S&P Capital IQ

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Mercury General Corporation NYSE:MCY

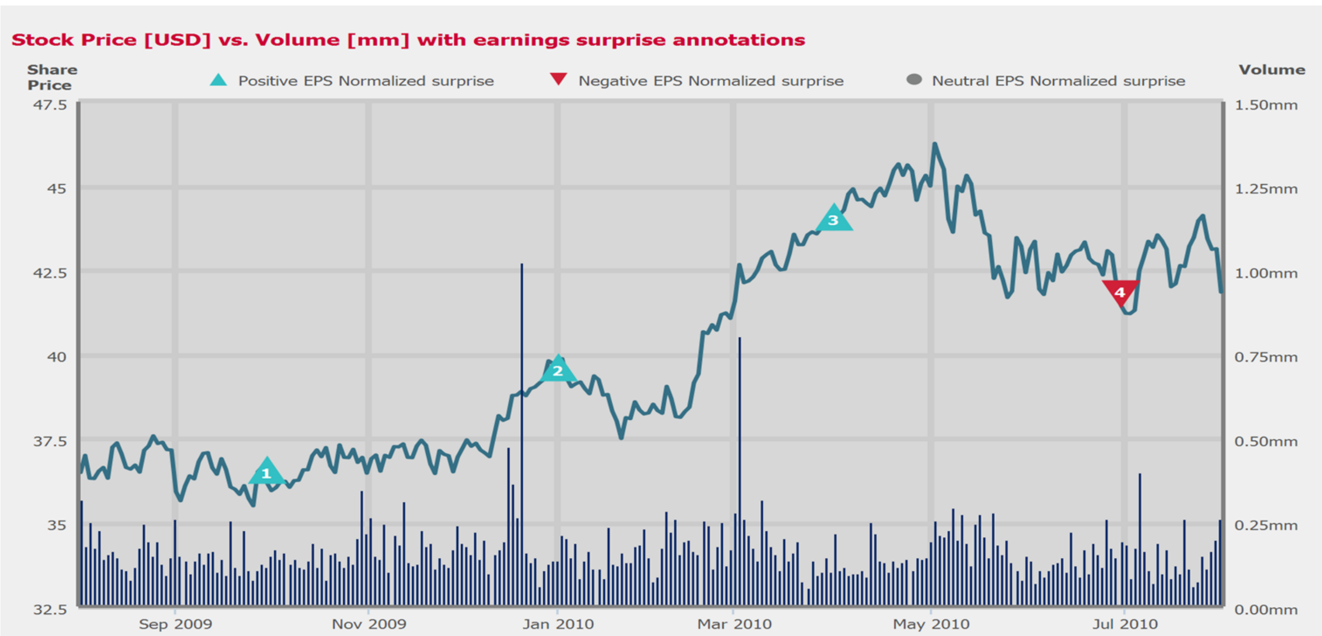
FQ3 2010 Earnings Call Transcripts

Monday, November 01, 2010 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.76	0.74	(2.63 %)	0.71	3.01	3.09
Revenue (mm)	670.03	654.69	(2.29 %)	636.27	2605.34	2604.32

Currency: USD
Consensus as of Nov-01-2010 3:07 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	0.66	0.84	27.27 %
FQ4 2009	0.68	0.69	1.47 %
FQ1 2010	0.68	0.85	25.00 %
FQ2 2010	0.71	0.65	(8.45 %)

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

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

ANALYSTS

Caroline Steers
Macquarie Research

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

Presentation

Operator

Good morning. My name is Michael, 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
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, CFO; Robert Houlihan, Vice President and Chief Product Officer; Chris Graves, Vice President and Chief Investment Officer; and John Sutton, Senior Vice President, Customer Service.

Before we take question, we will make a few comments regarding the quarter. Our third quarter 2010 operating results deteriorated slightly as compared to the third quarter of 2009. Our combined ratio was 98% in the third quarter of 2010 compared to 96.4% in the third quarter of 2009. The increase in combined ratio was primarily due to less positive reserve development in 2010 as compared to 2009. Year-to-date, we have recorded approximately $18 million of positive reserve development on prior accident years compared to $40 million in 2009.

In addition, increases in advertising and technology-related costs increased the expense ratio in the third quarter of 2010 to 29.4% from 28.1% in the third quarter of 2009. As we look forward to 2011, we expect a reduction in technology-related expenditures as compared to 2010.

As we have previously reported, we have had an auto rate filing pending in California for some time. We have now reached a verbal agreement with the California Department of Insurance. The agreement reached includes a 4.96% rate reduction in Mercury Insurance Company and a 4.44% rate reduction in Mercury Casualty and California Automobile Insurance Company. In addition, the rate filing improves our segmentation and introduces new discounts and roadside assistance coverage. We anticipate the rate filing to become effective on December 15, 2010, and expect our new rates will make us more competitive for new business. Although the rate reduction will put pressure on our California margins, we will be very diligent in underwriting our risks to ensure we are paying the proper premium for the risk written.

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 seven rating changes in our auto line and introduced homeowners in Nevada. Currently, seven prior passenger auto rating changes and one homeowners rating change are planned for the fourth quarter of 2010. We are making significant progress in improving our profitability outside of California.

However, our Florida homeowner line continues to present significant challenges as a result of sinkhole claims. Our Florida homeowner line produced a $5 million underwriting loss during the quarter on $3 million of earned premium. There is significant advertising in the state from public adjusters soliciting sinkhole claims, and the legal requirements imposed makes it very difficult and expensive to defend these claims.

Consequently, we are planning on filing to withdraw from our Florida homeowner line with the Florida Department of Insurance. We see no other solution to this problem as the current environment is untenable.

The rate of decline in premiums written of 1.2% during the quarter was similar to the 1% rate of decline during the second quarter 2010 and an improvement over the 4.7% rate of decline during the third quarter of 2009.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Caroline Steers with Macquarie.

Caroline Steers
Macquarie Research

My first question is just what is driving -- it seems like in the quarter alone, there was some adverse development. And I was just wondering what the driver of that was.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Caroline, this is Ted. It's about $4 million, and it's just a reanalysis of our BI [bodily injury] losses from '08 accident year and '09 accident year. We took our severity estimates for the '08 accident year up slightly.

Caroline Steers
Macquarie Research

And that's what's sort of been driving the more favorable development year-to-date? It's just sort of re-estimating that?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Correct.

Caroline Steers
Macquarie Research

And then just a question on the investment portfolio. I was just wondering how much of that portfolio gets reinvested over the next one or two years. And then I was just looking at the duration and it's down a decent amount from year end. And I was wondering if you had a target on where you wanted that to go.

Christopher Graves
Chief Investment Officer and Vice President

Caroline, it's Chris. I think the duration probably continues to trend lower, maybe down to three years. I can't really give you an estimate as to exactly when we get there, but it should be over the next six to 12 months. Coming horizon, we've got next year something in the neighborhood of about 250 million bonds maturing with about another third and 50 that are callable. The remainder of this year is about 100 million. So we've got quite a lot of work to do as far as the rollover goes and we've got cash on hand. But frankly, it doesn't bother me in this environment quite yet. So I'm okay with the way we're proceeding.

Caroline Steers
Macquarie Research

And where are you putting that money right now?

Christopher Graves
Chief Investment Officer and Vice President

Most of it continues to go into municipal bonds.

Caroline Steers
Macquarie Research

And then finally, can you just touch on what loss costs look right now in California? Frequency and severity?

Christopher Graves
Chief Investment Officer and Vice President

We're looking at a slight tick up in frequency in the low-single digits. And severity is still running the low-single-digit inflation.

Operator

Your next question comes from the line of Meyer Shields with Stifel, Nicolaus.

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

Gabe, am I correct in inferring that advertising costs for next year are expected to basically stay where they are now?

Gabriel Tirador
Chief Executive Officer, President and Director

Either that or lower. Our expectation is that they're not going to be any higher.

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

If we were to break up, I guess, the sequential change in written premium growth, is it more inside California or outside California where you saw the quarterly deterioration?

Gabriel Tirador
Chief Executive Officer, President and Director

Can you say that again? I didn't quite hear that.

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

When we look -- the net written premium growth rate was a little worse in the third quarter than in the second. Is that change inside California or outside?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, outside of California, they were up, I think, in the low-single digits, maybe 2½% or so. And they were down a little bit in California.

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

The tax rate on the investment income was lower than I thought. Is that a function of the focus on munis?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

What were you expecting?

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

About 13% overall.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

It's been running about 11%. 10% or 11%.

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

10% or 11% will be basically flat.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Yes.

Operator

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

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

One kind of numbers question. Was there any particular cat losses in the quarter at all? Anything of note?

Gabriel Tirador
Chief Executive Officer, President and Director

Nothing of note, unless you call sinkholes cat.

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

How much did the sinkholes impact the overall loss ratio, again?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

It was a $5 million underwriting loss.

Gabriel Tirador
Chief Executive Officer, President and Director

On $3 million of earned premium.

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

And when does the withdrawal begin? Is that effective fourth quarter? Or will it take longer than that?

Gabriel Tirador
Chief Executive Officer, President and Director

Well, we plan on filing to withdraw early this month in November. And I think the process will probably take a good 18 months. These are annual policies. And you've got to give appropriate notice. And so once we get approval from the Florida Department, which we believe we will get approval. Others have been approved that are slightly larger than us. We're a small player in that market. So that will happen within the next 18 months. But in addition to that, I will note that we have a 25% rate increase that's going into effect. I believe that's going into effect in the first quarter, sometime in January or February, a 25% rate increase in that line.

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

And then, I guess, the other question is the modest rate decline you spoke of about in California. Can you touch on those again? I think I'm correct in saying that in August you did have a 1½% increase go through. So then this is the sort of a downward adjustment now?

Gabriel Tirador
Chief Executive Officer, President and Director

No, we have not had a rate increase go through in August. Just to clarify that, that we haven't had a rate change here in California for at least two years. This rate filing is over two years old, and with this filing, we're now compliant with the auto rating factor regulations. And part of the reason for the delay in finalizing this filing was really the capacity of the California Department of Insurance. When the regulations were issued a couple years ago, every company had to make a filing and the department simply did not have the resources to review all the filings in a timely manner. But we also wanted to move forward with this not only because it would make us compliant with the new auto rating factors, but there's other changes in this filing that I mentioned in my prepared remarks that's going to improve our segmentation. It's going to introduce new discounts and roadside assistance. So there are other things in the filing that we wanted to get out there. And we're probably going to follow-up shortly with another class plan filing and another rate filing.

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

Do you have any idea what they'll be as far as percentage change as of yet?

Gabriel Tirador
Chief Executive Officer, President and Director

On the class plan filing is -- a class plan filing will be revenue neutral, which will just further improve our segmentation and our competitive position, we believe. And the rate filing, I can't give you an answer to that right now. Maybe by the time we meet in the next quarter, I'll have some more information that I can share with you.

Operator

[Operator Instructions] Your next question is a follow-up from Meyer Shields with Stifel, Nicolaus.

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

Did you say before that the Florida homeowners written premium is about $3 million? Did I get that right?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes, for the quarter. Earned premium, yes.

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

Do you have any sense as to how many of your Florida homeowners policyholders are also auto policyholders?

Gabriel Tirador
Chief Executive Officer, President and Director

Do you have that, Robert, offhand?

Robert Houlihan
Chief Product Officer and Vice President

I don't have that at my fingertips now.

Gabriel Tirador
Chief Executive Officer, President and Director

I don't have that offhand.

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

And last question, I guess. We agreed to rate decreases from the 4½% to 5% roughly. Did I cover -- is that an average rate for your entire California auto book?

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. The average will probably be in the neighborhood of like 4.75%, 4.80%. Something like that when you weight the three companies, in that neighborhood, Meyer.

Operator

And there are no further questions at this time. I'd now like to turn the call back to management.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, I'd like to thank everyone for joining us for this third quarter conference call. And we look forward to speaking with you next quarter. Thank you very much.

Operator
Thank you, ladies and gentlemen. This does conclude today's conference call, you may now disconnect.