S&P Capital IQ

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Mercury General Corporation NYSE:MCY

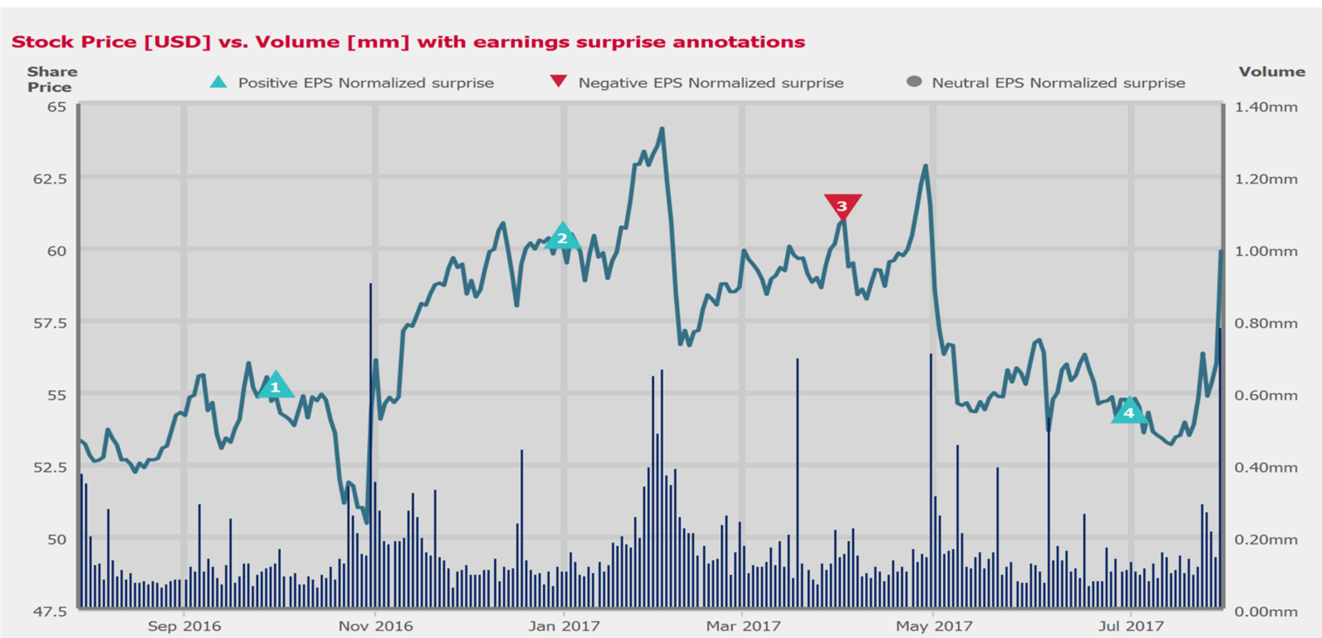
FQ3 2017 Earnings Call Transcripts

Monday, October 30, 2017 5:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2017-			-FQ4 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.52	0.60	▲15.38	0.50	1.90	2.62
Revenue (mm)	835.00	827.42	▼(0.91 %)	841.35	3234.00	3343.00

Currency: USD
Consensus as of Oct-16-2017 5:03 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2016	0.54	0.67	▲1 24.07 %
FQ4 2016	0.51	0.58	▲2 13.73 %
FQ1 2017	0.54	0.20	▼3 (63.64 %)
FQ2 2017	0.50	0.68	▲4 36.00 %

Call Participants

EXECUTIVES

Christopher Graves
Chief Investment Officer and Vice President

Gabriel Tirador
Chief Executive Officer, President and Director

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

ANALYSTS

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Presentation

Operator

Good morning -- afternoon. My name is Amy, 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, 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 third quarter operating earnings were $0.60 per share compared to $0.67 per share in the third quarter of 2016. The deterioration in operating earnings was primarily due to an increase in the combined ratio from 98.1% in the third quarter of 2016 to 99.3% in the third quarter of 2017.

Our results in the quarter were negatively impacted by $19 million of catastrophe losses, primarily caused by Hurricane Harvey and Irma. In addition, we recorded $4 million of unfavorable reserve development. This compares to the third quarter of 2016, which had $4 million of catastrophe losses and $7 million of unfavorable reserve development. Excluding the impact of catastrophe losses and unfavorable reserve development, the combined ratio was 96.5% in the quarter compared to 96.7% in the third quarter of 2016.

The expense ratio was 25% in the third quarter compared to 25.2% in the third quarter of 2016. The lower expense ratio was primarily due to a decrease in acquisition costs and cost efficiency savings, offset by higher advertising spend. Net advertising expense in the quarter was $12 million compared to $10 million in the third quarter of 2016.

To help offset increasing loss trends, we have been increasing rates in most states. In California, we implemented a 6.9% personal auto rate increase in California Automobile Insurance Company effective in May and a 6.9% rate increase in our homeowners' line in August. In addition, a 5% rate increase for Mercury Insurance Company and a 6.9% rate increase for California Automobile Insurance Company are pending approval with the Department of Insurance.

Personal auto premiums in Mercury Insurance Company represents about half of our company-wide premiums earned, and California Automobile Insurance Company represents about 14% of our company-wide premiums earned. California homeowner premiums represent about 12% of our company-wide premiums earned.

Premiums written grew 2.4% in the quarter, primarily due to higher average premiums per policy. Company-wide private passenger auto new business applications submitted to the company increased approximately 1% in the quarter. Company-wide homeowners' applications increased 5.5% in the quarter.

Lastly, we generally expect our accident quarter combined ratio for the fourth quarter, excluding catastrophes, to be higher than the rest of the year due to increased loss frequency and higher severities caused by seasonal driving and weather. That said, it is hard to predict with certainty whether the

underlying combined ratio will be higher as there are many factors currently unknown or beyond our control.
With that brief background, we will now take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Greg Peppers (sic) [Greg Peters] with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

It's Greg Peters, not Peppers. Gabe, I was wondering if you could circle back and provide more color around new business trends, both inside California and outside California. I think last quarter, you talked about some headwinds outside of the state of California weighing down on the consolidated results. I'm curious if you could provide an update.

Gabriel Tirador
Chief Executive Officer, President and Director

Yes. I think when you take a look at the outside of California, our new business private passenger auto apps are down quite a bit. We're down about 19% quarter-over-quarter. And that's the result of us just taking action on rates, Greg, and trying to improve the profitability. If you take a look at our results outside of California, excluding cats and excluding some positive development, we actually had positive development outside of California. The combined ratio was under 100 or it was, I think, in the high 90s, 97%, 98% or so, outside of California. But obviously, we paid a little bit of a price. We're paying a little bit of price with respect to growth as the outcomes are down 19%. However, in California, our private passenger auto apps were up about 7.5% in California for private passenger auto. So combined, total apps were up 1%, which is what I said in my prepared remarks.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

And what was the California-only combined ratio? You gave us that was running for outside California? What was the California piece?

Gabriel Tirador
Chief Executive Officer, President and Director

Do you have that, Ted?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

It's running -- for personal auto or for everything?

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Well, I think Gabe just said 97%, 98% for outside California in some-auto only?

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

In California, for private passenger auto, we booked about a 96.5% for private passenger auto and about a 98.5% for homeowners.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. Okay. Thanks for the color. The 19% outside -- I guess, what I'd -- what I'm -- I'll just cut to the chase. So what I'm trying to get to is trying to sort of figure out when the drag from outside of California will dwindle down and possibly stabilize and prospectively grow? Is there an inflection point? Is it middle next year? Is it end of next year? If you have any update and perspective, that would be helpful.

Gabriel Tirador
Chief Executive Officer, President and Director

There are some states that we think have leveled out. Other states, I think, have a little bit more to go, assuming that the app counts stay at this current level. So you have various assumptions with respect to what's happening in the market. Are other people taking rate as well? We were -- we've been pretty aggressive, but there's a lot of rate activity going on right now as well with the competitors. So there's a lot of factors, but I would say that there's still a ways to go for some states, and other states, I believe, has reached a plateau.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. And then just on the California piece for the auto business. Would you characterize the -- I'm trying to sort of read into your fourth quarter commentary about a deterioration in the underlying. And I guess, with all the rate activity that you've applied in California, I would expect -- I would have expected that the trend would be positive or a little bit positive, gradually growing. But not sure we have it yet or maybe some color on that would be helpful.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, the only thing we want to comment on is that generally speaking, the fourth quarter has higher frequency and severity here in California for -- and if you take -- go back many, many years, our fourth quarter here in California primarily has been higher than the rest of the quarters from frequency and severity standpoints. So that's really the only thing that we're trying to say that generally speaking, there's some seasonality, and we feel that the fourth quarter here in California -- and California being such a large market for us, we just thought it was prudent to let folks know that generally speaking, right after Thanksgiving, you got the holidays, and typically, you have some weather that contribute to the higher fourth quarter frequency and severity. Sometimes it may not occur -- I don't -- we don't know. There's things that we just can't foresee, but that's why I made that comment.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. That's fair. I had 2 other questions, and then I'll requeue. First, appreciate your color around the wildfire potential losses. And I'm just curious if you have a perspective on what kind of changes might happen to your reinsurance cost next year, considering that it looks like there's a pretty big gross loss for the company this year.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Well, the reinsurers -- this is Ted. The reinsurers are, in general, are assuming a lot of losses from the storms, the hurricanes in the Southeast and then this fire. So pricing, in general, may go up depending on the capacity of reinsurers. We're not sure. We think that they take a long-term view, and we may see some increases next renewal. But at this point, we're not really sure.

Gabriel Tirador
Chief Executive Officer, President and Director

It's really too early to tell right now, Greg.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

When is the renewal period again? I'm sorry. I forgot that one.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

July 1 to June 30, 3D.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. Perfect. The last question. And Chris, I'd be remiss if I didn't ask you a question. I noticed that the after-tax yield is down year-over-year and down in the third quarter relative to the year-to-date result. Is there something going on there that's driving a lower yield or on an after-tax basis? Or is it just -- well, I'll let you answer.

Christopher Graves
Chief Investment Officer and Vice President

Greg, yes, it's -- again, rates are where they are. They have come down a lot from year-end. Actually, I have allowed our cash to build up some much less activity on fixed-income investing through the third quarter. So there's some dilution there. But this recent reversal in the 10-year treasury and rates in general is making me a little more optimistic. We're putting money back to use. Spreads have also been very tight, and that's been the primary problem really the way I look at it. So with this recent reversal in rates, I'm optimistic that I'll get a lot more money put to use at better levels through the fourth quarter and should hopefully then see a lift in those yields.

Operator

[Operator Instructions] Your next question comes from the line of Alison Jacobowitz with Bank of America.

Alison Marnie Jacobowitz
BofA Merrill Lynch, Research Division

Two numbers questions, actually. Other revenue looked like it was up a lot year-over-year. I just wondered what was in there. And then also the acquisition expense ratio was the lowest we've seen in a while. I just was wondering if you can give more color on what's driving that number down and if it's sustainable going forward.

Theodore R. Stalick
Chief Financial Officer and Senior Vice President

Alison, it's Ted. So on the other revenue/other income, the company realized a $3.3 million gain on the sale of land. We had some land in Brea than that we have been holding for about 10 years that we sold. So that's sort of a onetime impact to that line item. And on the question on the acquisition expenses. I think we said on calls before, but we kind of had a long-term decrease in our acquisition expenses primarily due to lower commission or commissions have been going down gradually. The July 1 is when we do our annual agent commission adjustment. And so there were some decreases in the third quarter, and those flow through the healthy acquisition expense ratio.

Operator

Your next question comes from the line of Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Just one other follow-up to sort of building on Alison's question. The ad spend, I think, you said is up to $12 million in the third quarter from $10 million a year ago. I know your big expenses are in the first and third quarter. As we think about 2018, are you -- do you have any perspective on whether the budget's going to be flat, up or down for our models?

Gabriel Tirador
Chief Executive Officer, President and Director

I think right now, we believe it will be slightly up in 2018.

Operator

There are no further questions at this time. I'll turn the call back over to the presenters.

Gabriel Tirador
Chief Executive Officer, President and Director

Well, thank you for joining us today. We look forward to speaking with you next quarter. Thank you very much.

Operator
This concludes today's conference call. You may now disconnect.