

Mercury General Corporation NYSE:MCY

FQ3 2012 Earnings Call Transcripts

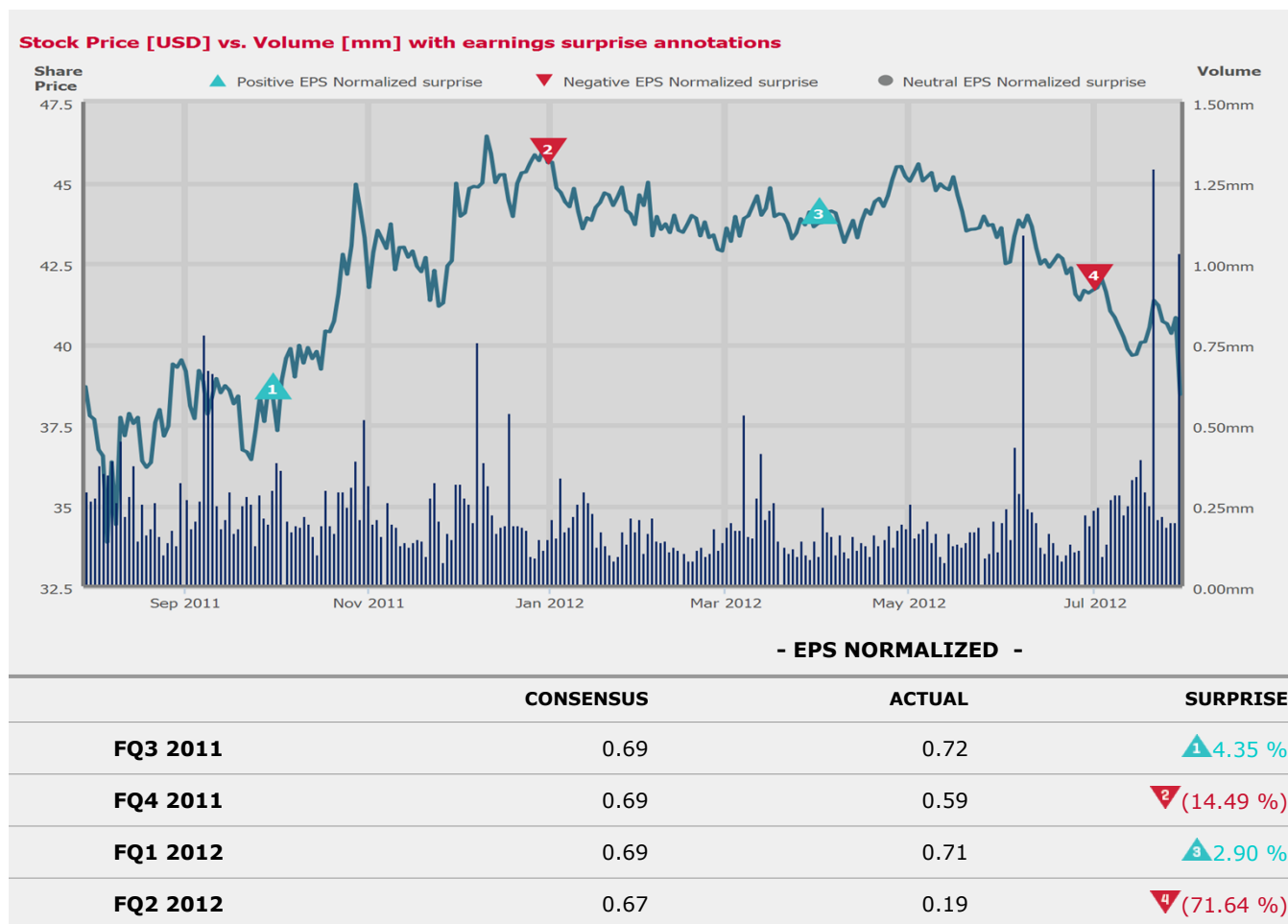
Monday, October 29, 2012 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.56	0.62	▲10.71	0.55	2.03	2.35
Revenue (mm)	675.53	684.88	▲1.38	652.55	2720.00	2738.80

Currency: USD

Consensus as of Oct-29-2012 2:44 PM GMT



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

ANALYSTS

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

Raymond Iardella

Macquarie Research

Ronald David Bobman

Capital Returns Management, LLC

Presentation

Operator

Good morning. My name is Marly, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mercury General Corporation Third Quarter Results 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 third 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; Chris Graves, Vice President and Chief Investment Officer; and John Sutton, Senior Vice President, Customer Service. On the phone, we have Robert Houlihan, Vice President and Chief Product Officer. Before we take questions, we will make a few comments regarding the quarter.

For the seventh consecutive quarter, our premiums written increased over the prior year. In the third quarter, premiums written grew by 3.4%, the highest it has been since we started growing in 2011. The growth is attributable to several factors including our California revenue neutral rating plan we implemented in December of 2011 that made us more competitive for new business, as well as an increase in the number of agents selling our products.

California new business private passenger automobile sales increased year-over-year in the quarter by 20%. Our combined ratio was 99.1% in the third quarter of 2012 compared to 98.3% in the third quarter of 2011. We recorded \$4 million of unfavorable reserve development on prior accident years in the quarter and \$33 million for the first 9 months of 2012. Most of the \$4 million development in the quarter came from our discontinued Florida homeowners line of business and from a few large claims in commercial property that developed worse than we anticipated.

The third quarter results were aided by a decline in the expense ratio. The 26.6% expense ratio in the quarter was lower than the 27% expense ratio recorded in the third quarter of 2011, primarily due to a reduction and profitability-related accruals. Going forward, our current expectation is for the expense ratio to be in the 27% to 27.5% range.

In California, we obtained approval from the California Department of Insurance for an approximately 4% private passenger auto rate increase. The increase went into effect on October 26, 2012, for both new and renewal policies. Although the 4% rate increase is less than the 6% increase we requested, this rate increase will get us closer to our targeted combined ratio. In addition, we are evaluating the possibility of filing for further rate increases.

As I mentioned last quarter, our hearing on our California homeowners rate filing has concluded. A recommended decision from the judge was due to the Commissioner on September 24. We expect to receive a copy of that decision any day now, and the Commissioner has up to 100 days from the date he received the decision to take action.

Outside of California, the rate actions and cost management initiatives we have taken are starting to take hold. The combined ratio outside of California was a little over 100% in the quarter. We expect the results outside of California to continue to improve.

I am pleased to report that last week we launched our Baybon [ph] platform in California. Our Baybon [ph] platform allows for the sale of new business online and also includes our agency partners in the

transaction. Our Board of Directors approved an increase in our quarterly dividend to \$0.6125 per share, marking the 27th consecutive year that Mercury has increased our shareholder dividend.

Lastly, we know that Hurricane Sandy is on everyone's mind right now. We are following the hurricane closely, and our catastrophe team will be ready to respond for our affected policyholders in their time of need.

In our North East region, which includes New York, New Jersey, Pennsylvania and Virginia, we have 25,000 homeowner policies in force. At this point, it's difficult to estimate what our losses from Hurricane Sandy will be.

With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Meyer Shields with Stifel, Nicolaus.

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

Two quick questions if I can. One, are the policies that are going to reflect the rate increase in California, are those going to be 12-month or 6-month policies?

Gabriel Tirador

Chief Executive Officer, President and Director

They are a combination of both, but I would say the majority are 6-month policies. I would say probably 90% of the policies are 6 months right now.

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. Is it simply the insurance decision about whether you're going 6 months or 12?

Gabriel Tirador

Chief Executive Officer, President and Director

Well, in Mercury Insurance Company, we started writing annual policies earlier this year, so our Mercury Insurance, which is by far our biggest company in California, there was no auction. It was historically only 6 months that we roll, but it's, yes, typically the agent talks to the insured about the various alternatives, and it's up to them to decide whether it's a 6-month or 12-month policy. But in our largest company, again, we just started writing annual policies recently.

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And I guess the pretax investment yield picked up fairly significantly from the second quarter, just wondering whether you could talk to that a little bit.

Gabriel Tirador

Chief Executive Officer, President and Director

Yes. On the pretax or the after-tax or both?

Meyer Shields

Stifel, Nicolaus & Company, Incorporated, Research Division

I'm looking on the pretax basis, but if there's something on the after-tax then please let me know.

Gabriel Tirador

Chief Executive Officer, President and Director

Okay. Well, there's been a larger allocation to dividend paying stocks in the portfolio. And I have Chris, do you want to talk about that?

Christopher Graves

Chief Investment Officer and Vice President

Well, yes, in terms of the pretax, we are trying to pick up more yield mainly off of dividend stocks, but municipal bond income levels -- the reinvestment yields are so low right now, and going out on the curve doesn't make a lot of sense to me. So we have allocated quite a bit more into common equities. That's most likely what's driving that change.

Gabriel Tirador

Chief Executive Officer, President and Director

And then on the after-tax, that's also driving the effective tax rate up a little bit on investment income as the dividends are not as tax sheltered out the municipal bond interest.

Operator

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

Alison Marnie Jacobowitz

BofA Merrill Lynch, Research Division

I guess 2 questions. One is, did the shift to annual policies impact premium growth materially this quarter? And then the second is, did you make any changes to current year reserves in the quarter?

Gabriel Tirador

Chief Executive Officer, President and Director

Well, the shift to annual policies really started in late December last year, and we're seeing that under 7% of the total California portfolio personal auto policies written are now annual policies. But it's hard to tell because it's somewhat distorted when you look at it on a year-over-year basis. And there was somewhat of an offset from the temporary decline and retention from the dislocation that was caused by our rate plan we implemented last December. We do know that California personal auto policies and force counts are up a little over 2% when you compare them from September of 2012 to September of 2011. So to the extent that you can measure it based on policies in force, they're growing at a comparable rate to the rate of premium growth. On your question on the loss development within the year, we, really, Alison, analyze it on a year-to-date basis now, and so it's hard for us to make any comment on what was happening within the current accident year.

Operator

And your next question comes from Ray Iardella with Macquarie.

Raymond Iardella

Macquarie Research

Just a few questions for me. Could you -- would you mind repeating the policyholder number you gave in terms of the North East?

Gabriel Tirador

Chief Executive Officer, President and Director

There's 25,000 homeowner policies in the Northeast region for us, homeowners.

Raymond Iardella

Macquarie Research

Okay. Okay, that's perfect. And how does that compare to, I guess, last year around this time? I mean, has that materially increased? Has it been pretty consistent, or has it been declining?

Gabriel Tirador

Chief Executive Officer, President and Director

The growth in our homeowners misses, it's up. I don't have that specific number for you, but it's definitely up year-over-year. Our homeowners line has grown. To give you some context, last year, we had Hurricane Irene. And it's hard to estimate what the impact of Sandy is going to be compared to Irene, but Irene cost us \$4 million last year, to try to put it into context. But it's way too early for us to estimate what we think the impact is going to be.

Raymond Iardella

Macquarie Research

Okay. No, I can appreciate that. I'm just trying to get directionally how we should be thinking about that relative to Irene. I guess other question, I know in you -- in the past, you guys talked a lot about BI severity in California. Just curious, what are the current loss trends in California given, I guess, the roughly 4% rate increase you guys are putting into place in late October?

Christopher Graves

Chief Investment Officer and Vice President

We're seeing severity in the lower middle single digits, if that makes sense, the 3% to 4% range and frequency in the low-single digit, 1% to 2% in California.

Raymond Iardella

Macquarie Research

Okay. That's certainly helpful as well. And then just last one for me. In terms of Proposition 33, can you guys kind of comment on your thoughts on that initiative and kind of how that would position Mercury going forward if it were to pass and if it weren't to pass?

Gabriel Tirador

Chief Executive Officer, President and Director

Well, if it were to pass, we think it's going to make it easier to attract new business for us since companies today are not allowed to operate continuous insurance discount to new customers but only to existing clients. So I think it's going to improve our competitiveness on new business by allowing us to offer this discount to customers that are getting it from their existing carriers. So it will improve our competitive position. And if it doesn't pass, well, we still feel that we have a competitive product, we're growing in California. As we mentioned earlier, our app [ph] counts in the quarter year-over-year was up a little bit over 20%. So we still feel good about Mercury's position here in California despite what happens with the initiative. But obviously, if the initiative were to pass, we feel that long term, that will be a nice plus for Mercury because it will allow us to attract new business. And we also feel it's good for consumers as well because consumers are going to be able to shop for better rates. So it's a net-net win for both, we believe for us and consumers. So -- but again, I just want to reiterate that we are growing. We grew 20% this quarter, so if it doesn't pass, we still feel pretty good about our position here in California.

Raymond Iardella

Macquarie Research

Okay. That's certainly helpful. And one last one if I could sneak it in, and just update the Florida homeowners business assuming that is -- you guys are completely out of that. I think the previous guidance was the end of September.

Gabriel Tirador

Chief Executive Officer, President and Director

Yes, we are completely out of the homeowner business in Florida. We do have some one-off claims that we're going to have for some time but basically have no policies in force at the end of September in Florida.

Operator

[Operator Instructions] Your next question comes from Ron Bobman with Capital Returns.

Ronald David Bobman

Capital Returns Management, LLC

A question on Florida, about Florida Auto. I was curious, in the wake of the PIP, guess legislative changes, what's your rate plan and your thoughts about recognizing or not yet recognizing any impact from the legislative change there?

Gabriel Tirador

Chief Executive Officer, President and Director

Robert, do you want to take that question?

Robert Houlihan

Chief Product Officer and Vice President

Sure. In Florida, we have -- I'm just checking on our filing for our line of product.

Gabriel Tirador

Chief Executive Officer, President and Director

Well, we made the required filing. I guess, it was due on 10/1, Robert.

Robert Houlihan

Chief Product Officer and Vice President

Yes.

Gabriel Tirador

Chief Executive Officer, President and Director

And the filing indicated that our PIP indication was higher than 10% for PIP. So basically, we filed for no change in rates because our -- even though that the new statute required you to reduce rates by 10%, our indication was that for PIP that it would be over than 10% -- higher than 10%. So we did not take the rate increase that was indicated because of that. So that's what I believe we did. Robert?

Robert Houlihan

Chief Product Officer and Vice President

Yes, that's correct. We are assuming that the improvement in PIP from the regulatory changes will offset our indicated rate B, but we didn't actually decrease our PIP rates.

Gabriel Tirador

Chief Executive Officer, President and Director

Right.

Ronald David Bobman

Capital Returns Management, LLC

And then some people I think have assumed adverse losses in BI or sort of other liability lines in the auto product. If I'm close to right, are you making any assumptions about that?

Gabriel Tirador

Chief Executive Officer, President and Director

Robert, did we make any assumptions on BI? I think we just used -- in our latest filing, we just used our historical trends, which BI was going up in Florida. But I don't believe that in our latest filing we made any kind of estimated forecast as to what we thought BI would be after the PIP legislation, at least not in this latest filing.

Robert Houlihan

Chief Product Officer and Vice President

That's correct. Yes, we used our historical trends. We didn't project for any changes in BI relative to the PIP reform.

Gabriel Tirador

Chief Executive Officer, President and Director

Right.

Operator

And there are no further questions at this time.

Gabriel Tirador

Chief Executive Officer, President and Director

Okay. Well, thank you, everyone, for joining us. And those of you in the East Coast, please stay safe. Thank you very much, and we'll talk to you next quarter.

Operator

Thank you for your participation. This does conclude today's conference. You may now disconnect.

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