started to deteriorate.

Joshua Shanker
Citigroup

That's true, that's true. Do you see anyone paying more than 15% commissions out there right now?

Gabriel Tirador

On selected basis for some times see for a period of time company come in and say we'll pay you X revenue a the new business policy. But generally, I have got to say that we don't see that often people pay more than 15.

Joshua Shanker
Citigroup

Okay. Well thank you for your answers. I appreciate it.

Gabriel Tirador

Thank you.

Operator

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

Meyer Shields
Stifel Nicolaus & Company, Inc.

Thanks. Hi everybody.

Gabriel Tirador

Hi.

Meyer Shields
Stifel Nicolaus & Company, Inc.

Do you see any change to either your levels or competitor rate levels; this is for California personal auto under the Commissioners recent emergency regulations?

Gabriel Tirador

Under the emergency regulations?

Meyer Shields
Stifel Nicolaus & Company, Inc.

Right.

Gabriel Tirador

Well, we're still evaluating those emergency regulations. On the whole, they appear to be a little better than the existing regulations. But we're still in the process of evaluating that, Meyer.

Meyer Shields
Stifel Nicolaus & Company, Inc.

Okay. So, right now you don't have any... well let me ask this differently. When you make your next filling in July, do you expect any rate changes in that?

Gabriel Tirador

We're still evaluating that. We just, as you know, implemented a small rate reduction that was effective just about a week or two ago. And our actuaries and product management group are working right now and looking at what this next rate that is going to be. Inflation is going up. As I mentioned in my comments, we are seeing severity going up. So depending on how far out you think that rate level is going to be effective, it's possible that you may see some rate change there.

Meyer Shields
Stifel Nicolaus & Company, Inc.

That's helpful, thank you. Also, this is a tricky question to ask, obviously Mercury has been decided frequently in the news following Liberty Mutual announced were plan by SAFECO, I don't expect that you want to comment on that, but can you talk a little bit about how county [ph] compatible you think Mercury would be with another company?

Gabriel Tirador

Personally, I think we have unique culture at Mercury. And it would be difficult, I think, to match another company's culture. There are some divisional type companies that I've heard of, that appear to have similar culture. But net-net I think that we have a culture that is somewhat unique.

Meyer Shields
Stifel Nicolaus & Company, Inc.

Okay. Thank you very much. Very helpful.

Operator

[Operator Instructions]. And there are no further questions at this time.

Gabriel Tirador

Okay, no further questions. Are you sure?

Operator

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

Unidentified Company Representative

Okay.

Meyer Shields
Stifel Nicolaus & Company, Inc.

Thanks. It just seems like there is time today. If I look at the accident period combined ratios outside of California, we really haven't seen much of a change there. It's been sort of in the mid 100 plus range. If that, should that surprise us?

Gabriel Tirador

Well, I think there is a couple of things there, Meyer, that you have to take into consideration is, one is the current accident period is obviously the most difficult to predict. And, we've had a situation like we did in this quarter, where we did bring down some reserves from prior periods, which impacted the calendar year results. We are going to continue to monitor our results going forward with respect to the current accident period. But I can tell you that we are making a lot of changes to our products, as I mentioned earlier, we have... we just filed two rate changes this month. We have another six changes that we want to make in the second quarter, all of which... some of which are increasing rate levels, but in addition to that, improving segmentation.

We have found pockets of areas where we clearly are not segmenting our pricing accurately, and all of these things, I think, are going to continue to have a positive impact on our results outside of California, in addition to all the operational improvements that we continue to have outside of California on a claims and underwriting side. So, I guess to answer your question, we are still playing it under current accident year, we are still waiting to see solid results before we bring down any kind of accident, current accident year results.

Meyer Shields
Stifel Nicolaus & Company, Inc.

Okay. If I can dig into, I guess, one of your comments, you said that you're seeing areas where your segmentation needs to be improved. Is that based on analysis of your own data or what your competitors are doing?

Gabriel Tirador

I will let Robert take that, but it's a little both but

Robert Houlihan

Yes, I would say, it's a little bit both. I would say the primary types of changes we are making are in tiering [ph], where we found that we utilize a number of variables in our in our tiering such as accidents and violations, which we also surcharged for and resulted in some incorrect pricing as a result. And we are simplifying our tearing and improving our segmentation based on internal analysis as well as supplementing that with relativity that are generally used by competitors.

Meyer Shields
Stifel Nicolaus & Company, Inc.

Okay. That's very helpful. Thanks so much.

Gabriel Tirador

Thank you.

Operator

Your next question comes from the line Wan Bobman with Capital Return [ph].

Unidentified Analyst

Hi, thanks a lot. I thought we are going to get one more question from Charlie Gates, I guess not. I had two questions with two different topics. I was curious if the recent legislative session in Florida brought forth any legislation that that would impact your auto business there, was my first question?

Gabriel Tirador

Why don't you... Ron, you on?

Ronald Deep

Yes I am. I don't see anything in the revision to the law that is going to be problematic for the automobile side. Most of what is obtained the focus of that law has been to strengthen the Office of Insurance Regulation and to strengthen the prior approval regulations in Florida. But when you look at the country as a whole, most other states that we do business in, have some kind of prior approval regulation already in place.

Unidentified Analyst

Okay. And just as a follow up on that one topic. So there was nothing addressed with respect to PIP of late? Is that still as it stood before?

Ronald Deep

PIP is back in essentially the same format that it left. There are some improvements around who can own some of these treatment centers and some of the fee schedules. But essentially PIP is virtually unchanged, and PIP did not make it to the legislative session this year.

Unidentified Analyst

I see. Okay. But it's reinstated as it was before it lapped in partiality?

Ronald Deep

Yes.

Unidentified Analyst

Okay. And I had an unrelated question with respect to bodily injury. And I'm curious to know with respect to sort of medical utilization, if you're seeing any up-tick in BI, which would be attributable, so you sort of... your suspicion of sort of increased utilization, increased number of testing prescribed, et cetera, at the, I guess, the hospital and medical center level. And if you're seeing any of that, if it's localized or if it's geographically spread? Thanks.

Gabriel Tirador

I don't know we're seeing really any increased utilization. We are seeing just inflationary pressure in the bodily injury line, in fact, probably in the mid to high-single digits. But I can't really comment on the fact that we're seeing actually increased utilization with respect to the medical.

Unidentified Analyst

Do you track the components of BI across sort of different buckets, so you could... so you then would be able to track changes in meaningful buckets whether it be prescription drugs or tests for a certain sort, et cetera, et cetera?

Gabriel Tirador

Well, we track medical specials, and we also track the pain and suffering piece. So, we have an idea of how much medical costs are going up versus the other non-component, but don't have a tracking mechanism for a more granular level that you are talking about.

Unidentified Analyst

Okay. So it's really like two major buckets comprised in your view.

Gabriel Tirador

Yes.

Unidentified Analyst

Okay. All right. Thanks a lot and best of luck. I appreciate your time.

Gabriel Tirador

Okay. Thank you.

Operator

Thank you. [Operator Instructions]. And you have no further question.

Gabriel Tirador

Okay. With no further questions, I'd like to thank everyone for being on the call, and we'll talk to you next quarter. Thank you very much.

Operator

This concludes today conference call. You may now disconnect.