S&P Capital IQ

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Mercury General Corporation NYSE:MCY

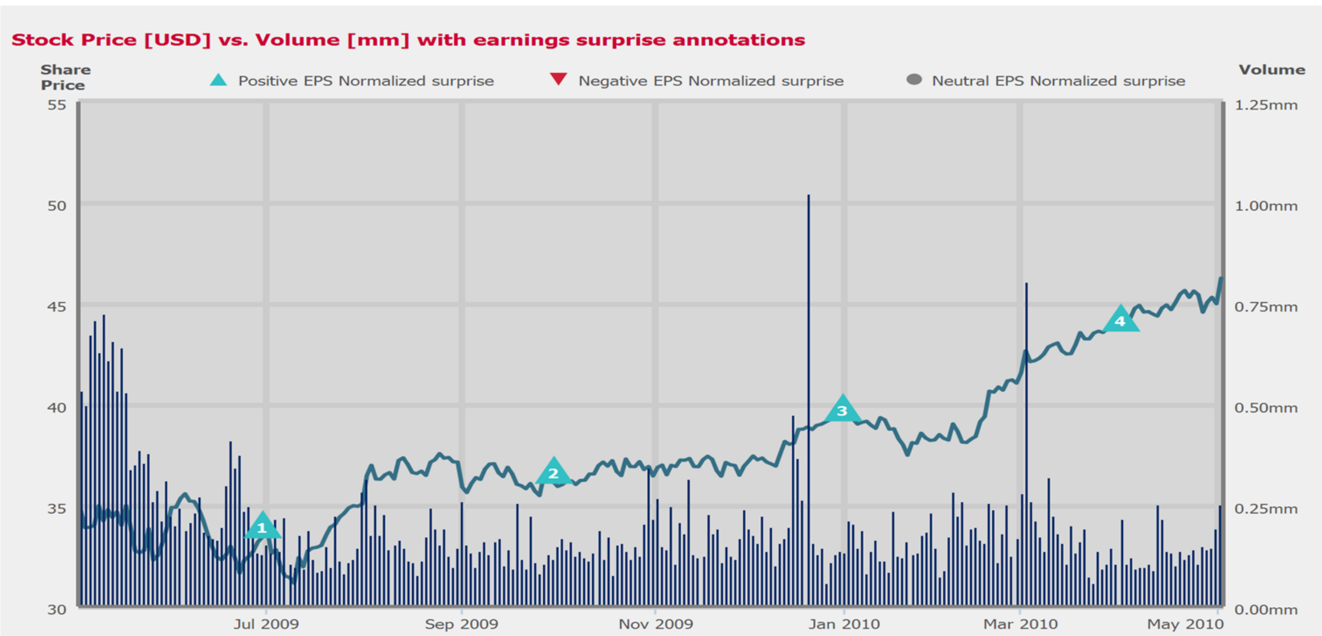
FQ2 2010 Earnings Call Transcripts

Monday, August 02, 2010 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.71	0.65	(8.45 %)	0.72	3.10	3.12
Revenue (mm)	673.73	631.11	(6.33 %)	649.50	2536.30	2526.20

Currency: USD
Consensus as of Aug-02-2010 2:30 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2009	0.70	0.86	22.86 %
FQ3 2009	0.66	0.84	27.27 %
FQ4 2009	0.68	0.69	1.47 %
FQ1 2010	0.68	0.85	25.00 %

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

Gabriel Tirador
Chief Executive Officer, President and Director

George Joseph
Founder and Chairman

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Ron Bobman
Capital Returns

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 Second 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 today's conference 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, Vice President and CFO; and Chris Graves, Vice President and Chief Investment Officer.

Before we take questions, we will make a few comments regarding the quarter. Excluding $12.1 million of costs associated with our support of Proposition 17 and $4.5 million of losses related to significant hailstorms in Oklahoma, our second quarter combined ratio was 96.4%.

As we reported in previous quarters, we supported Proposition 17, the Continuous Coverage Insurance Discount Act. Proposition 17 would have provided for a portable persistency discount, allowing insurance companies to offer new customers discounts based on having continuous insurance coverage from any insurance company.

Although we are disappointed the initiative was narrowly defeated, we continue to offer a competitive product in California. In addition, we believe our pending rate filing in California, which introduces new discounts and roadside assistance coverage, will make us more competitive on new business. We have a meeting scheduled tomorrow with the California Department of Insurance to discuss the filing. We are hopeful that we will finalize the rate filing very soon.

In states outside of California, we continue to aggressively make changes to our rating plans to improve our segmentation and overall pricing adequacy. During the quarter, we implemented eight rating changes in our auto line and two rating changes in our homeowner line. Currently, six rating changes are planned for the third quarter of 2010.

The rate of decline in premiums written continued to improve during the quarter. Although premiums written declined 1% during the quarter to $631.1 million, this was an improvement over the 2.7% decline in the first quarter of 2010 and the 3.5%, 4.7% and 6.8% decline in the fourth, third and second quarter of 2009, respectively.

Our new Mercury First front-end sales system has now been deployed to all of our agents in California, and the utilization rate for the system is high. Feedback from our agents on the new system continues to be mostly positive.

Ted Stalick will now provide you with information regarding our tax provision for this quarter.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

During the quarter, the company adjusted our tax contingency reserves, resulting in an income tax benefit of approximately $3 million. This benefit is equal to $0.06 per share and is included in the operating income.

Also affecting taxes in the quarter was the non-deductibility of Prop 17-related cost. The tax benefit loss due to Prop 17 cost in the quarter was approximately $4 million or $0.08 per share. Without the impact of total expenditures of $12.1 million related to Prop 17 and the $3 million tax adjustment, the operating earnings would have been $0.81 per share for the quarter.

And with that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Dean Evans with KBW.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

I was wondering, first, if you could touch on the PIF [Policies-in-Force] growth in the quarter. It looks like the first quarter we've seen positive PIF movement in quite a while. What’s sort of underlying that growth?

Gabriel Tirador
Chief Executive Officer, President and Director

Most of that PIF growth is coming in our homeowner line. Ted, you want to elaborate?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes, we actually -- if you do year-over-year analysis from June of '10 compared to June of '09, total PIF growth was up a little under 1%, and that's coming off from the homeowners line. And we've expanded our homeowners. We're growing in California, but we've also expanded into some other states, including New Jersey and New York and Virginia. The only state that we're really curtailing our homeowners is in Florida.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

Also, just wondering, I believe there was $2 million in reserve releases for prior years. Was there any movement in current-year reserves? And I guess could you give a little more detail on reserve movements in general?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

We don't really comment anymore on reserves within the accident period because the way we analyze it, we think that the accident year reserves are a little bit more stable to look at. But in general, I can comment on frequency and severity, if that's helpful. We're seeing -- and this obviously changes a lot depending on which state and coverage you're looking at. But in general, in our larger states, frequency is trending up slightly. We're seeing some declines in material damage severity and some increases in bodily injury severity.

Operator

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

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

The tax adjustment itself, was that about $3 million, or is that just the net number because of the tax?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, there was a tax contingency reserve adjustment that was $3 million, benefit.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

And if you would separate -- well, I can probably do this on my own. I guess, I don't know if this is a question that you're still answering. But if we look at recent quarters, what we've seen is a sort of a swap off. We've had significant -- immediately prior accident year is favorable development, and that's been partly offset by adverse developments on older accident years. I just want to get a sense of whether that continued in the second quarter.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Most of the development in the year-to-date and in the quarter was on the 2009 bodily injury losses in California. And severity from the initial picks is lower today than the picks at year-end. And the claim count development is a little less than what we anticipated at year-end. To answer your question, are we taking more reserve takedowns in the '09 year, but seeing adverse development in prior periods, that's happened in the past. It's happening slightly to a less extent now and, primarily, where that's happening is in New Jersey.

Operator

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

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

The first question is, what is the new money yield you're getting, given what you're buying? And then the second question is, if you could tell us who the major opponents of Prop 17 were?

Gabriel Tirador
Chief Executive Officer, President and Director

Go ahead, Chris.

Christopher Graves
Chief Investment Officer and Vice President

Hi, Alison, it's Chris. Well, we're still trying to keep relatively short on the yield curves, so cash yields are not great. You're talking anywhere from 20 to 40 basis points. We remain focused on the tax-exempt part of the market for the bonds. And those yield, depending on how short you are, anywhere from practically 0% to like 4%. If you get a higher-yielding kicker bond, you can out just a few years on the curve to yield to call. You can get about 4%. So we're all over the map. I don't know exactly what you're trying to drive at other than perhaps tuning your model for on the income. But all I can give you is what we're getting in the current market, and that's about the shape of it.

Gabriel Tirador
Chief Executive Officer, President and Director

With respect to the organizations that were against Prop 17, the major organization was Consumer Watchdog was against Proposition 17.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And then one last question on the California changes that you've got filed, that includes that overall 2% rate increase, correct? That still hasn't come through yet.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, that's been filed for -- that's included in that filing. And I think it was less than 2%; it was like 1 1/2% is what we had filed for. And that's still under discussion, though, as I mentioned earlier, Alison, with the Department of Insurance. In fact, we have a meeting scheduled with them tomorrow.

Operator

Your next question comes line of Corey Rein [ph] (10:53) with Pico and Company [ph] (10:55).

Analyst

I have a question in regard to the current premium cycle, insurance cycle. When do you foresee -- are you seeing any signs that -- I see Policies-in-Force have gone up slightly, but are you seeing any signs of the competitive pressures coming off? I mean, we see the advertisements of force [Policies-in-Force] everywhere. And the other question I would have, I was in a meeting, I don't know, 10 years ago or something like that, and I remember somebody asking a question about if you were not a public company, is there something you would be doing differently in the business as far as rating or pricing and things like that. I was wondering if, George, do you have any color to add to that?

Gabriel Tirador
Chief Executive Officer, President and Director

Let me take the first question, and I'll let you take the second question, Mr. Joseph. The competitive pressures, they're still pretty -- competition is still very fierce. Although what we are noticing in some of the states, for example, where we take rate increases, we're seeing a lot more rate increases taken by our competitors in the auto line. So we're seeing our rate increases stick, when we do make a rate increase. So we are starting -- and it's not the same in every state. It's different by state. You have states where the pure premium trends are rising faster than other states. But generally speaking, I would say that we are seeing -- it's still very competitive, but we are seeing more rate increases than rate reductions. And because of that, we're seeing that our rate increases are sticking more.

Analyst

Do you think that's because of the interest rate environment, low yields on investments?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I think our rates are sticking more because, overall, rates are going up for everybody.

Analyst

And the reason they're raising the rates, though, is because they can't get the investment yields to offset lower rates, maybe?

Gabriel Tirador
Chief Executive Officer, President and Director

That's possible, but I also think that they're not hitting their underwriting targets. So it's a combination of both, I would say. And on the second question, Mr. Joseph, you want to...

George Joseph
Founder and Chairman

I guess the second part of that question is would we do anything differently if the company was private. Well, I guess in retrospect, if the company was private, of course it was private for five years, I would say that, perhaps, things that we did in the past, such as expanding too fast into some of the other states before we really were ready, we wouldn't do that. But I'm not sure that I would change very much of what we are doing today even if we were private. It is a very tough environment. You've got states like New Jersey, which has been a problem state for us, and the industry loss ratio was something like 85% there last year. So we're faced with a state where we got in too quick, we made some mistakes, we're trying to work our way out of it. It is an extremely difficult state to sit proper reserves in, but I think we're getting a better and better handle on it. But in order to work our way out of it, we've probably still got another year or so of underwriting losses there. So I hope that answers your question.

Analyst

And at what point would you say goodbye to a state? I mean, I don't recall you ever withdrawing from any of the states you've entered. But is there any point that you would get to where you would say I've had enough and I want to focus on the other states?

George Joseph
Founder and Chairman

Well, as you said that's never happened, and we got to be realistic. I think that we're to the point with maybe one of our states where we do have to begin to think, can we straighten this thing out in the next 12 months? I think we can. I think the things that we're doing in New Jersey are, in effect, the same things that we did in California at one time, to become very competitive in the bodily injury line. And that is to handle the bodily injury claims much more aggressively than the industry does. And I think, also, we are experimenting and I think successfully so, but slowly, in doing things that the industry doesn't do in handling the PIF line, which is the real problem line in New Jersey. But I think within 12 months, you're going to see some good results there. We already know that if we look at this year, just on an accident-year basis, the loss ratio in New Jersey is acceptable. It's acceptable. But our big expenditures are on the loss adjustment expenses, not on the other expenses. And we brought that down, percentage-wise, as a percent of earned premium. It's come down comfortably the first six months of this year. And I think that trend will continue.

Operator

[Operator Instructions] And we do have a follow-up question from the line of Alison Jacobowitz with Bank of America.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

I just wanted to make sure I fully get the tax adjustment in the $12 million. So the $12 million of costs related to Prop 17, that added the 1.9 points to the expense ratio. And then was tax benefit associated with that, or was it a separate issue entirely?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

The $12.1 million is non-deductible for tax. And then there's a completely separate $3 million tax benefit on an unrelated issue.

Gabriel Tirador
Chief Executive Officer, President and Director

I think the important thing, Alison, to understand is that if Prop 17 -- if there were no Prop 17 in the numbers at all and if there was no adjustment to this tax contingency reserve at all, we would have been at an $0.81. And I might add, and if you add the fact that we have $4.5 million of Oklahoma losses, related to the hailstorms which were very well publicized, and I know other companies took a hit from it, that's another $0.05. So that would take it from an $0.81 to an $0.86, if that's what you're trying to do.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

And then as far as cat losses go, then the only identifiable cat losses would be that $4.5 million?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes.

Operator

[Operator Instructions] We do have a question that just came in from the line of Bobman [Ron Bobman] with Capital Returns.

Ron Bobman
Capital Returns

There's a Ron in front of that Bobman. I had a question about sort of related to the Proposition. Are there any California auto-writers that are effectively offering discounts on new business that's associated or linked to continuing insurance in-force, so to speak effectively providing a persistency discount but on new business?

Gabriel Tirador
Chief Executive Officer, President and Director

Not that we're aware of. That would be illegal.

Operator

And you have no further questions at this time.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, thank you very much, everyone, for joining us. And we look forward to talking to you next quarter. Thank you.

Operator
Ladies and gentlemen, this concludes today's Mercury General Second Quarter Conference Call. You may now disconnect.